Steven H. Ancel Annual Bankruptcy Institute
December 22, 2022
Index

Steven H. Ancel Annual Bankruptcy Institute
December 22, 2022
Index

ICLEF Electronic Publications

Feature Release 4.1
August 2020

To get the most out of your *ICLEF Electronic Publication,* download this material to your PC and use Adobe Acrobat® to open the document. The most current version of the Adobe® software may be found and installed by clicking on one of the following links for either the free Adobe Acrobat Reader® or the full retail version of Adobe Acrobat®.

Feature list:

1. **Searchable** – All ICLEF Electronic Publications are word searchable. To begin your search, click on the "spyglass" icon at the top of the page while using the Adobe® software.
1. **Bookmarks** – Once the publication is opened using the Adobe Acrobat® software a list of bookmarks will be found in a column located on the left side of the page. Click on a bookmark to advance to that place in the document.
2. **Hypertext Links** – All of the hypertext links provided by our authors are active in the document. Simply click on them to navigate to the information.
3. **Book Index** – We are adding an INDEX at the beginning of each of our publications. The INDEX provides "jump links" to the portion of the publication you wish to review. Simply left click on a topic / listing within the INDEX page(s) to go to that topic within the materials. To return to the INDEX page either select the "INDEX" bookmark from the top left column or right-click with the mouse within the publication and select the words "*Previous View*" to return to the spot within the INDEX page where you began your search.

Please feel free to contact ICLEF with additional suggestions on ways we may further improve our electronic publications. Thank you.

Indiana Continuing Legal Education Forum (ICLEF)
230 East Ohio Street, Suite 300
Indianapolis, Indiana 46204
Ph: 317-637-9102 // Fax: 317-633-8780 // email: iclef@iclef.org
URL: https://iclef.org

STEVEN H. ANCEL ANNUAL BANKRUPTCY INSTITUTE™

December 22, 2022

WWW.ICLEF.ORG

DISCLAIMER

The information and procedures set forth in this practice manual are subject to constant change and therefore should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein. Further, the forms contained within this manual are samples only and were designed for use in a particular situation involving parties which had certain needs which these documents met. All information, procedures and forms contained herein should be very carefully reviewed and should serve only as a guide for use in specific situations.

The Indiana Continuing Legal Education Forum and contributing authors hereby disclaim any and all responsibility or liability, which may be asserted or claimed arising from or claimed to have arisen from reliance upon the procedures and information or utilization of the forms set forth in this manual, by the attorney or non-attorney.

Attendance of ICLEF presentations does not qualify a registrant as an expert or specialist in any discipline of the practice of law. The ICLEF logo is a registered trademark and use of the trademark without ICLEF's express written permission is prohibited. ICLEF does not certify its registrants as specialists or expert practitioners of law. ICLEF is an equal opportunity provider of continuing legal education that does not discriminate on the basis of gender, race, age, creed, handicap, color or national origin. ICLEF reserves the right to refuse to admit any person or to eject any person, whose conduct is perceived to be physically or emotionally threatening, disruptive or disrespectful of ICLEF registrants, faculty or staff.

INDIANA CONTINUING LEGAL EDUCATION FORUM

STEVEN H. ANCEL ANNUAL BANKRUPTCY INSTITUTE™

Agenda

ICLEF
INDIANA CONTINUING LEGAL EDUCATION FORUM

Issues in Consumer Bankruptcy – Morning Session

8:55 A.M.	Welcome and Introduction *Mark S. Zuckerberg, James E. Rossow, Jr., Institute Co-Chairs*
9:00 A.M.	Student Loans *Stacy M. Wissel*
10:00 A.M.	Bankruptcy Case Law Update *John M. Hauber*
11:00 A.M.	Break
11:15 A.M.	2022 Update from the United States Trustee *Nancy J. Gargula*
12:15 P.M.	Lunch (on your own)

Issues in Business Bankruptcy – Afternoon Session

1:15 P.M.	PANEL I – You Don't Notice Me Anymore *Jason R. Burke*, Jason W. Cottrell, Jeffrey M. Hester, & Elizabeth M.Little*
2:15 P.M.	PANEL II – The Third Rail of Bankruptcy – Injunctions, Releases, and Ethics relating to Non-Debtors *Martha Reddy Lehman *, Wendy D. Brewer, Andrew C. Ozete,& Meredith R. Theisen*
3:15 P.M.	Break
3:30 P.M.	PANEL III – Avoidance Actions, Alter Egos, Accountability, & Crypto Assets: A Mixed Bag of Commercial Bankruptcy Updates *Jonathan Sundheimer*, Samuel D. Hodson or John R.Humphrey, & Jason T. Mizzell*
4:30 P.M.	**Adjournment**

* Denotes Panel Moderator

December 22, 2022

STEVEN H. ANCEL ANNUAL BANKRUPTCY INSTITUTE™

Faculty

Mr. Mark S. Zuckerberg - Co-Chair
Bankruptcy Law Office of Mark S. Zuckerberg, P.C.
429 North Pennsylvania Street, Suite 100
Indianapolis, IN 46204
ph: (317) 687-0000
e-mail: debtnomo@aol.com

Mr. James E. Rossow, Jr. - Co-Chair
Rubin & Levin, P.C.
135 North Pennsylvania Street, Suite 1400
Indianapolis, IN 46204
ph: (317) 860-2893
e-mail: jim@rubin-levin.net

Morning Faculty

Ms. Nancy J. Gargula
United States Trustee, Region 10
Birch Bayh Federal Building and U.S. Courthouse
46 East Ohio Street, Room 520
Indianapolis, IN 46204
ph: (317) 691-1086
e-mail: nancy.gargula@usdoj.gov

Mr. John M. Hauber
Chapter 13 Standing Trustee
Southern District of Indiana
320 North Meridian Street, Suite 200
Indianapolis, IN 46204
ph: (317) 636-1062 Ext. 103
e-mail: johnh@hauber13.com

Ms. Stacy M. Wissel
Chapter 7 Trustee
P.O. Box 68
Decker, IN 47524-0068
ph: (812) 886-6452
e-mail: swissel@sbcglobal.net

Afternoon Faculty

Ms. Wendy D. Brewer
Fultz Maddox Dickens PLC
333 North Alabama Street, Suite 350
Indianapolis, IN 46204
ph: (317) 567-9048
e-mail: wbrewer@fmdlegal.com

Mr. Jason R. Burke-Moderator
Blackwell, Burke & Ramsey, P.C.
101 West Ohio Street, Suite 1700
Indianapolis, IN 46204
ph: (317) 635-5005
e-mail: jburke@bbrlawpc.com

Mr. Jason W. Cottrell
Stuart & Branigin LLP
300 Main Street, Suite 900
Lafayette, IN 47901
ph: (765) 428-7081
e-mail: jwc@stuartlaw.com

Mr. Jeffrey M. Hester
Hester Baker Krebs LLC
One Indiana Square, Suite 1330
211 North Pennsylvania Street
Indianapolis, IN 46204
ph: (317) 608-1129
e-mail: jhester@hbkfirm.com

December 22, 2022

STEVEN H. ANCEL ANNUAL BANKRUPTCY INSTITUTE™

Faculty

Mr. Samuel D. Hodson
Taft Stettinius & Hollister LLP
One Indiana Square, Suite 3500
Indianapolis, IN 46204
ph: (317) 713-3557
e-mail: shodson@taftlaw.com

Mr. John R. Humphrey
Taft Stettinius & Hollister LLP
One Indiana Square, Suite 3500
Indianapolis, IN 46204
ph: (317) 713-3571
e-mail: jhumphrey@taftlaw.com

Ms. Martha Reddy Lehman - Moderator
Amundsen Davis
201 North Illinois Street, Suite 1400
Capital Center, South Tower
Indianapolis, IN 46204
ph: (317) 464-4142
e-mail: mlehman@smithamundsen.com
OR mlehman@amundsendavislaw.com

Ms. Elizabeth M. Little
Faegre Drinker Biddle & Reath LLP
600 East 96th Street, Suite 600
Indianapolis, IN 46240
ph: (317) 569-4608
e-mail: elizabeth.little@faegredrinker.com

Mr. Jason T. Mizzell
Kroger, Gardis & Regas, LLP
111 Monument Circle, Suite 900
Indianapolis, IN 46204
ph: (317) 777-7434
e-mail: jmizzell@kgrlaw.com

Mr. Andrew C. Ozete
Farmer Scott Ozete Robinson & Schmitt LLP
21 SE Third Street, Suite 900
Evansville, IN 47708
ph: (812) 602-3582
e-mail: aozete@fsolegal.com

Mr. Jonathan Sundheimer - Moderator
Barnes & Thornburg LLP
11 South Meridian Street
Indianapolis, IN 46204
ph: (317) 231-7319
e-mail: jsundheimer@btlaw.com
OR jonathan.sundheimer@btlaw.com

Ms. Meredith R. Theisen
Rubin & Levin, P.C.
135 North Pennsylvania Street, Suite 1400
Indianapolis, IN 46204
ph: (317) 860-2877
e-mail: mtheisen@rubin-levin.net

December 22, 2022

James E. Rossow, Jr., Seminar Co-Chair, Partner, Rubin & Levin, P.C.

Firm partner *Jim Rossow* concentrates his practice in the areas of bankruptcy, debtors and creditors' rights, commercial law, secured transactions, commercial finance, commercial foreclosure, and business litigation. He represents clients out of court and in state and federal-court litigation in enforcing creditor interests and pursuing remedies.

Mr. Rossow's bankruptcy practice includes representing and advising creditors, trustees, receivers, and occasionally business debtors and insiders in economic disputes out of court, in state and federal court, and in bankruptcy court. He prosecutes and defends avoidance actions (preferences, fraudulent transfers, and subsequent transferee litigation), and advances creditor interests in out-of-court workouts and in chapter 11 bankruptcies. He has represented sellers and buyers of assets in a variety of contexts. In chapter 11 cases, he has represented secured creditors, trade creditors, creditor's committees, chapter 11 trustees, and debtors in a wide array of matters these parties encounter.

This work includes litigation concerning relief from the automatic stay and adequate protection, use of cash collateral, allowance and payment of administrative expenses, compensation of a chapter 11 debtor's officers, claims litigation, contested plan confirmation proceedings (as plan proponent and opponent), motions to appoint chapter 11 trustees, convert or dismiss cases, Bankruptcy Code section 363 sale motions, lease assumption and assignment or rejection motions, and professional fee disputes.

Mr. Rossow advises businesses on credit decisions, structuring secured credit, and the economic risks clients face in competitive business environments. He also has experience negotiating license agreements and other commercial contracts, and when things go awry, prosecuting and defending claims in arbitration, and in state and federal courts. He has also represented debtors and creditors in out-of-court assignments for the benefit of creditors, and he represents those parties and receivers in receivership cases.

James E. Rossow, Jr.
Rubin & Levin, P.C.
135 North Pennsylvania Street, Suite 1400
Indianapolis, IN 46204
ph: (317) 860-2893
fax: (317) 453-8619
e-mail: jim@rubin-levin.net

Mark S. Zuckerberg, Seminar Co-Chair, Bankruptcy Law Office of Mark S. Zuckerberg

Mark S. Zuckerberg is one of only twelve Board Certified Consumer Bankruptcy Specialists in the entire State of Indiana and has filed over twenty-thousand (20,000) bankruptcy cases in his twenty-two (22) year career. He frequently lectures both locally and nationally to lawyers and various groups on the topic of consumer bankruptcy law. Mr. Zuckerberg has spoken at the National level at the American Bankruptcy Institute, the National Association of Consumer Bankruptcy Attorneys and the National Conference of Bankruptcy Judges Annual Conferences. He has been quoted on several occasions in the New York Times, Indianapolis Star, The Indianapolis News, and several other news publications. Mr. Zuckerberg has been interviewed by NBC Evening news, Business Week, and People Magazine. Mr. Zuckerberg currently serves on the board of the American Board of Certification. Mr. Zuckerberg is a member of the Indianapolis Bar Association and past Chairman of the Bankruptcy and Creditors Right's Section of the Indiana State Bar Association. He was the only consumer bankruptcy attorney to debate Senator Grassley on the merits of bankruptcy reform on National Public Radio's Morning Edition. Mr. Zuckerberg has been recognized by Who's Who in American Law, the Best Lawyers in America Consumer Guide, and was the only consumer bankruptcy attorney to be named in the March 2005 Edition of the Indianapolis Monthly Magazine's list of Indiana Super Lawyers. Mr. Zuckerberg was awarded Master Distinguished Fellow by the Indianapolis Bar Association. Mr. Zuckerberg received his BA from Indiana University and his JD degree from Capital University. Mr. Zuckerberg has concentrated his practice exclusively to the area of Bankruptcy Law for over twenty-two (22) years.

Accomplishments:

- One of two lawyers asked to speak on bankruptcy law at the Judicial College for Indiana State Court Judges, - an organization devoted to educating Indiana judges on bankruptcy.
- Member of the Indiana State Bar Association (Past President of the Commercial Law Section)
- Member of the Indianapolis Bar Association (Commercial Law), which awarded Mark the Master Distinguished Fellow.
- Recognized in the Indianapolis Business Journal, "40 Under Forty" recipient, May 1998.
- Recognized by Who's Who in American Law and The Best Lawyers in America Consumer Guide.
- Was the only consumer bankruptcy attorney in America asked to debate Senator Grassley on the merits of the pending bankruptcy reform legislation on National Public Radio's Morning Edition.

Wendy D. Brewer, Fultz Maddox Dickens PLC, Indianapolis

Wendy has a broad range of experience practicing in the areas of business bankruptcy and restructuring, commercial foreclosure, commercial litigation, loan documentation, contract drafting and analysis, and providing general counsel advice for both small and large businesses. Wendy has a long history of representing banks and borrowers, creditors and debtors, and businesses and business owners in all aspects of workout and restructuring matters.

Wendy is also a graduate of the Bankruptcy Mediation Training Program offered by the American Bankruptcy Institute and the St. Johns University School of Law.

Wendy is a regular speaker on bankruptcy and restructuring topics for continuing education programs, and has served as a bankruptcy instructor for an auctioneer certification program and as an adjunct instructor in bankruptcy for IUPUI.

Wendy D. Brewer
Fultz Maddox Dickens PLC
333 North Alabama Street, Suite 350
Indianapolis, IN 46204
ph: (317) 567-9048
e-mail: wbrewer@fmdlegal.com

Jason R. Burke, Blackwell, Burke & Ramsey, P.C., Indianapolis

Jason R. Burke began his legal career as an Assistant State Attorney in Florida prosecuting criminal cases. After several years representing corporations in Chapter 11 Bankruptcy proceedings, Jason joined the firm in 2000 bringing additional depth in Bankruptcy and Litigation. Born in West Point, NY, Jason attended the University of Georgia for his undergraduate degree (cum laude, Phi Beta Kappa) and Washington&Lee University for his law degree (cum laude). Jason has been recognized as a "Super Lawyer" by an annual survey of peers published by Indianapolis Monthly magazine, and has the highest professional rating (AV) by Martindale Hubbell.

PROFESSIONAL EXPERIENCE

- Represents debtors and creditors in bankruptcy cases, including litigation involving claims of fraudulent transfers, preferences and subordination and reclassification issues
- Represents businesses, banks, and individuals in commercial litigation
- Represents financial institutions and borrowers regarding workouts, loan documentation and related business matters

BAR ADMISSIONS

- Indiana, 1997
- U.S. District Court for the Southern District of Indiana, 1997
- U.S. District Court for the Northern District of Indiana, 2000

EDUCATIONAL BACKGROUND

- University of Georgia, A.B., cum laude, 1991, Phi Beta Kappa
- Washington & Lee University School of Law, J.D., cum laude, 1994

PROFESSIONAL AND CHARITABLE ORGANIZATIONS

- Indianapolis Bar Association (Member, Commercial and Bankruptcy Law Section)
- Indiana State Bar Association (Member, Bankruptcy Law Section)
- American Bankruptcy Institute
- Indiana Association for Corporate Renewal
- Best Lawyers 2016 – Bankruptcy and Creditor debtor Rights/ Insolvency and Reorganization Law & Commercial Litigation

PUBLICATIONS AND LECTURES

- Author and Lecturer, "Bankruptcy Ethics and Retention of Professionals," Annual Bankruptcy Institute, Indiana Continuing Legal Education Forum (December, 2004).
- Author and Lecturer, "Recent Developments in Avoidance Actions," Annual Bankruptcy Institute, Indiana Continuing Legal Education Forum (December, 2004).
- Author, The Freedom of Contract vs. Patient's Right to Choose Physician: Non-Competition Agreements in Physicians' Employment Contracts, 43 Res Gestae 24 (September, 1999).

PUBLISHED CASES

- Board of Trustees, Sheet Metal Workers' Nat. Pension Fund v. Elite Erectors, Inc., 212 F.3d 1031, C.A.7 (Ind., 2000)
- Massey v. Baker O'Neal Holdings, Inc., 2006 WL 897880 (S.D.Ind., 2006)

REPRESENTATIVE CASES

- Represented Creditor's Committee in multi-million dollar investment fraud Chapter 11. Supervised forty lawsuits on behalf of Committee and returned millions of dollars to the benefit of the unsecured creditors.
- Represented large concrete manufacturer in defense of multi-million dollar anti-trust class action suit.
- Represented Bank through a loan workout and sale of 200+ convenience store/ wholesale petroleum distributor. Secured Bank's position through Chapter 11 bankruptcy and liquidation of debtor's assets. Obtained full recovery for Bank of $23 million.
- Represented minority stockholders in post-merger litigation. Defended stockholders against securities fraud allegations and negotiated buyout of clients' shares in multi-million dollar transaction.
- Represented Bank in bankruptcy and related litigation involving developer and investors for fraud with over nine million dollars in exposure. Guided Bank through bankruptcy, recovery, and claims against title insurance companies insuring title in companies involved in fraudulent transfers. Pursued multiple borrowers who provided credit to debtor on behalf of Bank.

Jason R. Burke-Moderator
Blackwell, Burke & Ramsey, P.C.
101 West Ohio Street, Suite 1700
Indianapolis, IN 46204
ph: (317) 635-5005
e-mail: jburke@bbrlawpc.com

Jason W. Cottrell, Stuart & Branigin, LLP, Lafayette

An analytical thinker with broad background in litigation, creditors' rights, and contracts, Jason is a knowledgeable and experienced advocate for a wide range of firm clients. Before joining Stuart + Branigin, Jason represented public and private companies in commercial disputes and bankruptcy matters, and served as a county prosecutor.

The core of his practice is in resolving contract disputes on behalf of privately held companies and individuals. Jason's experience ranges from business ownership and management conflicts to consumer protection defense to property and home construction disputes. He is typically able to resolve disputes before a case must be tried through either mediation or private negotiation; however, as a former prosecutor with substantial courtroom experience, he is also equipped to represent clients at trial or arbitration.

Jason's contract litigation experience also helps him to guide Indiana businesses navigating a variety of commercial agreements. He provides ongoing counsel to a diversified industrial manufacturer assisting the in-house counsel and interacting with procurement executives to review and negotiate contracts with many domestic and international suppliers.

Nancy J. Gargula, United States Trustee, Region 10, Indianapolis

Nancy J. Gargula is the United States Trustee for Region 10 (Indiana and Central and Southern Districts of Ill.), having been appointed in June 2002, was appointed to serve as the interim United States Trustee in Region 21 (Georgia, Florida, U.S. Virgin Islands and the Commonwealth of Puerto Rico) in April 2019, and also served as the United States Trustee for Region 13 (Missouri, Nebraska and Arkansas) from May 2006 through December 2014. Prior to serving as U.S. Trustee, she was a partner with the Commercial, Financial and Bankruptcy Services Team at the firm Baker & Daniels (now Faegre Drinker Biddle & Reath, LLP) in Indianapolis. Before joining Baker & Daniels in 1997, she was in-house counsel at Bank One, Indiana, NA, for 12 years, including serving as general counsel and secretary to the board of directors of the bank and its holding company. Mrs. Gargula received her law degree from the University of Notre Dame Law School in 1981, and graduated from Ball State University, *summa cum laude,* in 1977. Mrs. Gargula is active in a number of professional associations, including the American Bankruptcy Institute, the Seventh Circuit Bar Association, the Indianapolis Bar Association, the Indianapolis Bar Foundation, the Indiana State Bar Association and the Indiana Bar Foundation. Mrs. Gargula also is a frequent speaker on bankruptcy, banking, commercial law and related topics and has spoken on a wide variety of panels at conferences for the National Association of Chapter 13 Trustees, the National Association of Chapter 7 Trustees, the National Conference of Bankruptcy Judges and the American Bankruptcy Institute. In addition, she serves on the NCBJ Liaison Committee with other members of the Executive Office of U.S. Trustees.

Nancy J. Gargula
United States Trustee, Region 10
101 West Ohio Street, Suite 1000
Indianapolis, IN 46204
ph: (317) 226-6101
e-mail: nancy.gargula@usdoj.gov

John M. Hauber, Chapter 13 Standing Trustee, Indianapolis

John M. Hauber
Chapter 13 Standing Trustee
Southern District of Indiana
320 North Meridian Street, Suite 200
Indianapolis, IN 46204
ph: (317) 636-1062
fax: (317) 636-1186
e-mail: johnh@hauber13.com

Jeffrey M. Hester, Hester Baker Krebs LLC, Indianapolis

Jeffery Hester is Board Certified in Business Bankruptcy Law from the American Board of Certification, Jeff focuses his practice on business bankruptcy, work-outs and chapter 7 and 11 bankruptcies. Jeff is a former president of the Commercial and Bankruptcy Section of the Indianapolis Bar Association and teaches at seminars many times a year. Jeff grew up in Indianapolis and is a graduate of North Central High School. Jeff was born in 1973 and is married with one child.

Tucker Hester Baker Krebs
One Indiana Square 1600
Indianapolis, IN 46204
email: jhester@thbklaw.com
Ph: 317.608.1129

Samuel D. Hodson, Taft Stettinius & Hollister LLP, Indianapolis

Sam's practice is focused upon clients in transition. He helps them with acquisitions, debt restructuring, refinancing, workouts and turnarounds. Sam represents both healthy and troubled companies. These solutions have included: sales inside and outside of bankruptcy, refinancing, workouts, Chapter 11 reorganizations and compromises with state and local taxing authorities. He also counsels individuals and companies in wealth protection strategies.

Sam represents municipalities and the organizations with which they do business. His experience includes general obligation bonds, tax increment financing bonds, private/public partnerships, utility rate adjustments, annexation, redevelopment grants and general regulatory matters.

Sam also represents companies before taxing authorities and regulatory agencies. His experience includes the defense of DEA initiated civil forfeitures, tax audits and tax collection.

Sam is a member of the American Bankruptcy Institute, the Indiana State Bar Association (2014-2015 Chair of the Bankruptcy and Insolvency Committee) and the Indianapolis Bar Association. He is also the treasurer for the Indiana Association for Corporate Renewal. Sam is a frequent author and lecturer on financing and restructuring topics. He is certified in business bankruptcy by the American Board of Certification and serves as one of its directors. He is admitted to state and federal courts in Indiana.

Sam currently serves as a director on the boards of Music for All, a national music advocacy organization based in Indianapolis and Big Brothers, Big Sisters of Central Indiana. He has also advised, on a *pro bono* basis, Art With A Heart, the Ebenezer Missionary Baptist Church, Partners in Housing and Trusted Mentors. Sam has helped several not-for-profit organizations obtain 501(c)(3) status with the Internal Revenue Service. He regularly helps boards and board members of troubled charities navigate their problems while protecting their officers and members.

Sam is recognized by *Best Lawyers in America®* for Bankruptcy and Creditor Debtor Rights, Insolvency and Reorganization, Tax Litigation and Controversy and Banking and Finance. He was honored by *Best Lawyers®* as "Lawyer of the Year" in the Indianapolis market: in 2018 for Litigation-Banking and Finance, in 2017 for Litigation-Bankruptcy and in 2016 for Litigation and Controversy-Tax. He has been recognized as in Indiana *Super Lawyers* for Bankruptcy and Creditor Debtor Rights since 2010. He has also earned an AV Peer Review Rating from Martindale-Hubbell and was recognized in 2017 as "Platinum Client Champion".

John R. Humphrey, Partner, Taft Stettinius & Hollister LLP

John Humphrey represents secured lenders, trade creditors, landlords, buyers and sellers of distressed businesses and others seeking financial solutions in complex legal matters.

A member of the American Bankruptcy Institute and a frequent lecturer on bankruptcy and out-of-court restructuring matters, John consults with business and individual debtors to help resolve financial problems through negotiation, out-of-court resolutions and bankruptcy. He has represented numerous clients in significant bankruptcy litigation matters, including multi-million dollar preference and fraudulent transfer cases. He is a member of Taft'sDistressed Company Task Force, which was created to assist borrower clients in every way during the COVID-19 pandemic, including how to navigate discussions with their lenders and in addressing concerns over suppliers and stakeholders.

John is a Certified Public Accountant and was in private practice in business consulting and taxation prior to becoming an attorney. He continues to apply this expertise in tax controversy cases.

Throughout his tenure, John has been recognized with industry accolades for his work, including as an honoree by Indiana *Super Lawyers* and *Best Lawyers in America®* for Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law.

John R. Humphrey
Taft Stettinius & Hollister LLP
One Indiana Square, Suite 3500
Indianapolis, IN 46204
ph: (317) 713-3571
e-mail: jhumphrey@taftlaw.com

Martha Reddy Lehman, Amundsen Davis, Indianapolis

Martha Lehman concentrates her practice in the area of creditors' rights and bankruptcy. Ms. Lehman's practice has included all facets of bankruptcy and insolvency representation including secured lenders, unsecured creditors, creditors' committees, and debtors. Ms. Lehman is board certified by the American Board of Certification in Business Bankruptcy. Ms. Lehman has also assisted clients with purchase of assets from insolvent entities, both inside and outside of bankruptcy. Representative Experience Represented a client in connection with strategic acquisition of a competitor during a bankruptcy asset sale which enabled client to expand its sales force in new locations and substantially increase its workforce Represented a client in connection with structured liquidation of assets in a Chapter 11 bankruptcy case Assisted a client with the liquidation of environmentally contaminated real estate outside of bankruptcy Representation of client in connection with obtaining critical vendor status in Chapter 11 case of local area trucking firm Represent major financial institution in connection with liquidation of real estate collateral, in forced and consensual situations Representation of court-appointed receiver in connection with discharge of his duties Representation of energy re-marketer in connection with its claims in various bankruptcy cases, including treatment of its contractual obligations Education Vanderbilt University School of Law, Nashville, Tennessee (J.D., 1987) University of Dayton, Dayton, Ohio (B.A., summa cum laude, 1984) Bar Admissions Indiana, 1988 U.S. District Court for the Northern District of Indiana, 1988 U.S. District Court for the Southern District of Indiana, 1988 U.S. Supreme Court, 2001 U.S. Court of Appeals 7th Circuit, 2007 Ohio, 1987 U.S. District Court for the Southern District of Ohio, 2012 Professional Associations American Board of Certification of Bankruptcy and Creditors' Rights Attorneys (Director and Executive Committee Member) Indianapolis Bar Association - Commercial and Bankruptcy Section (Executive Committee and Chair for 2005) Indiana State Bar Association – Creditors Rights Section (Member) House of Delegate (Member) American Bankruptcy Institute (Member) Indianapolis Bar Foundation (Distinguished Fellow) Indiana Network of International Women's Insolvency and Restructuring Conference (Charter Member) Indianapolis Bar Association Commercial and Bankruptcy Section Legal Help Line, 2005 and 2006 Indianapolis Bar Association "Ask A Lawyer Live", 2000 - 2001 Indianapolis Bar Association Pro Bono Task Force, 1998 - 1999 St. Monica School Commission, 1997 - 1998 Indianapolis Bar Association Pro Bono Program, 1989 - 1992 Marion County Guardian Ad Litem Panel, 2009 - Present Awards and Recognitions Board Certified in Business Bankruptcy Seminars and Presentations Annual Bankruptcy Institute, Indiana Continuing Legal Education Forum, 2006 -2011 Fundamentals of Acquisition Transactions, Lorman Seminars, 2006 - 2008 Practical & Ethical Considerations in Dealing with Pro Se Litigants, Indianapolis Bar Association, 2004 Revised Article 9, NBI, 2002 Basic Bankruptcy, Half-Moon Seminars, 2002 Collections, Wishard Hospital, 2001 1994 Amendments to Bankruptcy Code, Indiana Assn. of Credit Management, 1995 Creditors' Rights, CPM Seminar Systems, 1992 Single Assets Cases, Indianapolis Bar Association, 1990 Lender Liability, Indiana Continuing Legal Education Forum, 1990 Chapter 11 Plans, Indiana Continuing Legal

Education Forum, 1989

Martha Reddy Lehman
SmithAmundsen LLC
201 North Illinois Street, Suite 1400
Capital Center, South Tower
Indianapolis, IN 46204
ph: (317) 464-4142
e-mail: mlehman@salawus.com

Elizabeth M. Little, Faegre Drinker Biddle & Reath LLP, Indianapolis, IN

Elizabeth Little provides integrated and strategic legal counsel on financial matters, including complex financial transactions, corporate debt restructurings, and related litigation matters.

Previous Experience

During law school, Elizabeth worked as a legal extern with the American Civil Liberties Union of Indiana, judicial extern for the Honorable Tim A. Baker in the U.S. District Court for the Southern District of Indiana, and summer associate at Faegre Baker Daniels.

Elizabeth also served in the Conservation Law Clinic and received a Graduate Certificate in Environmental and Natural Resources Law.

Jason T. Mizzell, Kroger, Gardis & Regas, LLP, Indianapolis

Jason focuses his practice in the areas of litigation, E-discovery, creditors' rights, secured transactions, and bankruptcy matters. He served as staff counsel for the Honorable James M. Carr, United States Bankruptcy Judge for the Southern District of Indiana from 2013-2017 before moving into private practice. His substantial background in electronic discovery has seen his practice shift from exclusively creditors' rights and bankruptcy issues to include litigation in a number of different practice areas including environmental law and sports and entertainment law.

He is active in leadership roles within the Indianapolis Bar Association and the Indiana State Bar Association and regularly gives educational presentations to other attorneys on bankruptcy matters.

Andrew C. Ozete, Farmer Scott Ozete Robinson & Schmitt LLP, Evansville

My practice is centered on advising businesses, banking, and creditors' rights, including bankruptcy, State Court, and negotiated workout solutions. I represent businesses, financial institutions, trade creditors, and debtors in transactions, leases, litigation, business workouts, loan restructurings, and Chapter 11 cases. I help guide my clients through the uncertain waters of the bankruptcy process and help them maximize their returns.

I advise institutional clients and small business owners in a wide range of matters and serve in general counsel capacity for various clients.

I am board certified in business bankruptcy law by the American Board of Certification. I was selected as an Indiana Super Lawyer each year from 2012 through 2018. I also received the Distinguished Barrister Leadership in Law award from the Indiana Lawyer in 2019. Additionally, I am a frequent speaker on bankruptcy and creditors' rights issues, in which I provide information, training and education to local business groups as well as local and state-wide attorney legal education organizations.

Andrew C. Ozete
Farmer Scott Ozete Robinson & Schmitt LLP
21 SE Third Street, Suite 900
Evansville, IN 47708
ph: (812) 602-3570
fax: (812) 602-3591
e-mail: aozete@fsolegal.com

Jonathan Sundheimer, Partner, Barnes & Thornburg LLP

Simply put, Jonathan counsels businesses and individuals that loan money or are owed money. On the front-end of lending relationships, Jonathan has experience representing banks, both large and small, with loan originations, extensions, modifications and amendments. He has advised banks regarding loan participations, subordination agreements and mezzanine financing.

On the back-end of lending relationships, Jonathan has experience enforcing commercial real estate loans, representing receivers and collecting judgments. He regularly represents special servicers and financial institutions throughout Indiana in negotiating loan modifications and loan enforcement. In bankruptcy, he has represented creditors in all aspects of Chapter 11 proceedings, including cash collateral disputes, 363 sales and plan confirmations.

In both bankruptcy and commercial litigation, Jonathan's work has led to published opinions in Indiana state and federal courts, the Indiana Court of Appeals and the U.S. Court of Appeals for the Seventh Circuit. Out of court, he has helped restructure loans secured by real property, rents and equipment.
Jonathan has frequently advised manufacturing clients on strategies for minimizing risk in the supply chain. His advice has helped both suppliers and original equipment manufacturers avoid assembly line shutdowns and ensure continuing operations. Whether negotiating contract terms or seeking the appointment of a receiver over a supplier's operations, Jonathan's work has reduced losses when sole source suppliers go dark.

Jonathan is a frequent speaker, and has presented to the National Association of Credit Managers, Indianapolis Bar Association's Leonard H. Opperman Chapter 11 Roundtable, ICLEF Annual Bankruptcy Institute, and the Building Owners and Managers Association.

Dedicated to direct and clear communication, Jonathan is at his best when faced with the fast pace, obstacles, complexity and diversity of legal representation involving lending and collections. Whether he is in or out of court, Jonathan is appreciated by clients and colleagues alike for being practical and reasonable, and for providing a realistic assessment of each client's options and how that path could support their end game.

Jonathan Sundheimer - Moderator
Barnes & Thornburg LLP
11 South Meridian Street
Indianapolis, IN 46204
ph: (317) 231-7319
e-mail: jsundheimer@btlaw.com

Meredith R. Theisen, Partner, Rubin & Levin, P.C., Indianapolis

Meredith R. Theisen concentrates her practices in the areas of bankruptcy, bankruptcy litigation, debtors and creditors' rights, business representation, secured transactions, real estate sales, state court receiverships, commercial litigation, and bankruptcy trustee and state court receiver representation.

Her bankruptcy practice includes representing individuals, businesses, debtors, and creditors in Chapters 7, 11, 12 and 13 bankruptcy cases, out of court debt restructuring, receivership actions, and litigation matters. She has served as counsel to individuals and businesses reorganizing in Chapter 11 cases or liquidating in complex Chapter 7 cases. She also has extensive experience representing bankruptcy trustees in both Chapter 7 and 11 cases. Throughout her practice, Meredith has developed an expertise in asset protecting, business liquidation and wind down, property acquisition through a bankruptcy 363 sale, lease assignment through a bankruptcy 365 assumption and assignment process, defending preference/fraudulent conveyance actions and non-dischargeability actions.

Much of her representation includes providing proactive counsel to businesses as she helps identify and minimize potential issues that could negatively impact operations. She also assists new business owners form business entities, choose the best entity type based upon their needs, and assist with start-up compliance issues so that new ventures will be on a firm legal ground for success.

Meredith R. Theisen
Rubin & Levin, P.C.
135 North Pennsylvania Street, Suite 1400
Indianapolis, IN 46204

Stacy Wissel
PO Box 68
Decker, Indiana 47524-0068
812-886-6452
swissel@sbcglobal.net

BIOGRAPHY

Anastasia (Stacy) Wissel currently serves as a Chapter 7 Panel Trustee in the Southern District of Indiana - Evansville Division. She also serves as a part time staff attorney for Mark Zuckerberg, in Indianapolis. She began her career in the bankruptcy world in 1991 as an employee of the Bankruptcy Court Clerk's office in Indianapolis. She finished her employment with the Court as a Courtroom Deputy to the Honorable Robert L. Bayt. In 1997 she left the Clerk's office to serve as staff attorney to Robert Brothers, Chapter 13 Trustee. In October 2002, she was appointed by the United States Trustees Office as a panel trustee. She has been a frequent speaker on consumer bankruptcy issues for ICLEF.

Table of Contents

Section One

Student Loan Dischargeability –
A Brave New World.. Stacy M. Wissel

Section Two

2022 Case Law Update.. John M. Hauber

Section Three

Section Four

You Don't Notice Me Anymore........................Jason R. Burke-Moderator
Jeffrey M. Hester
Jason W. Cottrell
Elizabeth M. Little

Section Five

Section Six

Avoidance Actions, Alter Egos, Accountability, & Crypto Assets: A Mixed Bag of Commercial Bankruptcy Updated........Jonathan D. Sundheimer – Moderator

Samuel D. Hodson
John R. Humphrey
Jason T. Mizzell

Section One

Student Loan Dischargeability – A Brave New World

Stacy M. Wissel
Chapter 7 Trustee
Decker, Indiana

Section One

STUDENT LOAN DISCHARGEABILITY –

A BRAVE NEW WORLD

Stacy Wissel

December 2022

Pre November 17 , 2022 Dischargeability

“Bruner”   - Attached

Totality of Circumstance - discussion

Post November 17, 2022 Dischargeability

Guidance from DOJ - Attached

Blank “Attestation” - Attached

Sample Attestation – Attached

Adversary Practice - Discussion

Pre November 17, 2022 Dischargeability

831 F.2d 395

42 Ed. Law Rep. 535, Bankr. L. Rep. P 72,025

Marie BRUNNER, Appellant,
v.
NEW YORK STATE HIGHER EDUCATION SERVICES CORP., Appellee.

(parties)

No. 41, Docket 87-5013.

**United States Court of Appeals,
Second Circuit.**

*Argued Sept. 22, 1987.
Decided Oct. 14, 1987.*

Marie Brunner, pro se.

Frederick J. Schreyer, Albany, N.Y., for appellee.

Before LUMBARD, OAKES and KEARSE, Circuit Judges.

PER CURIAM:

1 Marie Brunner, pro se, appeals from a decision of the United States District Court for the Southern District of New York, Charles S. Haight, Judge, which held that it was error for the bankruptcy court to discharge her student loans based on "undue hardship," 46 B.R. 752 (Bankr.D.C.N.Y.1985). We affirm.

2 While this court is obliged to accept the bankruptcy court's undisturbed findings of fact unless they are clearly erroneous, it is not required to accept its conclusions as to the legal effect of those findings. Montco, Inc. v. Glatzer (In re Emergency Beacon Corp.), 665 F.2d 36, 40 (2d Cir.1981) (citing Queens Blvd. Wine & Liquor Corp. v. Blum, 503 F.2d 202 (2d Cir.1974); R.Bankr.P. 810 (current version, see R.Bankr.P. 8013); Bank of Pa. v. Adlman, 541 F.2d 999, 1005 (2d Cir.1976)). Whether not discharging Brunner's student loans would impose on her "undue hardship" under 11 U.S.C. Sec. 523(a)(8)(B) requires a conclusion regarding the legal effect of the bankruptcy court's findings as to her circumstances. Therefore, the bankruptcy court's conclusion of "undue hardship" properly was reviewed by the district court.

3 As noted by the district court, there is very little appellate authority on the definition of "undue hardship" in the context of 11 U.S.C. Sec. 523(a)(8)(B). Based on legislative history and the decisions of other district and bankruptcy courts, the district court adopted a standard for "undue hardship" requiring a three-part showing: (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans. For the reasons set forth in the district court's order, we adopt this analysis. The first part of this test has been applied frequently as the minimum necessary to establish "undue hardship." See, e.g., Bryant v. Pennsylvania Higher Educ. Assistance Agency (In re Bryant), 72 B.R. 913, 915 (Bankr.E.D.Pa.1987); North Dakota State Bd. of Higher Educ. v. Frech (In re Frech), 62 B.R. 235 (Bankr.D.Minn.1986); Marion v. Pennsylvania Higher Educ. Assistance Agency (In re Marion), 61 B.R. 815 (Bankr.W.D.Pa.1986). Requiring such a showing comports with common sense as well.

4 The further showing required by part two of the test is also reasonable in light of the clear congressional intent exhibited in section 523(a)(8) to make the discharge of student loans more difficult than that of other nonexcepted debt. Predicting future income is, as the district court noted, problematic. Requiring evidence not only of current inability to pay but also of additional, exceptional circumstances, strongly suggestive of continuing inability to repay over an extended period of time, more reliably guarantees that the hardship presented is "undue."

« up

5 Under the test proposed by the district court, Brunner has not established her eligibility for a discharge of her student loans based on "undue hardship." The record demonstrates no "additional circumstances" indicating a likelihood that her current inability to find any work will extend for a significant portion of the loan repayment period. She is not disabled, nor elderly, and she has--so far as the record discloses--no dependents. No evidence was presented indicating a total foreclosure of job prospects in her area of training. In fact, at the time of the hearing, only ten months had elapsed since Brunner's graduation from her Master's program. Finally, as noted by the district court, Brunner filed for the discharge within a month of the date the first payment of her loans came due. Moreover, she did so without first requesting a deferment of payment, a less drastic remedy available to those unable to pay because of prolonged unemployment. Such conduct does not evidence a good faith attempt to repay her student loans.

6 It is true, however, that considerable time has elapsed since the original filing of Chapter 7 proceedings, and even since the hearing before the bankruptcy judge. We note that Judge Haight's order was without prejudice to Brunner's seeking relief pursuant to R.Bankr.P. 4007(a), (b).

7 Judgment affirmed.

Post November 17, 2022 Dischargeability

November 17, 2022

GUIDANCE FOR DEPARTMENT ATTORNEYS REGARDING STUDENT LOAN BANKRUPTCY LITIGATION

I. Introduction

This memorandum provides guidance (Guidance) to Department of Justice (Department) attorneys regarding requests to discharge student loans in bankruptcy cases. Developed in coordination with the Department of Education (Education), this Guidance will enhance consistency and equity in the handling of these cases. In accordance with existing case law and Education policy, the Guidance advises Department attorneys to stipulate to the facts demonstrating that a debt would impose an undue hardship and recommend to the court that · debtor's student loan be discharged if three conditions are satisfied: (1) the debtor presently lacks an ability to repay the loan; (2) the debtor's inability to pay the loan is likely to persist in the future; and (3) the debtor has acted in good faith in the past in attempting to repay the loan.

To assist the Department attorney in evaluating each of these factors, a debtor will typically be asked to provide relevant information to the government by completing an attestation form (Attestation). The Attestation requests information about the debtor's income and expenses to enable the Department attorney to evaluate the debtor's present ability to pay. The Attestation also seeks information that will help the Department attorney evaluate the other two factors. In the following sections, this Guidance provides more detail about the Attestation that a debtor will be asked to complete, and how the information provided in the Attestation will be considered by the Department attorney. In Appendix A, this Guidance provides a sample attestation form. In addition, in Appendix B, this Guidance provides a concrete example of how a debtor's request for discharge of a student loan will be evaluated.

II. Objectives of the Guidance and Education's Role in Supporting Discharge Cases

In cases where a debtor seeks the discharge of a student loan in bankruptcy, the Department shares with Education the responsibility to represent the interests of the United States in accord with existing law and in the interests of justice. This responsibility includes recommending that a bankruptcy court grant full or partial discharge of student loan debts in appropriate cases. To fulfill that responsibility, Department attorneys should stipulate to facts necessary to demonstrate undue hardship and recommend discharge where the debtor provid information in the Attestation (or otherwise during the adversary proceeding) that satisfies the elements of the analysis below. Some debtors have been deterred from seeking discharge of student loans in bankruptcy due to the historically low probability of success and due to the mistaken belief that student loans are ineligible for discharge. Other student loan borrowers have been dissuaded from seeking relief due to the cost and intrusiveness entailed in pursuing an adversary proceeding. This Guidance is intended to redress these concerns so that discharges are sought and received when warranted by the facts and law. In addition, Department attorneys are expected to consult proactively with Education to evaluate the specific circumstances of each case.

In collaborating in the preparation of this Guidance, the Department and Education have sought to promote three goals in particular:

1. To set clear, transparent, and consistent expectations for discharge that debtors understand regardless of representation;
2. To reduce debtors' burdens in pursuing an adversary proceeding by simplifying the fact-gathering process. This includes use of an Attestation, and where feasible, information provided through prior submissions to the bankruptcy court and available student loan servicing records;
3. Where the facts support it, to increase the number of cases where the government stipulates to the facts demonstrating a debt would impose an undue hardship and recommends to the court that a debtor's student loans be discharged.

Education is committed to supporting Department attorneys handling these cases. Department attorneys should expect that, for each adversary proceeding, Education will provide to the Department attorney a record of the debtor's account history, loan details, and—where available—educational history, which the Department attorney will share with the debtor. This information will be provided with the Education litigation report.

The Department attorney is expected to consult with Education in each case; consultation includes sharing the completed Attestation and conferring on an appropriate course of action. In its initial litigation report, Education will advise on matters including whether it has data relating to the presumptions in this Guidance regarding assessment of future circumstances and whether it considers the debtor made good faith efforts to repay their student loans. This process will ensure the final decision is informed by Education's experience administering student loans and its role as creditor. Once the Department attorney reaches a recommendation in accordance with this Guidance, the Department attorney shall submit their recommendation or approval, as appropriate, along with Education's recommendation, under the standard procedures applicable in that attorney's component.

III. Applicable Law

Under Section 523(a)(8) of the Bankruptcy Code, certain student loans may not be discharged in bankruptcy unless the bankruptcy court determines that payment of the loan "would impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. § 523(a)(8); *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 278 (2010) ("the bankruptcy court must make an independent determination of undue hardship . . . even if the creditor fails to object or appear in the adversary proceeding.").[1] This inquiry is undertaken through a formal adversary proceeding in the bankruptcy court. *United Student Aid Funds*, 559 U.S. at 263-64; Fed. R. Bankr. P. 7001(6). The parties in that proceeding may stipulate to the existence of certain facts and recommend that the bankruptcy court find, based on such facts, that repayment of the student loan would cause the debtor an undue hardship.

The most common framework for assessing undue hardship is the so-called *Brunner* test, emanating from *Brunner v. New York State Higher Education Services Corp.*, 831 F.2d 395 (2d Cir. 1987). To discharge a student loan under the *Brunner* test, a bankruptcy court must find that the debtor has established that (1) the debtor cannot presently maintain a minimal standard of living if required to repay the student loan, (2) circumstances exist that indicate the debtor's financial situation is likely to persist into the future for a significant portion of the loan repayment period, and (3) the debtor has made good faith efforts in the past to repay the student loan. *Id.* at 396.

Other courts have employed a "totality of circumstances" test (Totality Test) to determine whether repayment of student loan debt would cause an undue hardship. *See, e.g.*, *In re Long*, 322 F.3d 549, 553 (8th Cir. 2003). The Totality Test looks to: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and their dependents' reasonably necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case. *Id.*

This Guidance applies in both *Brunner* and Totality Test jurisdictions. Courts have recognized the *Brunner* and Totality Tests "consider similar information—the debtor's current and prospective financial situation in relation to the educational debt and the debtor's efforts at repayment." *In re Polleys*, 356 F.3d 1302, 1309 (10th Cir. 2004); *see also In re Jesperson*, 571

[1] Section 523(a)(8) requires the debtor to demonstrate an undue hardship to discharge nearly all federal student loans, excluding Health Education Assistance Loans, as well as private education loans that meet the definition of qualified education loans under the Internal Revenue Code. *See* 26 U.S.C. § 221(d)(1).

F.3d 775, 779 (8th Cir. 2009).[2] Both tests require assessment of the debtor's income and reasonable expenses to determine whether the debtor has the present and future ability to maintain a "minimal standard of living" while making student loan payments. *See, e.g.*, *In re Hurst*, 553 B.R. 133, 137 (B.A.P. 8th Cir. 2017) ("[I]f the debtor's reasonable financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal standard of living—then the debt should not be discharged.") (citing *In re Jesperson*, 571 F.3d at 779). Finally, both tests direct the court to review the debtor's past efforts at repayment. *In re Polleys*, 356 F.3d at 1309; *see also In re Bronsdon,* 435 B.R. 791, 797 (B.A.P. 1st Cir. 2010).

IV. Discussion of the Applicable Factors

As explained above, consideration of student loan debt discharge requires an evaluation of a debtor's present, future, and past financial circumstances. This Guidance offers a framework for Department attorneys to apply each of these factors.

With respect to the first factor, the Guidance relies upon the Internal Revenue Service Collection Financial Standards (the IRS Standards) to assess whether a debtor can presently maintain a "minimal standard of living" if required to repay student loan debt. In particular, the Department attorney is advised to use the IRS Standards to evaluate a debtor's expenses, and then to compare those expenses to the debtor's income, to determine whether the debtor has a present ability to pay the loan.

With respect to the second factor, the Guidance uses presumptions for determining whether inability to repay is likely to persist in the future. The Guidance recognizes, however, that even in the absence of such presumptions a debtor may be able to establish that their inability to pay will continue in the future.

With respect to the third factor, the Guidance identifies certain objective criteria that evidence a borrower's good faith. In addition, the Guidance discusses how to evaluate a debtor's

[2] The Eighth Circuit has described the Totality Test as "less restrictive" than the *Brunner* framework, *In re Long*, 322 F.3d at 554, but it has also recognized that the distinction between the standards "may not be that significant." *Jesperson*, 571 F.3d at 779 n.1, 782. *See, e.g.*, *In re Long,* 322 F.3d at 554-55 ("Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal stand d of living—then the debt should not be discharged. Certainly, this determination will require a special consideration of the debtor's present employment and financial situation—including assets, expenses, and earnings—along with the prospect of future changes—positive or adverse—in the debtor's financial position"); *see also Jesperson*, 571 F.3d at 782 (the totality approach also requires consideration of "evidence of a less than good faith effort to repay . . . student loan debts"). The Guidance does not supersede applicable case law in the circuits. Department attorneys should advance the principles and goals described in this Guidance consistent with that case law.

payment history and decision to participate in an income-driven repayment plan, and clarifies that neither of these factors are dispositive evidence where other evidence of good faith exists.

Finally, the Guidance also provides direction to Department attorneys regarding the treatment of a debtor's assets and the availability of partial discharge.

The Attestation provided with this Guidance will assist in the assembly of the information needed to assess these factors.[3] Department attorneys are expected to review completed Attestations in consultation with Education.

A. Assessment of Present Circumstances

The first factor relevant to whether a student loan debtor can meet the statutory undue hardship standard requires the debtor to prove an inability to presently maintain "a minimal standard of living" while making student loan payments. To address this factor, the Department attorney should complete two steps. First, the Department attorney should use the IRS Standards to determine the debtor's "allowable" expenses. Second, the attorney should compare those allowable expenses to the debtor's income to determine whether the debtor has income after expenses with which to make student loan payments. If the debtor's allowable expenses exceed their gross income, this element of the analysis is satisfied. If the debtor's financial circumstances changed since filing the initial bankruptcy petition, the Department attorney can look to the debtor's actual financial circumstances when making an undue hardship determination. *Cf. In re Walker* 650 F.3d 1227, 1232 (8th Cir. 2011).

1. Assessment of the Debtor's Expenses

The Attestation solicits expense information from debtors in categories corresponding to the IRS Standards, particularly the portions of the IRS Standards described as "National and Local Standards" and "Other Necessary Expenses."[4] The IRS Standards are a useful guide to assess a debtor's expenses for purposes of the "minimal standard of living" inquiry. Use of these standards will ensure more consistent and equitable treatment of debtors seeking discharge. The IRS has established and updated the IRS Standards to determine appropriate collection actions where taxpayers have outstanding unpaid tax obligations. The IRS Standards evaluate what

[3] As discussed in more detail below, the Attestation requires a debtor to present information relevant to the Department attorney's analysis in an efficient, organized manner. If the debtor's satisfaction of the requirements for discharge are clearly demonstrated by the complaint or other facts available outside the Attestation, then upon verification of those facts, a Department attorney may recommend discharge without requiring that the debtor complete the Attestation.

[4] Links to the IRS Standards are found at https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards.

expenses are "necessary to provide for a taxpayer's health and welfare[,]"[5] or, as described in the IRS Collection Manual, "the *minimum* a taxpayer and family needs to live."[6] Courts have recognized the IRS Standards as useful objective criteria in assessing "undue hardship" under Section 523(a)(8). *See, e.g.*, *In re O'Hearn*, 339 F.3d 559, 565 (7th Cir. 2003); *In re Cota*, 298 B.R. 408, 415 (Bankr. D. Ariz. 2003). The IRS Standards list certain expenses (the National and Local Standards) for which they provide a recommended maximum allowance, but also recognize other potential expenses (Other Necessary Expenses) that are potentially necessary for an individual's health and welfare.

Allowance of Expenses in National Standard Categories: The IRS National Standards consist of tables of allowable expense amounts in the following categories: food; housekeeping supplies; apparel and services; personal care products and services; and miscellaneous. Where the debtor's expenses are below the amount allowed under the IRS National Standards, no further inquiry into the debtor's actual expense amount is needed and the debtor is allowed the full National Standards amount. If a debtor's reported expenses exceed the IRS National Standard amount, a debtor's reasonable explanation for why particular actual expenses exceed the standard should be considered carefully by the Department attorney, in consultation with Education, and may be accepted if allowing the additional expenses is warranted by the debtor's circumstances and would comport with a "minimal standard of living."[7]

Allowance of Expenses in Local Standards Categories: The Local Standards provide expense standards for the categories of housing, utilities, and transportation. Unlike the expenses in the National Standards category, for the Local Standards categories, the Department attorney should limit the debtor to their *actual* expenses. To the extent such expenses do not exceed the amount prescribed in the Local Standards for the debtor's location and household size, Department attorneys should consider the debtor's actual expenses in these categories to be consistent with a minimal standard of living and treat such amount as allowed. If the debtor's actual expense exceeds the Local Standards amount, Department attorneys should generally limit the debtor's allowable expense to the standard amount. However, as with those expenses categorized as National Standards expenses, the Department attorney should, in consultation

---

[5] IRS, *Collection Financial Standards*, https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards.

[6] IRS, Internal Revenue Manual: Part 5.15.1.8 (July 24, 2019), https://www.irs.gov/irm/part5/irm_05-015-001#idm139862108264304 (emphasis added).

[7] The decision whether to allow expenses in excess of the National and Local Standards will necessarily be fact-intensive, but allowable excess expenses could, for example, include specific health-related costs, costs for special dietary needs, unique commuting requirements, or other needs of the debtor or dependents.

with Education, carefully consider and accept a debtor's reasonable explanation for the need for the additional expenses.

Allowance of Other Necessary Expenses: The IRS Standards recognize "Other Necessary Expenses" in addition to the National and Local Standards expenses. The Attestation requests that debtors list expenses in these "Other Necessary Expense" categories. For example, the IRS Standards allow expenses for alimony and child support payments if they are court-ordered and actually being paid, as well as for baby-sitting, day care, nursery and preschool costs where reasonable and necessary. These Other Necessary Expenses are consistent with a "minimal standard of living," so long as they are necessary and reasonable in amount.[8]

Allowance for Reasonable Expenses Not Incurred: In addition to the comparison of expenses and income described above, Department attorneys should also recognize there may be circumstances in which a debtor's actual expenditures fall below the expenses required to maintain a minimal standard of living and to meet basic needs. For example, a debtor may be living in housing that the debtor is not paying for (e.g., the debtor is staying with a family member) or living in substandard or overcrowded housing but should not be required to remain there indefinitely. Likewise, a debtor may be forgoing spending on childcare, dependent care, technology, or healthcare that would otherwise be expenses one would reasonably expect to maintain a minimal living standard. A simple comparison of present expenses and income could unduly assess the debtor's financial situation against a standard that is below a minimal standard of living. In such circumstances, it would be inappropriate to conclude a debtor possesses income with which to make student loan payments and ignore the debtor's actual living standard. To address these situations, the Attestation provides an opportunity for a debtor to identify and explain expenses the debtor would incur if able to address needs that are unmet or insufficiently provided for. The Department attorney should use those projected expenses in assessing the debtor's present and future financial circumstances. Unless the amount of the projected expenses exceeds the Local Standards, it is not necessary to probe the debtor's calculation.

Appendix B includes specific examples of the recommended analysis of expenses.[9]

---

[8] The Department attorney may consult the IRS Standards themselves to assist in determining whether these expenses are necessary to a debtor's minimal standard of living.

[9] The Attestation process is intended to be distinct from the bankruptcy "means test," which is used to determine a debtor's eligibility for Chapter 7 relief. Although the means test also uses the IRS Standards as part of its calculation of a debtor's household disposable income for the purpose of establishing bankruptcy eligibility, courts have recognized that the means test is not a test of a "minimal standard of living." *See In re Miller*, 409 B.R. 299, 319–320 (Bankr. E.D. Pa. 2009) (means test not appropriate to determine whether the "undue hardship" standard is met) (citing *In re Savage*, 311 B.R. 835, 840 n.7 (1st Cir. B.A.P. 2004). Moreover, the means test calculation differs from the Attestation in specific ways, including that (1) the means test (unlike

2. *Comparison of Expenses with the Debtor's Gross Income*

After determining the debtor's allowable household expenses using the National and Local Standards and Other Necessary Expenses, the Department attorney should compare the debtor's expenses to the debtor's household gross income. Gross income includes income from employment of the debtor and other household members, as well as unemployment benefits, Social Security benefits and other income sources. Debtors normally provide this information in the Schedule I filing. Where debtors filed this form less than 18 months prior to the adversary proceeding, the debtor may use the information on Schedule I to complete the Attestation. Where Schedule I was filed more than 18 months prior to the adversary proceeding or the debtor's circumstances have changed, the Attestation directs the debtor to provide the new income information.

Using the expense and income information provided in the Attestation, the Department attorney should determine whether the debtor possesses income with which to make student loan payments. If the debtor's allowable expenses exceed the debtor's income, the minimal standard of living requirement is satisfied and the debtor may be eligible for a student loan discharge, subject to consideration of the additional factors below. If, however, after considering the analysis described above, the debtor has sufficient discretionary income to make full student loan payments as required under their loan agreement, the debtor has not satisfied the test for undue hardship.[10] Where a debtor's income allows for payment toward the student loan debt but in an amount insufficient to cover the required monthly student loan payment, the Department attorney

the Attestation) is required only for "consumer" debtors whose income exceeds a state "median," and (2) in practice, the means test often allows expenses regardless of their necessity to the debtor's basic or minimal standard of living, such as payments on multiple vehicles or for real property other than the debtor's residence.

[10] Department attorneys are expected to consult with Education to determine the monthly repayment amount. Generally, where permitted in a given jurisdiction, the Department attorney should use the monthly payment amount due under a "standard" repayment plan for the student loan in question when determining whether the debtor has the ability to make payments. The standard repayment amount is the payment amount required to pay the student loan within the remaining term of the loan, as determined by Education. *See* 34 C.F.R. § 685.208. Where the account includes unpaid interest, Department attorneys should take care to ensure that the monthly payment amount would be sufficient to pay the loan obligation in full. Except as required by controlling law, the Department attorney should not use the monthly payment amount available through income-driven repayment plan options as the comparator. Finally, where a student loan has been accelerated, whether based on a debtor's payment default or otherwise, the Department attorney should, following consultation with Education, determine the standard repayment amount either prior to default or as calculated if the loan were removed from default status.

should consider the potential for a partial discharge (discussed more fully in Section IV.E. below).

B. Assessment of Future Circumstances

The second factor for discharge is whether the debtor's current inability to repay the debt while maintaining a minimal standard of living will likely persist for a significant portion of the repayment period. This showing is required in both *Brunner* Test and Totality Test jurisdictions. *See In re Thomas*, 931 F.3d 449, 452 (5th Cir. 2019); *In re Long*, 322 F.3d at 554.

A presumption that a debtor's inability to repay debt will persist is to be applied in certain circumstances, including: (1) the debtor is age 65 or older; (2) the debtor has a disability or chronic injury impacting their income potential;[11] (3) the debtor has been unemployed for at least five of the last ten years; (4) the debtor has failed to obtain the degree for which the loan was procured; and (5) the loan has been in payment status other than 'in-school' for at least ten years.[12] The Attestation is designed to identify any such circumstances, and it advises the debtor to disclose all of the circumstances applicable to their situation and not rely exclusively on a single presumptive basis for claiming a continuing inability to repay.

The presumptions identified in this Guidance are rebuttable. Although circumstances supporting rebuttal of a presumption will likely be uncommon, the Department attorney need not apply a particular presumption if the debtor's attestation nonetheless indicates a likely future ability to pay. Such a rebuttal must be based on concrete factual circumstances. Mere conjecture about the borrower's future ability is not enough. For example, the presumption in favor of a

---

[11] The debtor may, but is not required to, submit information from a treating physician indicating that the debtor suffers from a disability or chronic injury impacting their income potential, and when provided, that information should be considered carefully. The presumption may be applied even in the absence of a formal medical opinion.

Education offers Total and Permanent Disability (TPD) discharge for qualifying borrowers with certain severe disabilities. Because TPD discharge has its own requirements, the existence of that potential administrative relief generally should not foreclose the debtor from showing a future inability to pay. If, in the view of the Department attorney, the debtor may qualify for TPD discharge, the attorney can provide information to the debtor about the program. Finally, Education's denial of a TPD discharge request is not dispositive of the future circumstances analysis: a prior denial for TPD discharge only implies that Education determined the borrower is likely to have some ability to earn income at the time of the application based on the information provided and evaluation criteria in place, but does not otherwise suggest that the debtor's income is sufficient to service student loan debt or that future circumstances are likely to change.

[12] In the case of consolidation loans, the length of time the debtor has been in repayment includes periods in repayment on the original underlying loans.

debtor who failed to obtain a degree may be rebutted by evidence that the debtor has received employment offers with salaries significantly higher than their current income. In sum, a presumption may be rebutted by evidence that a debtor's future financial circumstances render them able to pay their outstanding debt.

The presumptions identified above are not the sole bases upon which a future inability to pay may be found. A debtor may attest to any facts the debtor believes are relevant to future inability to pay, and the Department attorney should review the Attestation to determine whether the facts presented by the debtor satisfy the standards for proof of likely persistence of inability to pay. A Department attorney may find, for example, that a debtor's financial circumstances are unlikely to improve in the future where the debtor has a significant history of unemployment, even if the debtor's unemployment does not meet the criteria for a presumption. A stipulation may also be appropriate, even absent a particular presumption, where the institution that granted the debtor's degree has closed, and that closure has inhibited a debtor's future earning capacity.[13] Education has indicated that closure of a school after completion of the debtor's degree may affect a debtor's future ability to pay where the debtor incurs reputational harm from such closure or where the debtor's lack of access to records hampers employment efforts.[14]

C. Assessment of Good Faith

Whether a debtor has demonstrated good faith with regard to repayment of student loan debt depends upon the debtor's actions relative to their loan obligation.[15] Good faith may be demonstrated in numerous ways and the good faith inquiry "should not be used as a means for courts" or Department attorneys "to impose their own values on a debtor's life choices." *Polleys*, 356 F.3d at 1310. A debt should not be discharged if the debtor has "willfully contrive[d] a hardship in order to discharge student loans," *id.*, abused the student loan system, *In re Coco*, 335 Fed. App'x 224, 228-29 (3rd Cir. 2009), for example, by committing fraud in connection with obtaining the loans, or otherwise demonstrated a lack of interest in repaying the debt, *id.*

[13] Education offers a loan discharge for students attending a school that closed while the borrower was in attendance or shortly after withdrawal. As with a TPD discharge, the availability of this administrative relief should have limited influence on the analysis discussed in this Guidance. Debtors may not receive the "closed-school" discharge for a range of reasons that do not implicate their financial status.

[14] The presumptions discussed in this Guidance are intended to direct a Department attorney's assessment of the debtor's situation and do not shift any burden of proof in undue hardship litigation. Before the court in the adversary proceeding, the debtor retains the burden of proof on all elements of the undue hardship claim.

[15] In discussing good faith, this Guidance intends to encompass satisfaction of both Prong Three of the *Brunner* test and good faith as considered under the Totality Test in evaluating the debtor's past efforts at repayment.

Where the debtor has taken at least one of the following steps and in the absence of countervailing circumstances as discussed below, the steps demonstrate good faith. We would normally expect the Department attorney to be able to determine the presence of any countervailing circumstances based on the information contained in the Attestation and provided by Education or that is publicly available.

Evidence of good faith: The following steps evidence good faith:

- making a payment;
- applying for a deferment or forbearance (other than in-school or grace period deferments);
- applying for an IDRP plan;
- applying for a federal consolidation loan;
- responding to outreach from a servicer or collector;
- engaging meaningfully with Education or their loan servicer, regarding payment options, forbearance and deferment options, or loan consolidation; or
- engaging meaningfully with a third party they believed would assist them in managing their student loan debt.

The good faith standard also assesses criteria such as "the debtor's efforts to obtain employment, maximize income and minimize expenses." *In re Mosko*, 515 F.3d 319, 324 (4th Cir. 2008) (citing *In re O'Hearn*, 339 F.3d at 564); *see, e.g., In re Jesperson,* 571 F.3d at 780. A debtor's handling of finances in a manner that suggests responsible management of their debt, including student loan debts, also suggests good faith. A debtor has minimized expenses if their expenses fall within the IRS Standards as discussed in this Guidance.[16] Good faith can be satisfied where debtors' personal or family obligations significantly reduce their employment opportunities or increase their expenses." Issues concerning employment, income, and expenses are case-specific and may be highly dependent on a debtor's family, community, and individual circumstances. Debtors may provide an explanation of those circumstances, and the Department attorney should weigh the explanation in consultation with Education.

Actual payment history and IDRP enrollment: Department attorneys should consider the following two issues that frequently arise and deserve additional attention: a debtor's actual payment history and a debtor's enrollment or non-enrollment in an IDRP. Department of Education studies have shown that the servicing of student loan debt has been plagued at tim

[16] By contrast, a debtor whose expenses exceed the IRS Standards should not be foreclosed from showing they have minimized expenses, and the Department attorney and Education should carefully assess any explanations debtors may provide for exceeding the standard expenses.

by administrative errors and dissemination of confusing and inaccurate information, and that these issues may have affected debtors' responses to their loan obligations. In addition, the Consumer Financial Protection Bureau has found that debtors have been wrongfully denied IDRP enrollment and that monthly payments have been inaccurately calculated. *See* Consumer Financial Protection Bureau, *Supervisory Highlights* Fall 2022, Summer 2021, and Fall. The Bureau has also found that servicers falsely but affirmatively represented to borrowers that loans were never dischargeable in bankruptcy. *See* Consumer Financial Protection Bureau, *Supervisory Highlights*, Fall 2014 & Fall 2015. These problems have also given rise to a lack of trust by debtors in the repayment process. As a result, the good faith inquiry should not disqualify debtors who may not have meaningfully engaged with the repayment process due to possible misinformation, wrongful IDRP determinations, or a lack of adequate information or guidance. When considering a debtor's attempts to engage with their student loan, attorneys should look at the entire life of the loan rather than merely considering the recent history.

Department attorneys should consider payment history within the broader context of the debtor's financial means and personal circumstances. Where other evidence of good faith exists, including evidence that the debtor lacked financial means to pay or that the debtor made meaningful contact with Education or the servicer to explore repayment options, the failure to repay (or inconsistent or limited repayment) does not indicate a lack of good faith. In some circumstances, the Department of Education may not have records or have incomplete records about a debtor. The absence of ED data should not reduce the weight of the borrower's evidence.[17]

Department attorneys should also exercise caution in assessing IDRP enrollment. IDRPs are intended to provide a means through which debtors may respond to difficult financial circumstances, and the model Attestation asks a debtor to identify if they enrolled in an IDRP and to offer an explanation if they did not. Where a debtor participated in an IDRP, this factor is evidence of good faith.[18]

---

[17] Between March 2020 and December 2022, borrowers were placed into an automatic COVID-related forbearance. The vast majority of borrowers remained in that forbearance for the duration of the period because it included a zero percent interest rate and eligibility toward IDRP and PSLF forgiveness. Due to this extended period, many debtors may not have taken any action toward their loans. This period of inactivity is not evidence of bad faith and actions taken prior to March 2020 should not be discounted because they are not recent.

[18] *See, e.g.*, *In re Tingling*, 990 F.3d 304, 309 (2d Cir 2021); *In re Krieger*, 713 F.3d 882, 884 (7th Cir. 2013); *In re Coco*, 2009 WL 1426757, at *228–229; *In re Mosko*, 515 F.3d at 323; *In re Barrett*, 487 F.3d 353, 363-64 (6th Cir. 2007); *In re Mosley*, 494 F.3d 1320, 1327 (11th Cir. 2007); *In re Jesperson*, 571 F.3d at 782-83; *In re Nys*, 446 F.3d 938, 947 (9th Cir. 2007); *In re Alderete*, 412 F.3d 1200, 1206 (10th Cir. 2005); *In re Bronsdon*, 435 B.R. at 802.

However, where a debtor has not enrolled in an IDRP, the Department attorney should give significant weight to the fact that, as noted, Education has found widespread problems with IDRP servicing. In particular, Education has advised that IDRPs have not always been administered in ways that have been effective for, or accessible to, student loan debtors. In some cases, borrowers may not have been aware of their IDRP options. At times, servicers failed to inform borrowers about these options in favor of other repayment plans or nonpayment options like forbearance. Likewise, many schools have failed to advise prospective borrowers about IDRPs, despite being legally obligated to do so. *See* 20 U.S.C. § 1092(d). Thus, non-enrollment alone does not show a lack of good faith.

Where a debtor did not enroll in an IDRP, the Department attorney is expected to look first to the debtor's Attestation response and to accept any reasonable explanation or evidence supporting the debtor's non-enrollment in an IDRP. Acceptable explanations or evidence could include, for example:

- that the debtor was denied access to, or diverted or discouraged from using, an IDRP, and instead relied on an option like forbearance or deferment;
- that the debtor was provided inaccurate, incomprehensible, or incomplete information about the merits of an IDRP;
- that the debtor had a plausible belief that an IDRP would not have meaningfully improved their financial situation;
- that the debtor was unaware, after reasonable engagement, of the option of an IDRP and its benefits; or
- where permitted under controlling case law, that the debtor was concerned with the potential tax consequences of loan forgiveness at the conclusion of an IDRP.

Where these explanations are based in part on contact or attempted contact with Education, servicers, or trusted third parties, they evidence good faith.

If a debtor provides an explanation that lacks sufficient detail or is not otherwise acceptable (or fails to provide any explanation), the debtor may still demonstrate good faith through other actions such as making payments, responding to outreach from a servicer or collector, enrolling in deferment or forbearance, making contact with Education or their servicer about their loan, or otherwise taking professional or financial steps that indicate a good-faith attempt to meet their loan obligations. In sum, we would expect Department attorneys not to oppose discharge for lack of good faith where there is a basis to conclude that the debtor's IDRP non-enrollment was not a willful attempt to avoid repayment.

D. Consideration of a Debtor's Assets

A debtor's assets must also be considered in the undue hardship analysis. Department attorneys, however, should not give dispositive weight to the existence of assets that are not easily converted to cash or are otherwise critical to the debtor's well-being, and should be cautious in concluding that the existence of real property or other financial assets demonstrates a lack of undue hardship.[19]

The Attestation facilitates this inquiry by seeking information regarding the debtor's assets. It may be appropriate to suggest that a debtor consider liquidating an asset where the asset is unnecessary to the debtor's and dependents' support and welfare. Residential real property and funds in retirement accounts are often exempt from collection under federal or state exemption laws. Although the exempt status of property may not be dispositive of whether that property is necessary for a minimal standard of living, the Department attorney should be careful in considering such property in the undue hardship analysis. *In re Marcotte*, 455 B.R. 460, 471 (Bankr. D.S.C. 2011).[20] The Department recognizes that liquidating a primary residence or retirement account is an extreme measure and therefore requests to liquidate those assets should be exceptionally rare.

E. Partial Discharge.

Where appropriate and permissible under governing case law, Department attorneys may recognize the availability of partial discharge. Partial discharge occurs where the bankruptcy

---

[19] The debtors' assets may be liquidated by a bankruptcy trustee to fund payments to creditors of the estate. Such property, if liquidated by the trustee, would not be available for the payment of student loan debt and thus should not be considered.

[20] The question of how exempt property should be considered under the "undue hardship" analysis has generated disagreement among courts. Generally, courts find that "the exempt character of an asset does not necessarily preempt its relevance to a hardship evaluation." *In re Armesto*, 298 B.R. 45, 48 (Bankr. W.D.N.Y. 2003); *see also In re Nys*, 446 F.3d at 947 (recognizing courts must consider availability of assets "whether or not exempt, which could be used to pay the loan"); *In re Gleason*, 2017 Bankr. LEXIS 3455, at *14 (Bankr. N.D.N.Y. Oct. 6, 2017) (allowing consideration of IRA or 401K account, regardless of exemption status). Other courts, however, have noted the necessity to weigh the policies underlying certain exemptions, for example, the homestead exemption in the debtor's residence, before considering such assets in assessing undue hardship. *Schatz v. Access Grp., Inc. (In re Schatz)*, 602 B.R. 411, 427-28 (1st Cir. B.A.P. 2019) (reversing bankruptcy court's treatment of exempt equity in homestead as dispositive of a lack of undue hardship). Notably, the *Schatz* opinion states that the bankruptcy court failed to make any finding whether the equity in the debtor's home could be liquidated without imposing an undue hardship on the debtor. *Id.* at 428.

court discharges a portion of the outstanding student loan debt while requiring payment of the remainder.[21]

Department attorneys may consider recommending partial discharge based upon a determination that the debtor has the ability to make some payments on the loan while maintaining a minimal standard of living, but an inability to make the full standard monthly repayment due. A partial discharge should not result in a remaining (undischarged) balance larger than what a debtor's discretionary income (as determined under the Prong One analysis) permits them to pay off in monthly payments over the remaining loan term. In practice, a full discharge is appropriate for debtors whose expenses are equal to or greater than their income where they meet the other elements of the analysis. Partial discharge may also be available to a debtor who is able to liquidate assets to pay a portion of the debt but remains unable to pay the remainder while maintaining a minimal standard of living. *See In re Stevenson*, 463 B.R. 586, 598-99 (Bankr. D. Mass. 2011); *In re Clavell*, 611 B.R. 504, 531-32 (Bankr. S.D.N.Y. 2020).

V. <u>Procedures</u>

Although the process for soliciting and reviewing the Attestation may vary from case to case, Department attorneys should generally observe the following procedures in soliciting Attestations.

A. Submission of the Attestation

Upon a debtor's commencement of an adversary proceeding seeking discharge pursuant to 11 U.S.C. § 523(a)(8), the Department attorney should provide a debtor the opportunity to complete and submit the Attestation. The Department attorney is encouraged to contact the debtor or debtor's counsel as soon as practicable after service of process in an adversary

---

[21] Section 523(a)(8) is silent with respect to whether bankruptcy courts may discharge part of a student loan based on undue hardship. The concept, however, has been recognized by several courts of appeals. *See generally In re Miller*, 377 F.3d 616, 622 (6th Cir 2004); *In re Saxman*, 325 F.3d 1168, 1173-1174 (9th Cir. 2003); *In re Alderete*, 412 F.3d at 1207; *In re Cox*, 338 F.3d 1238, 1243 (11th Cir. 2003). In most jurisdictions where no circuit level authority exists, lower courts have permitted partial discharges. *See, e.g., In re Rumer*, 469 B.R. 553, 564 n.12 (Bankr. M.D. Pa. 2012) (recognizing majority rule is to allow partial discharges); *In re Gill*, 326 B.R. 611, 644 (Bankr. E.D. Va. 2005) (recognizing lower courts have generally allowed partial discharges); *but see, e.g., In re Conway*, 495 B.R. 416, 423 (B.A.P. 8th Cir. 2013) (explaining that the general rule prevents discharging parts of individual loans). Prior to any partial discharge, a debtor must have established all elements necessary for an undue hardship determination. *See In re Saxman*, 325 F.3d at 1175; *Hemar Ins. Co. of Am. v. Cox (In re Cox)*, 338 F.3d 1238, 1243 (11th Cir. 2003).

proceeding, advising the debtor of the opportunity to submit the Attestation for review by the United States. Any Attestation should be submitted by a debtor under oath by signing under penalty of perjury pursuant to 28 U.S.C.§ 1746. The Attestation requests that a debtor provide documents corroborating the debtor's stated income (tax returns, or where appropriate, paystubs or other documents proving income). The Department attorney may seek additional evidence where necessary to support representations in the Attestation.

Education will provide debtors' account history and loan details to the Department and that information will be provided to the debtor with the Attestation form.

B. Time for Attestation

Ideally, the Department attorney would solicit the Attestation from the debtor at the outset of the case to permit early consideration whether to stipulate to facts relevant to undue hardship. The Department attorney is not required to impose any strict time limit for the Attestation.

C. Bankruptcy Court Authority

The Department attorney should advise debtors that although the United States may stipulate to facts relevant to undue hardship and recommend to the bankruptcy court that a finding of undue hardship is appropriate, the United States' position is not binding on the bankruptcy court, which will render its own determination whether a debtor has met the standard for an undue hardship discharge. Department attorneys and debtors should cooperate to file appropriate documents to enable the court to consider whether to issue an order to discharge student loan debt based upon undue hardship.

VI. Conclusion

The goal of this Guidance is to provide Department attorneys with a consistent and practical approach for handling student loan discharge litigation. Because of the fact-specific nature of such litigation, questions may arise about how the Guidance should be applied in particular cases. For assistance in interpreting and implementing the Guidance, Department attorneys are invited to contact the Commercial Litigation Branch, Corporate/Financial Litigation Section of the Civil Division.[22]

---

[22] This memorandum applies only to future bankruptcy proceedings, as well as (wherever practical) matters pending as of the date of this Guidance. This Guidance is an internal Department of Justice policy directed at Department components and employees. Accordingly, it is not intended to and does not create any rights, substantive or procedural, enforceable at law by any party in any matter.

[Updated November 2022]

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: [DEBTOR], Debtors. ________________________________	)	Case No. _______________ Chapter [7]
[DEBTOR], Plaintiff, v. UNITED STATES DEPARTMENT OF EDUCATION, [et al.], Defendant[s]. ________________________________	)	Adversary Pro. ______________

ATTESTATION OF **[NAME]** IN SUPPORT
OF REQUEST FOR STIPULATION CONCEDING
DISCHARGEABILITY OF STUDENT LOANS

I, **[NAME]**, make this Attestation in support of my claim that excepting the student loans described herein from discharge would cause an "undue hardship" to myself and my dependents within the meaning of 11 U.S.C. §523(a)(8). In support of this Attestation, I state the following under penalty of perjury:

I. PERSONAL INFORMATION

1. I am over the age of eighteen and am competent to make this Attestation.

2. I reside at _________________ [address], in ____________ County, [State].

3. My household includes the following persons (including myself):

____________ [full name] ______[age] ____________[self]

____________ [full name] ______[age] ___________[relationship]

____________ [full name] ______[age] ___________[relationship]

Questions four through nine request information related to your outstanding student loan debt and your educational history. The Department of Education will furnish this information to the Assistant United States Attorney ("AUSA") handling your case, and it should be provided to you. If you agree that the information provided to you regarding your student loan debt and educational history is accurate, you may simply confirm that you agree, and these questions do not need to be completed. If you have not received the information from Education or the AUSA at the time you are completing this form, or if the information is not accurate, you may answer these questions based upon your own knowledge. If you have more than <u>one</u> student loan which you are seeking to discharge in this adversary proceeding, please confirm that the AUSA has complete and accurate information for each loan, or provide that information for each loan.

4. I confirm that the student loan information and educational history provided to me and attached to this Attestation is correct: <u>YES / NO</u> [If you answered "NO," you must answer questions five through nine].

5. The outstanding balance of the student loan[s] I am seeking to discharge in this adversary proceeding is $_____________.

6. The current monthly payment on such loan[s] is ________________. The loan[s] are scheduled to be repaid in __________________ [month and year] **[OR]** ____ My student loan[s] went into default in _________ [month and year].

7. I incurred the student loan[s] I am seeking to discharge while attending ______________________, where I was pursuing a ___________ degree with a specialization in _________________.

8. In ______________ [month and year], I completed my course of study and received a _________________ degree **[OR]** In ______________ [month and year], I left my course of study and did not receive a degree.

9. I am currently employed as a __________________. My employer's name and address is ________________________ **[OR]** _____ I am not currently employed.

II. CURRENT INCOME AND EXPENSES

10. I do not have the ability to make payments on my student loans while maintaining a minimal standard of living for myself and my household. I submit the following information to demonstrate this:

A. ***Household Gross Income***

11. My current monthly household ***gross*** income from all sources is $__________.[1] This amount includes the following monthly amounts:

__________ my ***gross*** income from employment (if any)
__________ my unemployment benefits
__________ my Social Security Benefits
__________ my ____________
__________ my ____________
__________ my ____________
__________ ***gross*** income from employment of other members of household
__________ unemployment benefits received by other members of household
__________ Social Security benefits received by other members of household
__________ other income from any source received by other members of household

12. The current monthly household gross income stated above (select which applies):

[1] "Gross income" means your income before any payroll deductions (for taxes, Social Security, health insurance, etc.) or deductions from other sources of income. You may have included information about your gross income on documents previously filed in your bankruptcy case , including Form B 106I, Schedule I - Your Income (Schedule I). If you filed your Schedule I within the past 18 months and the income information on those documents has not changed, you may refer to that document for the income information provided here. If you filed Schedule I more than 18 months prior to this Attestation, or your income has changed, you should provide your new income information.

______ Includes a monthly average of the gross income shown on the most recent tax return[s] filed for myself and other members of my household, which are attached, and the amounts stated on such tax returns have not changed materially since the tax year of such returns; OR

______ Represents an average amount calculated from the most recent two months of gross income stated on four (4) consecutive paystubs from my current employment, which are attached; OR

______ My current monthly household gross income is not accurately reflected on either recent tax returns or paystubs from current employment, and I have submitted instead the following documents verifying current gross household income from employment of household members:

____

13. In addition, I have submitted ____________________ verifying the sources of income other than income from employment, as such income is not shown on [most recent tax return[s] or paystubs].

B. Monthly Expenses

14. My current monthly household expenses do not exceed the amounts listed below based on the number of people in my household for the following categories [Indicate "yes" if your expenses do not exceed the referenced amounts]:

(a) Living Expenses[2]

i. Food YES / NO
$431 (one person)

[2] The living expenses listed in Question 14 and 15 have been adopted from the Internal Revenue Service Collection Financial Standards "National Standards" and "Local Standards" for the year in which this form is issued. This form is updated annually to reflect changes to these expenses.

$779 (two persons)
$903 (three persons)
$1028 (four persons)

ii. Housekeeping supplies — YES / NO
$40 (one person)
$82 (two persons)
$74 (three persons)
$85 (four persons)

iii. Apparel & Services — YES / NO
$99 (one person)
$161(two persons)
$206 (three persons)
$279 (four persons)

iv. Personal care products and services (non-medical) — YES / NO
$45 (one person)
$82 (two persons)
$78 (three persons)
$96 (four persons)

v. Uninsured medical costs — YES / NO
$75 (per individual under 65)
$153 (per individual over 65)

vi. Miscellaneous expenses not included elsewhere on this Attestation: — YES / NO
$170 (one person)
$306 (two persons)
$349 (three persons)
$412 (four persons)

<u>(b) Households Greater Than Four Persons</u>

If your household consists of more than four people, please provide your *total* expenses for the categories in Question 14(a): $__________

[If you filed a Form 122A-2 Chapter 7 Means Test or 122C-2 Calculation of Disposable Income in your bankruptcy case, you may refer to lines 6 and 7 of those forms for information.][3]

---

[3] Forms 122A-2 and 122C-2 are referred to collectively here as the "Means Test." If you filed a Means Test in your bankruptcy case, you may refer to it for information requested here and in other expense categories below. If you did not file a Means Test, you may refer to your Schedule

(c) Excess Expenses

If your current monthly household expenses exceed the amounts listed above for any of the categories in Question 13(a) and you would like the AUSA to consider such additional expenses as necessary, you may list those expenses and explain the need for such expenses here.

____
____
____
____

15. My current monthly household expenses in the following categories are as follows:

(a) Payroll Deductions

i. Taxes, Medicare and Social Security $__________
[You may refer to line 16 of the Means Test or Schedule I, line 5]

ii. Contributions to retirement accounts $__________
[You may refer to line 17 of the Means Test or Schedule I, line 5]

Are these contributions required as a condition of your employment? YES / NO

iii. Union dues $__________
[You may refer to line 17 of the Means Test or Schedule I, line 5]

iv. Life insurance $__________
[You may refer to line 18 of the Means Test or Schedule I, line 5]

Are the payments for a term policy covering your life? YES / NO

v. Court-ordered alimony and child support $__________
[You may refer to line 19 of the Means Test or Schedule I, line 5]

I and Form 106J – Your Expenses (Schedule J) in the bankruptcy case, which may also list information relevant to these categories. You should only use information from these documents if your expenses have not changed since you filed them.

vi. Health insurance $___________
[You may refer to line 25 of the Means Test or Schedule I, line 5]

Does the policy cover any persons other than yourself and your family members? YES / NO

vii. Other payroll deductions

___________________ $___________
___________________ $___________
___________________ $___________

(d) Housing Costs[4]

i. Mortgage or rent payments $___________
ii. Property taxes (if paid separately) $___________
iii. Homeowners or renters insurance (if paid separately) $___________
iv. Home maintenance and repair (average last 12 months' amounts) $___________
v. Utilities (include monthly gas, electric water, heating oil, garbage collection, residential telephone service, cell phone service, cable television, and internet service) $___________

(e) Transportation Costs

i. Vehicle payments (itemize per vehicle) $___________
ii. Monthly average costs of operating vehicles (including gas, routine maintenance, monthly insurance cost) $___________
iii. Public transportation costs $___________

(f) Other Necessary Expenses

i. Court-ordered alimony and child support payments (if not deducted from pay) $___________
[You may refer to line 19 of Form 122A-2 or 122C-2 or Schedule J, line 18]

[4] You should list the expenses you actually pay in Housing Costs and Transportation Costs categories. If these expenses have not changed since you filed your Schedule J, you may refer to the expenses listed there, including housing expenses (generally on lines 4 through 6 of Schedule J) and transportation expenses (generally on lines 12, 15c and 17).

ii. Babysitting, day care, nursery and preschool costs $___________
[You may refer to line 21 of Form 122A-2 or 122C-2 or Schedule J, line 8][5]

Explain the circumstances making it necessary for you to expend this amount:

____

____

____

____

iii. Health insurance (if not deducted from pay) $___________
[You may refer to line 25 of the Means Test or Schedule J, line 15]

Does the policy cover any persons other than yourself and your family members? YES / NO

iv. Life insurance (if not deducted from pay) $___________
[You may refer to line 25 of the Means Test or Schedule J, line 15]

Are the payments for a term policy covering your life? YES / NO

v. Dependent care (for elderly or disabled family members) $___________
[You may refer to line 26 of the Means Test or Schedule J, line 19]

Explain the circumstances making it necessary for you to expend this amount:

____

____

____

____

[5] Line 8 of Schedule J allows listing of expenses for "childcare and children's education costs." You should not list any educational expenses for your children here, aside from necessary nursery or preschool costs.

vi. Payments on delinquent federal, state or local tax debt $___________
[You may refer to line 35 of the Means Test or Schedule J, line 17]

Are these payments being made pursuant to an agreement with the taxing authority? YES / NO

vii. Payments on other student loans I am not seeking to discharge $___________

viii. Other expenses I believe necessary for a minimal standard of living. $___________

Explain the circumstances making it necessary for you to expend this amount:

____
____
____
____

16. After deducting the foregoing monthly expenses from my household gross income, I have _______ [no, or amount] remaining income.

17. In addition to the foregoing expenses, I anticipate I will incur additional monthly expenses in the future for my, and my dependents', basic needs that are currently not met.[6] These include the following:

____
____
____
____

[6] If you have forgone expenses for any basic needs and anticipate that you will incur such expenses in the future, you may list them here and explain the circumstances making it necessary for you to incur such expenses.

III. FUTURE INABILITY TO REPAY STUDENT LOANS

18. For the following reasons, it should be presumed that my financial circumstances are unlikely to materially improve over a significant portion of the repayment period (answer all that apply):

___ I am over the age of 65.

___ The student loans I am seeking to discharge have been in repayment status for at least 10 years (excluding any period during which I was enrolled as a student).

___ I did not complete the education for which I incurred the student loan[s].

___ I have a permanent disability or chronic injury which renders me unable to work or limits my ability to work.

Describe the disability or injury and its effects on your ability to work, and indicate whether you receive any governmental benefits attributable to this disability or injury:

____

____

____

____

____

____

___ I have been unemployed for at least five of the past ten years.

Please explain your efforts to obtain employment.

____

____

____

____

____

____

19. For the following additional reasons, my financial circumstances are unlikely to materially improve over a significant portion of the repayment period (answer all that apply):

___ I incurred student loans I am seeking to discharge in pursuit of a degree I was unable to complete for reasons other than the closure of the educational institution.

Describe your reasons for being unable to complete the degree:

____

___ I am not currently employed.

___ I am currently employed, but I am unable to obtain employment in the field for which I am educated or have received specialized training.

Describe reasons for inability to obtain such employment, and indicate if you have ever been able to obtain such employment:

___ I am currently employed, but my income is insufficient to pay my loans and unlikely to increase to an amount necessary to make substantial payments on the student loans I am seeking to discharge.

Please explain why you believe this is so:

___ Other circumstances exist making it unlikely I will be able to make payments for a significant part of the repayment period.

Explain these circumstances:

IV. PRIOR EFFORTS TO REPAY LOANS

20. I have made good faith efforts to repay the student loans at issue in this proceeding, including the following efforts:

21. Since receiving the student loans at issue, I have made a total of $________ in payments on the loans, including the following:

___ regular monthly payments of $______ each.

___ additional payments, including $________, $________, and $________.

22. I have received ____ forbearances or deferments, for a period totaling ___ months.

23. I have attempted to contact the company that services or collects on my student loans or the Department of Education at least ______ times.

24. I have sought to enroll in one or more "Income Deferred Repayment Programs" or similar repayment programs offered by the Department of Education, including the following:

Description of efforts:

____
____
____
____
____
____
____
____
____

25. [If you did not enroll in such a program]. I have not enrolled in an "Income Deferred Repayment Program" or similar repayment program offered by the Department of Education for the following reasons:

____
____
____
____
____
____

26. Describe any other facts indicating you have acted in good faith in the past in attempting to repay the loan, including efforts to obtain employment, maximize your income, or minimize your expenses:

____
____
____
____
____
____

V. CURRENT ASSETS

27. I own the following parcels of real estate:

Address: ____________________

____

____

Owners:[7] ____________________

____

Fair market value: ____________________

[7] List by name all owners of record (self and spouse, for example)

Total balance of mortgages and other liens. ____________________________

28. I own the following motor vehicles:

Make and model: ____________________________

Fair market value: ____________________________

Total balance of Vehicle loans And other liens ____________________________

29. I hold a total of ______________________ in retirement assets, held in 401k, IRA and similar retirement accounts.

30. I own the following interests in a corporation, limited liability company, partnership, or other entity:

Name of entity	State incorporated[8]	Type[9] and %age Interest
____________________	________________	________________
____________________	________________	________________
____________________	________________	________________

31. I currently am anticipating receiving a tax refund totaling $________.

VI. ADDITIONAL CIRCUMSTANCES

32. I submit the following circumstances as additional support for my effort to discharge my student loans as an "undue hardship" under 11 U.S.C. §523(a)(8):

[8] The state, if any, in which the entity is incorporated. Partnerships, joint ventures and some other business entities might not be incorporated.

[9] For example, shares, membership interest, partnership interest.

[Updated November 2022]

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Signature:

Name:

Date:

APPENDIX B:
Debtor Example Scenario

On January 3, 2022, Jane Smith filed a chapter 7 bankruptcy case in Maryland. She later filed a complaint to seek to discharge approximately $26,000 in student loans. The complaint and summons were served on February 12, 2022. In the complaint, Ms. Smith pleads that her student loan debt should be discharged because requiring payment will cause an "undue hardship" for her and her ten-year-old daughter, Sarah. Ms. Smith's bankruptcy attorney forwards a signed Attestation to the Department Attorney with a copy of Ms. Smith's 2020 tax return. (She has not yet completed the 2021 return.) Pursuant to the Guidance, the Department Attorney would evaluate the information provided in the Attestation as follows to determine if the facts in Ms Smith's case justify stipulating that she has shown an undue hardship within the meaning of Section 523(a)(8) of the Bankruptcy Code.

Part I: Personal Information

Part I of Ms. Smith's Attestation lists relevant background information. It shows that she lives in Baltimore County, Maryland, in a household consisting of herself (age 30) and her daughter (age 10). She lists a student loan balance of $26,369 and indicates her loan has been in default since June 2012. Part I also shows that Ms. Smith incurred her student loans to attend John Doe Community College, seeking a nursing degree, but that Ms. Smith left school in December 2010 and did not receive a degree. Ms. Smith is currently employed as a nursing assistant at Baltimore County Hospital in Baltimore.

Part II: Present Ability to Pay

Ms. Smith provided information about her income and expenses in Part II of the Attestation. Ms. Smith has reported on her Attestation that she earns $3900 per month and has current monthly expenses of $3782, including $600 that is deducted from her paycheck for taxes, Medicare, Social Security, and health insurance. Ms. Smith has indicated that she resides in inadequate housing and needs to incur additional housing expenses to achieve a minimal standard of living which will increase her total expenses by $800 (for a total expense amount of $4582). Below are the steps the Department attorney, in consultation with Education, takes in analyzing Ms. Smith's income and expenses:

(1) The Department attorney checks Ms. Smith's submitted tax return to determine if it is consistent with her stated monthly gross income ($3900). Ms. Smith has not yet filed her 2021 tax return, so the only income the Department attorney can review . from her 2020 return. That return shows Adjusted Gross Income of $45,952. This amount divided by 12 is $3829, a monthly average which is consistent with (and

slightly less) than the $3900 Ms. Smith has listed on the Attestation. The income stated on the Attestation thus appears correct.[1]

(2) The Department attorney should use the IRS standards to determine Ms. Smith's allowable expenses:

(a) Payroll deductions. Ms. Smith's payroll deductions of $600 are almost certainly allowable. She has deducted $400 for taxes, Medicare, and Social Security expenses, which are generally allowed under the IRS Standards, and the Department attorney should accept the amount of tax withholdings as an expense unless there is an obvious pattern of over withholding. In general, excessive withholding will be accompanied by a significant tax refund; however, Ms. Smith's most recent tax refund is $3000[2] (which averages to a hypothetical $250 in monthly income) an amount which is not significant. Accordingly, there is no basis to conclude that Ms. Smith has engaged in excessive withholding.

Ms. Smith's payroll deduction for health insurance of $200 (Line 15(a)(vi)) is also almost certainly allowable. The Department attorney should generally allow health insurance expenses (whether payroll deductions or not) as long as the debtor indicates the policy covers only family members and not others. Here, Ms. Smith has indicated this on Line 15(a)(vi), and the deduction therefore appears appropriate.

(b) Living Expenses (National and Local Standards).

Line 14 of the Attestation asks the debtor to confirm whether certain expenses are within amounts allowed under the IRS National Standards. Here, Ms. Smith has confirmed that her household monthly expenses do not exceed the allowed amounts for the following categories, and the Department attorney should allow the full amount for these categorie. (for a household of two):

Food: $779
Housekeeping supplies: $82
Apparel & Services: $161
Personal care products and services: $82
Miscellaneous: $306

---

[1] The Department attorney may request further corroboration if necessary, for example, where a debtor's bankruptcy filings in total reflect unexplained inconsistencies.

[2] The Department attorney may review the debtor's most recent tax return to assess whether a listed refund suggests potential over-withholding.

Ms. Smith has indicated that her uninsured medical costs are $150, an amount which exceeds the IRS allowed amount of $75. However, she has explained that her daughter requires medication and an inhaler, and the total cost not covered by insurance is $150. Because Ms. Smith has reasonably explained why she needs this excess expense in order to meet her daughter's health care needs, she should be allowed her actual expense amount of $150.

Ms. Smith's total expense amount for the categories identified in Line 14 is $1560.

Lines 15(d) and (e) of the Attestation allow the debtor to list living expenses in categories corresponding to the IRS Local Standards. The following chart compares Ms. Smith's listed expenses to those allowed under the Local Standards for a family of two based on her locality. The final column shows the amount—typically, the lesser of the IRS Local Standards expense and Ms. Smith's actual expense in the category—that the Department attorney may treat as allowed, unless the Department attorney finds the higher amount within specific categories is justified.

Expense	**Ms. Smith's Actual Expense**	**IRS Allowed Amount**	**Department Attorney Allowed Amount**
Housing & Utilities	$765	$2233	$765
Vehicle Payments	$400	$588	$400
Average costs of operating vehicles	$350	$307	$307
TOTAL	$3290	$4232	$1472

Ms. Smith's actual expenses in each category other than "vehicle operating costs" are less than the amount allowed by the IRS Local Standards. Accordingly, they are consistent with a minimal standard of living. Ms. Smith exceeds the IRS Local Standards amount for vehicle operating costs. The Department attorney should generally limit the debtor's allowable expenses to the IRS Standard expenses amount, unless allowing the additional expenses is warranted by the debtor's circumstances.[3]

(c) Other Necessary Expenses. Line 15(f) allows a debtor to list expenses consistent with the IRS Other Necessary Expenses categories. Ms. Smith has listed only one expense, $150 per month for babysitting, day care

[3] The Department attorney may ask the debtor to provide an explanation for any expenses over the standard expense amount, but the Department attorney need not do so where, as shown below, the debtor's aggregate expenses as limited still show an inability to make student loan payments.

nursery and preschool costs. The Other Necessary Expenses categories require explanation of the necessity for these expenditures, and Ms. Smith explains that she needs to pay for her daughter to attend before and after care because her daughter's school schedule conflicts with her work schedule. Because Ms. Smith must pay this expense in order to maintain her job, and it is reasonable that she use the services provided by her daughter's school, this expense is "reasonable and necessary."

(d) Expenses for Unmet Needs. The expenses calculated above total $3782, an amount less than Ms. Smith's income. However, the Department attorney should also consider anticipated expenses that the debtor has identified on Line 17 of the Attestation. Ms. Smith has explained in Line 17 that she currently lives in her mother's basement apartment, but that this living situation is not sustainable. She has located an apartment for $1300 per month where she intends to move within a few months, increasing her total housing and utilities expense by $800. Because Ms. Smith will need to incur this additional expense in order to meet basic housing needs for her and her daughter, the Department attorney should consider Ms. Smith's anticipated rent increase when calculating her total expenses.

(e) Ms. Smith's allowable expenses (including the additional housing expense) total $4582:

- $600 – Payroll deductions
- $1560 – National Standards
- $1472 - Local Standards (without additional future housing expense)
- $150 – Other Necessary Expenses
- $800 – future expenses (additional housing expense)

(3) Comparison to income. Ms. Smith's allowed expenses of $4582 exceed her monthly income of $3829, which has been verified by her tax returns. Because her allowed expenses exceed her income, the Department attorney should find she currently does not have sufficient means to pay her student loans while maintaining a minimal standard of living.

Part III: Future Circumstances

Part III of the Attestation allows a debtor to attest to matters showing that the inability to pay will persist into the future. In Line 18, the debtor can attest to circumstances that justify a *presumption* of a future inability to pay. Ms. Smith has indicated that her student loan went into repayment more than 10 years ago.[4] Accordingly, she is entitled to a presumption that she will remain unable to repay the loan in the future.

[4] This assertion is supported by Ms. Smith's statement in the Attestation that her loans entered repayment in June 2011, more than 10 years before she filed her bankruptcy case.

Although the presumption of future inability to pay is rebuttable, those circumstances should be infrequent. Illustratively, Ms. Smith has not provided any information in her Attestation that indicates a likely future ability to pay or that her financial circumstances are likely to change. The Attestation, as a whole, supports her claim that she will remain unable to pay. She has indicated on Line 19 that she (1) was forced to drop out of nursing school to care for her infant daughter, (2) she cannot obtain employment as a nurse because she did not obtain her degree, (3) her current job does not offer significant raises or promotions, and (4) she has been unable to obtain a second job and likely could not do so because her daughter suffers from asthma. None of that information provides a basis to rebut the presumption of future inability to pay. Indeed, this information would appear to support a conclusion that she lacks a future ability to pay even in the absence of any presumption. In this situation, there does not appear to be a need for the attorney to investigate further. Although there are circumstances where the Department attorney may reasonably make inquiry to supplement or elucidate statements in the Attestation, that need may be infrequent. In this example, the Department attorney should conclude that Ms. Smith's inability to pay will continue for a significant portion of the repayment period.

Part IV: Prior Efforts to Repay Loans

Part IV of the Attestation provides information the Department attorney should use to determine if Ms. Smith has made a good faith effort to repay her loans. In this case, good faith should likely be found, because the information provided on Ms. Smith's Attestation reflects that she has maximized income by obtaining full-time employment, minimized expenses, and has not willfully attempted to avoid repaying her loans.

Ms. Smith reports that she has made no payments on her loans (Line 21). Indeed, her responses on Part I of the Attestation show that the loans went into repayment in May 2011 and went into default in June 2012. While these facts are relevant to the "good faith" determination, the failure to make payments alone does not justify finding a lack of good faith. Here, Ms. Smith has offered an explanation for her failure to make payments (Line 26). She left school when her daughter was less than one year old. She had no support from the child's faither and initially was unable to obtain part-time employment. Since that time, she has never obtained employment permitting her to pay her student loans.

Ms. Smith also indicates she has not enrolled in an IDRP (Line 25). Failure to enroll in an IDRP, however, is not dispositive of a lack of good faith. Here, Ms. Smith attests that she contacted her loan servicer to discuss IDRPs. The servicer did not explain the process for enrolling and stated to Ms. Smith that she would pay a heavy tax burden if she completed a payment plan. Given the circumstances, as well as Ms. Smith's extremely limited income preventing any substantial payments under an IDRP, nothing in the Attestation suggests she acted "willfully" by not enrolling in an IDRP or was disinterested in repaying her loans. Rather, her lack of enrollment was reasonable in light of her confusion over the process as well as her concerns about tax consequences.

The Attestation also shows that Ms. Smith sought to maximize income and minimize expenses. On Line 26, she states that she continually worked full-time after her daughter started school, and that she cannot work more hours due to the need to care for her daughter. She also states she could not find higher paying work due to her lack of a degree. Line 26 presents information about minimization of expenses, including that Ms. Smith has lived with her mother for four years to reduce expenses. Finally, while Ms. Smith acknowledges she has acquired a vehicle with a car payment, she explains the need for reliable transportation. In addition, the vehicle payment is within the Local Standards above. Obtaining the vehicle is not evidence of a refusal to minimize expenses.

Part V: The Debtor's Assets

Ms. Smith's only asset is a 2018 Toyota Camry with approximately $5000 in equity (Line 28). Even if Ms. Smith did not claim an exemption for her car, it would be unreasonable to expect Ms. Smith to liquidate this asset in order to pay her student loan. Ms. Smith's Attestation demonstrates that she needs her vehicle to maintain a minimal standard of living for herself and her daughter. Ms. Smith would therefore have to purchase a new vehicle if this asset were liquidated. Additionally, requiring Ms. Smith to pay down the student loan would still leave approximately $20,000 due, and there is no showing that Ms. Smith would have the ability to satisfy this part of the student loan after liquidating the vehicle and paying $5000. For these reasons, liquidation of the asset would be inappropriate.

Conclusion

Based on review of the Attestation, it is appropriate for the Department attorney to conclude that Ms. Smith is entitled to a discharge of her student loans. She does not have a current ability to pay her loans while maintaining a minimal standard of living; this inability is likely to persist into the future; and she has made good faith efforts to repay her loans. In addition, she does not have any assets that are reasonably available for liquidation.

The Department attorney should contact Ms. Smith's counsel and indicate the United States would be willing to enter into a stipulation that Ms. Smith has shown undue hardship under Section 523(a)(8) and recommend the Court grant her a judgment discharging her loans.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	
	)	
JANE SMITH,	)	Case No.
	)	Chapter [7]
Debtors.	)	
	)	
_______________________________	)	
	)	
JANE SMITH,	)	
	)	
Plaintiff,	)	Adversary Pro. ____________
	)	
v.	)	
	)	
UNITED STATES DEPARTMENT	)	
OF EDUCATION, [et al.],	)	
	)	
Defendant[s].	)	
_______________________________	)	

ATTESTATION OF JANE SMITH IN SUPPORT
OF REQUEST FOR STIPULATION CONCEDING
DISCHARGEABILITY OF STUDENT LOANS

I, JANE SMITH, make this Attestation in support of my claim that excepting the student loans described herein from discharge would cause an "undue hardship" to myself and my dependents within the meaning of 11 U.S.C. §523(a)(8). In support of this Attestation, I state the following under penalty of perjury:

I. PERSONAL INFORMATION

1. I am over the age of eighteen and am competent to make this Attestation.

2. I reside at *123 Main Street, Towson MD 20204*, in Baltimore County, *Maryland*.

3. My household includes the following persons (including myself):

NAME:	AGE:	RELATIONSHIP:
Jane Smith	*30 years*	*[self]*
Sarah Smith	*10 years*	*daughter*

Questions four through nine request information related to your outstanding student loan debt and your educational history. The Department of Education will furnish this information to the Assistant United States Attorney ("AUSA") handling your case, and it should be provided to you. If you agree that the information provided to you regarding your student loan debt and educational history is accurate, you may simply confirm that you agree, and these questions do not need to be completed. If you have not received the information from Education or the AUSA at the time you are completing this form, or if the information is not accurate, you may answer these questions based upon your own knowledge. If you have more than one student loan which you are seeking to discharge in this adversary proceeding, please confirm that the AUSA has complete and accurate information for each loan, or provide that information for each loan.

4. I confirm that the student loan information and educational history provided t · me and attached to this Attestation is correct: YES / ***NO*** [If you answered "NO," you must answer questions five through nine].

5. The outstanding balance of the student loan[s] I am seeking to discharge in this adversary proceeding is *$26,369*.

6. The current monthly payment on such loan[s] is $*132.* The loan[s] are scheduled to be repaid in *???* [month and year] **[OR]** ____ My student loan[s] went into default in *June 2012* [month and year].

7. I incurred the student loan[s] I am seeking to discharge while attending *John Doe Community College,* where I was pursuing a *nursing* degree with a specialization in *n/a*.

8. In ______________ [month and year], I completed my course of study and received a _________________ degree **[OR]** In *December 2010* [month and year], I left my course of study and did not receive a degree.

9. I am currently employed as a *certified nursing assistant*. My employer's name and address is *Baltimore County Hospital, Baltimore MD* **[OR]** ______ I am not currently employed.

II. CURRENT INCOME AND EXPENSES

10. I do not have the ability to make payments on my student loans while maintaining a minimal standard of living for myself and my household. I submit the following information to demonstrate this:

A. Household Gross Income

11. My current monthly household ***gross*** income from all sources is $3900.[1]

This amount includes the following the following monthly amounts:

$3900 my ***gross*** income from employment (if any)
__________ my unemployment benefits.
__________ my Social Security Benefits
__________ my child support
__________ my ____________
__________ my ____________
__________ ***gross*** income from employment of other members of household
__________ unemployment benefits received by other members of household
__________ Social Security benefits received by other members of household
__________ other income from any source received by other members of household

12. The current monthly household gross income stated above (select which applies):

[1] "Gross income" means your income before any payroll deductions (for taxes, Social Security, health insurance, etc.) or deductions from other sources of income. You may have included information about your gross income on documents previously filed in your bankruptcy, including Form B 106I, Schedule I - Your Income (Schedule I). If you filed your Schedule I within the past 18 months and the income information on those documents has not changed, you may refer to that document for the income information provided here. If you filed Schedule I more than 18 months prior to this Attestation, or your income has changed, you should provide your new income information.

__X__ Includes a monthly average of income shown on the most recent tax return[s] filed for myself and other members of my household, which are attached, and the amounts stated on such tax returns have not changed materially since the tax year of such returns; OR

______ Represents an average amount calculated from the most recent two months of gross income stated on four (4) consecutive paystubs from my current employment, which are attached; OR

______ My current monthly household gross income is not accurately reflected on either recent tax returns or paystubs from current employment, and I have submitted instead the following documents verifying current gross household income from employment of household members: ____

13. In addition, I have submitted ____________________ verifying the sources of income other than income from employment, as such income is not shown on [most recent tax return[s] or paystubs].

B. Monthly Expenses

14. My current monthly household expenses do not exceed the amounts listed below based on the number of people in my household for the following categories [Indicate "yes" if your expenses do not exceed the referenced amounts]:

(a) Living Expenses[2]

i. Food — ***YES*** / NO
$431 (one person)
$779 (two persons)
$903 (three persons)
$1028 (four persons)

[2] The living expenses listed in Question 14 and 15 have been adopted from the Internal Revenue Service Collection Financial Standards "National Standards" and "Local Standards" for the year in which this form is issued. This form is updated annually to reflect changes to these expenses.

ii. Housekeeping supplies — ***YES*** / NO
$40 (one person)
$82 (two persons)
$74 (three persons)
$85 (four persons)

iii. Apparel & Services — ***YES*** / NO
$99 (one person)
$161(two persons)
$206 (three persons)
$279 (four persons)

iv. Personal care products and services (non-medical) — ***YES*** / NO
$45 (one person)
$82 (two persons)
$78 (three persons)
$96 (four persons)

v. Uninsured medical costs — *YES* / ***NO***
$75 (per individual under 65)
$153 (per individual over 65)

vi. Miscellaneous expenses not included elsewhere on this Attestation: — ***YES*** / NO
$170 (one person)
$306 (two persons)
$349 (three persons)
$412 (four persons)

(b) Households Greater Than Four Persons

If your household consists of more than four people, please provide your *total* expenses for the categories in Question 14(a): $__________

[If you filed a Form 122A-2 Chapter 7 Means Test or 122C-2 Calculation of Disposable Income in your bankruptcy case, you may refer to lines 6 and 7 of those forms for information.][3]

---

[3] Forms 122A-2 and 122C-2 are referred to collectively here as the "Means Test." If you filed a Means Test in your bankruptcy case, you may refer to it for information requested here and in other expense categories below. If you did not file a Means Test, you may refer to your Schedule I and Form 106J – Your Expenses (Schedule J) in the bankruptcy case, which may also list information relevant to these categories. You should only use information from these documents if your expenses have not changed since you filed them.

(c) Excess Expenses

If your current monthly household expenses exceed the amounts listed above for any of the categories in Question 13(a) and you would like the AUSA to consider such additional expenses as necessary, you may list those expenses and explain the need for such expenses here.

I buy inhalers and medications for my daughter, who has asthma, and the total cost not covered by insurance is approximately $150 per month.

15. My current monthly household expenses in the following categories are as follows:

(a) Payroll Deductions

i. Taxes, Medicare and Social Security $*400*
[You may refer to line 16 of the Means Test or Schedule I, line 5]

ii. Contributions to retirement accounts $ *0*
[You may refer to line 17 of the Means Test or Schedule I, line 5]

Are these contributions required as a condition of your employment? YES / NO

iii. Union dues $ *n/a*
[You may refer to line 17 of the Means Test or Schedule I, line 5]

iv. Life insurance $ *n/a*
[You may refer to line 18 of the Means Test or Schedule I, line 5]

Are the payments for a term policy covering your life? YES / NO

v. Court-ordered alimony and child support $ *n/a*
[You may refer to line 19 of the Means Test or Schedule I, line 5]

vi. Health insurance $*200*
[You may refer to line 25 of the Means Test or Schedule I, line 5]

Does the policy cover any persons other than yourself and your family members? YES / ***NO***

vii. Other payroll deductions

____________________	$ *n/a*
____________________	$___
____________________	$___

(d) Housing Costs[4]

i.	Mortgage or rent payments	$ *500*
ii.	Property taxes (if paid separately)	$ *n/a*
iii.	Homeowners or renters insurance (if paid separately)	$*15*
iv.	Home maintenance and repair (average last 12 months' amounts)	$ *n/a*
v.	Utilities (include monthly gas, electric water, heating oil, garbage collection, residential telephone service, cell phone service, cable television, and internet service).	$*250*

(e) Transportation Costs

i.	Vehicle payments (itemize per vehicle)	$*400*
ii.	Monthly average costs of operating vehicles (including gas, routine maintenance, monthly insurance cost)	$*350*
iii.	Public transportation costs	$ *n/a*

(f) Other Necessary Expenses

i. Court-ordered alimony and child support payments $ *n/a*
(if not deducted from pay)
[You may refer to line 19 of Form 122A-2 or 122C-2 or Schedule J, line 18]

ii. Babysitting, day care, nursery and preschool costs $*150*
[You may refer to line 21 of Form 122A-2 or 122C-2 or Schedule J, line 8][5]

---

[4] You should list the expenses you actually pay in Housing Costs and Transportation Costs categories. If these expenses have not changed since you filed your Schedule J, you may refer to the expenses listed there, including housing expenses (generally on lines 4 through 6 of Schedule J) and transportation expenses (generally on lines 12, 15c and 17).

[5] Line 8 of Schedule J allows listing of expenses for "childcare and children's education costs." You should not list any educational expenses for your children here, aside from necessary nursery or preschool costs.

Explain the circumstances making it necessary
for you to expend this amount:

I have to send my daughter to before care and after care for school because her school day is from 7:45-3:00 but I work from 7:00-3:30. This is what her school charges.

iii. Health insurance $ *n/a*
(if not deducted from pay)
[You may refer to line 25 of the Means Test or Schedule J, line 15]

Does the policy cover any persons other than yourself and your family members? YES / NO

iv. Life insurance $ *n/a*
(if not deducted from pay)
[You may refer to line 25 of the Means Test or Schedule J, line 15]

Are the payments for a term policy covering your life? YES / NO

v. Dependent care (for elderly or disabled family members). $ *n/a*
[You may refer to line 26 of the Means Test or Schedule J, line 19]

Explain the circumstances making it necessary
for you to expend this amount:

____
____
____
____

vi. Payments on delinquent federal, state or local tax debt $ *n/a*
[You may refer to line 35 of the Means Test or Schedule J, line 17]

Are these payments being made pursuant to an agreement with the taxing authority? YES / NO

vii. Payments on other student loans I am not seeking to discharge $ *n/a*

viii. Other expenses I believe necessary for $ *n/a* a minimal standard of living.

Explain the circumstances making it necessary for you to expend this amount:

____
____
____
____

16. After deducting the foregoing monthly expenses from my household gross income, I have *$128* remaining income.

17. In addition to the foregoing expenses, I anticipate I will incur additional monthly expenses in the future for my, and my dependents', basic needs which are currently not met.[6] These include the following:

I live in a basement apartment at my mother's house, but it is not possible to live there anymore with my daughter turning 10 years old. We don't have our own kitchen and the living space is too small. I have found an apartment in our area near where I work for $1300 per month. We are hoping to move there in a few months.

III. FUTURE INABILITY TO REPAY STUDENT LOANS

18. For the following reasons, it should be presumed that my financial circumstances are unlikely to materially improve over a significant portion of the repayment period (answer all that apply):

___ I am over the age of 65.

_X_ The student loans I am seeking to discharge have been repayment status for at least ten years (excluding any period which I was enrolled as a student).

___ I did not complete the education for which I incurred the student loan[s].

___ I have a permanent disability or chronic injury which renders me unable to work or limits my ability to work.

---

[6] If you have forgone expenses for any basic needs and anticipate that you will incur such expenses in the future, you may list them here and explain the circumstances making it necessary for you to incur such expenses.

Describe the disability or injury and its effects on your ability to work, and indicate whether you receive any governmental benefits attributable to this disability or injury:

____ I have been unemployed for at least five of the past ten years.

Please explain your efforts to obtain employment.

19. For the following additional reasons, my financial circumstances are unlikely to materially improve over a significant portion of the repayment period (answer all that apply):

X I incurred student loans I am seeking to discharge in pursuit of a degree I was unable to complete for reasons other than the closure of the educational institution.

Describe your reasons for being unable to complete the degree:

I was in nursing school but had to drop out to care for my daughter.

____ I am not currently employed.

X I am currently employed, but I am unable to obtain employment in the field for which I am educated or have received specialized training.

Describe reasons for inability to obtain such employment, and indicate if you have ever been able to obtain such employment:

I was in nursing school but did not complete my degree, so I cannot get a job as a nur.e. I work as a nursing assistant.

_X_ I am currently employed, but my income is insufficient to pay my loans and unlikely to increase to an amount necessary to make substantial payments on the student loans I am seeking to discharge.

Please explain why you believe this is so:

I have looked for other jobs that pay more, but they require a degree. My current job does not offer any significant raises or promotions. I also need to work during the hours that my daughter is in school, so I can't work the night or weekend shifts at my current job even though it would pay more.

_X_ Other circumstances exist making it unlikely I will be able to make payments for a significant part of the repayment period.

Explain these circumstances:

My daughter is ten years old. She has severe asthma, requiring inhalers and other medication. Because of these conditions, working a second job is not possible for me. I need to be at home to ensure she is safe after school, and I can't afford a babysitter or additional after school care.

IV. PRIOR EFFORTS TO REPAY LOANS

20. I have made good faith efforts to repay the student loans at issue in this proceeding, including the following efforts:

21. Since receiving the student loans at issue, I have made a total of $_0_ in paym. ts on the loans, including the following:

___ regular monthly payments of $______ each.

___ additional payments, including $________, $________, and $________.

22. I have received *no* forbearances or deferments, for a period totaling ___ months.

23. I have attempted to contact the company that services or collects on my student loans or the Department of Education at least _*10*_ times.

24. I have sought to enroll in one or more "Income Deferred Repayment Program or similar repayment programs offered by the Department of Education, including the following:

Description of efforts:

25. [If you did not enroll in such a program]. I have not enrolled in an "Income Deferred Repayment Program" or similar repayment program offered by the Department of Education for the following reasons:

> *I had heard of repayment plans, but I was confused when I tried to ask my servicer about the plans. They did not explain how to sign up, and they told me I might end up paying a lot of taxes if I did a payment plan. I can't afford to pay additional taxes.*

26. Describe any other facts indicating you have acted in good faith in the past in attempting to repay the loan, including efforts to obtain employment, maximize your income, or minimize your expenses:

> *I've always worked full time after my daughter was old enough to go to school. I can't work more hours because I have to take care of her on the weekends and after school. I have looked for higher paying jobs, but they all require degrees.*
>
> *I drove a used car for a long time, but I had to buy a new car a few years ago because my old one was starting to need a lot of repairs and I needed a reliable car to get to work and take my daughter to school, doctors etc. I've been living with my mother for the past 4 years to try and save expenses, but I need to move to an apartment. I'll need to stay in this area, though, because this is where my job and my daughter's school are.*
>
> *All of my paycheck goes toward providing my daughter and myself with our necessities, including groceries, clothes for her, and her school supplies.*

V. CURRENT ASSETS

27. I own the following parcels of real estate:

Address: *None*

Owners:[7] ____________________

____

Fair market value: ____________________

Total balance of mortgages and other liens. ____________________

28. I own the following motor vehicles:

Make and model: *2018 Toyota Camry*

Fair market value: $*25,000*

Total balance of Vehicle loans And other liens $*20,000*

29. I hold a total of $ *0* in retirement assets, held in 401k, IRA and similar retirement accounts.

30. I own the following interests in a corporation, limited liability company, partnership, or other entity:

Name of entity	State incorporated[8]	Type[9] and %age Interest

[7] List by name all owners of record (self and spouse, for example)

[8] The state, if any, in which the entity is incorporated. Partnerships, joint ventures and some other business entities might not be incorporated.

[9] For example, shares, membership interest, partnership interest.

31. I currently am anticipating receiving a tax refund totaling $*3,000*

VI. ADDITIONAL CIRCUMSTANCES

32. I submit the following circumstances as additional support for my effort to discharge my student loans as an "undue hardship" under 11 U.S.C. §523(a)(8):

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

/s/ Jane Smith
Signature:

Jane Smith
Name:

Date: *February 25, 2022*

Section Two

2022 Case Law Update

John M. Hauber
Chapter 13 Standing Trustee
Southern District of Indiana
Indianapolis, Indiana

Section Two

2022 Case Law Update…………………………………….… John M. Hauber

<u>2022 CASE LAW UPDATE</u>

-By John Hauber

CIVIL PROCEDURE REVIEW (several relevant codes and rules)

28 U.S.C. §1334 - Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Except as provided in subsection (e)(2), and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

(c)

(1) Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

(d) Any decision to abstain or not to abstain made under subsection (c) (other than a decision not to abstain in a proceeding described in subsection (c)(2)) is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. Subsection (c) and this subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(e) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction—

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.

28 U.S.C. §157 – Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district. [See. S.D.IN Local Rule 83-8 – Referral of Cases to Bankruptcy Court]

(b)

(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

(2) Core proceedings include, but are not limited to—

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges,

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

(4) Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).

...

(c)

(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.

Southern District of Indiana Local Rule 83-8 – Referral of Cases to Bankruptcy Court

(a) Cases Referred to Bankruptcy Court. Consistent with 28 U.S.C. § 157(a), all cases and proceedings arising under Title 11 of the United States Code, or relating to a case under Title 11 of the United States Code, are referred to the district's bankruptcy court. This includes all cases removed under 28 U.S.C. §§ 1441(a) or 1452.

28 U.S. Code § 1452 - Removal of Claims Related to Bankruptcy Cases

(a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

(b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title.

FRBP 5011. Withdrawal and Abstention from Hearing a Proceeding

(a) Withdrawal. A motion for withdrawal of a case or proceeding shall be heard by a district judge.

(b) Abstention From Hearing a Proceeding. A motion for abstention pursuant to 28 U.S.C. §1334(c) shall be governed by Rule 9014 and shall be served on the parties to the proceeding.

(c) Effect of Filing of Motion for Withdrawal or Abstention. The filing of a motion for withdrawal of a case or proceeding or for abstention pursuant to 28 U.S.C. §1334(c) shall not stay the administration of the case or any proceeding therein before the bankruptcy judge except that the bankruptcy judge may stay, on such terms and conditions as are proper, proceedings pending disposition of the motion. A motion for a stay ordinarily shall be presented first to the bankruptcy judge. A motion for a stay or relief from a stay filed in the district court shall state why it has not been presented to or obtained from the bankruptcy judge. Relief granted by the district judge shall be on such terms and conditions as the judge deems proper.

S.D. Indiana Bankruptcy Rule B-5011-1(b)

The Bankruptcy Court may recommend to the District Court that a case or proceeding be withdrawn under 28 U.S.C. §157(d). Any such recommendation shall be served on the parties to the case or proceeding.

O'FLYNN et. al vs. PHH MORTGAGE et. al
(Case Nos. Adv. Pro. 21-50079-RLM-13 & 22-cv-00335-JMS-DLP)

FACTS: Debtors filed Chapter 13 bankruptcy in 2012 and received a discharge in 2018. The case was reopened in August 2021 so that debtors could file a could file a class action. The six-count, class action alleged violations both core bankruptcy and non-bankruptcy issues [RICO, FDCPA, and RESPA] (and which included class plaintiffs that had not even filed bankruptcy in the Southern District of Indiana).

On November 22, 2021, three class defendants (AltiSource, PHH and Ocwen Financial) each moved for dismissal of the class action. Additionally, Ocwen and PHH filed a Motion to Strike Class Allegations, and a Motion to Strike Plaintiff's Jury Demand.

On January 12, 2022, the defendants filed a Joint Statement on Withdrawal of the Reference and stated the following positions:

1. Defendants respectfully contend that this Court may hear and grant the motions filed against the Complaint on November 22, 2021. See Adv. Dkts. 20-21, 24-25, 27-28.
2. Defendants respectfully reserve their views and positions as to whether this Court may hear or finally adjudicate Plaintiffs' claims at subsequent phases of this case should Defendants' motion to dismiss and related dispositive motions be denied.

In other words, if the Bankruptcy Court dismisses the class action, the defendants agree to jurisdiction. However, if the Bankruptcy Court denies the motions to dismiss the class action, the defendants reserve the right to remove the matter to the district court.

In explaining their reasoning to part 1 (above) the defendants focused on the U.S. Supreme Court holding in the case, *Wellness Int'l Network* [575 U.S. 665, 2015], and stated "'The Court holds that Article III permits bankruptcy courts to decide *Stern* claims submitted to them by consent.' Moreover, such consent need not be express but can be implied from a party's conduct. See *id.* at 684-685 (drawing on the 'implied consent standard articulated in *Roell*,' which concerned a statute governing the authority of federal magistrate judges). By filing the Complaint in this Court, Plaintiffs have consented to adjudication of their claims in this forum. Defendants likewise consent to this Court adjudicating the pending motions in this case **at this stage of the proceedings** [emphasis added]."

In a footnote to this paragraph the defendants again questioned the Bankruptcy Court's future jurisdiction and stated, "As noted previously, Defendants respectfully reserve their views and positions as to whether this Court may hear or finally adjudicate Plaintiffs' claims at subsequent phases of this case should Defendants' motion to dismiss and related dispositive motions be denied. As Defendants have stated previously, however, they do not consent to a jury adjudicating the claims asserted in the Complaint. As stated in their Motion to Strike Plaintiffs' Jury Demand and Incorporated Memorandum of Law [Adv. Dkt. 28] (the "Motion to Strike Jury Demand"), OFC and PHH do not consent to a jury trial in this case. See 28 U.S.C. § 157(e) (bankruptcy courts may only conduct a jury trial "with the express consent of all the parties")"

As, the defendants did not consent to a jury trial, then by the specific language of 28 U.S.C. § 157(e) the defendants do not consent to jurisdiction. In other words, if the defendants do not consent to a jury trial, the, they are not simply "reserving the right" for the District Court to have jurisdiction, instead *only* the District Court would have jurisdiction. Regardless of any other issues, the Bankruptcy Court may not conduct a jury trial unless all parties agree.

ISSUES: Have the defendants consented to the bankruptcy court jurisdiction?

If the defendants have not consented to the court hearing all non-core bankruptcy issues, does the Bankruptcy Court have any jurisdiction at all? Put another way, is subject matter jurisdiction related to the claims before a court (i.e. RICO), or to particular issues?

Does the Bankruptcy Court have subject matter jurisdiction to hear a motion to dismiss when there is not subject matter jurisdiction over the claim? Would *Stern v. Marshall* even allow the court to make recommendations to the District Court on a motion to dismiss on RICO, RESPA, and FDCPA claims when the defendants will not consent to a jury trial?

DISTRICT COURT DECISION:

On February 1, 2022, the Bankruptcy Court filed its Recommendation to the District Court to Withdraw the Reference and suggested that without a "complete consent" to jurisdiction of the Bankruptcy Court, the Bankruptcy Court could not enter any order, including a potential dismissal.

On May 18, 2022, the District Court, rejected the Bankruptcy Court's request. The District Court found that as part of the January 20, 2022, Joint Statement the defendants, "stated that they believe the Bankruptcy Court has jurisdiction to rule on the Motions to Dismiss and that withdrawal of the reference is not necessary." The Court further held that 28 U.S.C. § 157(d) was applicable and that district courts may withdraw a case or proceeding "for cause shown." The author notes that in the District Court's "Discussion" section never laid out any elements for cause but can only presume that the Court determined that since the parties consented that the Bankruptcy Court could rule on the Motion to Dismiss, there was not cause shown to withdraw the reference.

Further the District Court determined that 28 U.S.C. § 157(c) a bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court. After the District Court rejected the Bankruptcy Court's motion to withdraw the reference, the District Court added a footnote which stated, "Altisource argues that the Bankruptcy Court does not have jurisdiction over Mr. Wilhold's claim for violation of the discharge injunction and the automatic stay because that claim relates to orders entered by the United States Bankruptcy Court for the Southern District of Illinois. This is an issue to be decided at the motion to dismiss stage, and not in connection with whether the reference to the Bankruptcy Court should be withdrawn." Again, this footnote raises an interesting dilemma. The Bankruptcy Court requested a withdraw of the reference because of a concern that there was no jurisdiction. In rejecting the withdraw of reference, the District Court wanted the Bankruptcy Court to make a ruling on whether to dismiss the case due to a lack of jurisdiction. If the case is dismissed, would the plaintiff be able to simply have to refile in the District Court? In a transcript from the January 28, 2022, status conference, Judge Moberly remarked, "My concern about granting or just dismissing the case is that forces the plaintiff to refile and pay another filing fee." If the Bankruptcy Court denies the defendants' motions to dismiss and motion to strike, the Bankruptcy Court would necessarily have to rule that the Bankruptcy Court does in fact have subject matter jurisdiction to hear the non-core bankruptcy issues despite the defendants' failure to consent and failure to agree to a jury trial.

After an amended complaint was filed, PHH and Ocwen filed a motion to dismiss the first amended adversary complaint on October 13, 2022 [Doc. 93] asserting that plaintiffs have failed to state a claim upon which relief can be granted. Accordingly, there were no subject matter jurisdiction claims. However, the defendants also filed a motion to strike the jury trial demand and argued, *inter alia,* that "a jury trial cannot be conducted in the bankruptcy court without the express consent of all parties, and Ocwen does not consent."

Altisource also filed a motion to dismiss the first amended class action complaint on October 13 [Doc. 97]. In that motion, Altisource argued, *inter alia*, that "the Complaint should be dismissed for lack of subject matter jurisdiction," and "this Court does not have jurisdiction over Plaintiffs Novak and Wilhold's claims concerning discharge orders were issued by other courts." Does the Bankruptcy Court have authority to deny the motion to dismiss on subject matter grounds, when subject matter is dependent on consent of the defendant on non-core bankruptcy claims?

IN RE MIKHOV (Case Nos. 17-02880-JJG-7A & 22-cv-01321-SEB-DLP)

FACTS:

1. April 20, 2017, Debtors filed their case under Chapter 7 of the Bankruptcy Code

2. On May 26, 2017, the IRS filed its Proof of Claim (the "Proof of Claim") for amounts allegedly owed by Debtors arising for tax years 2008, 2009, 2010, 2011, 2012, 2013, and 2014 in the total amount of $1,500,475.26, of which $252,347.00 was secured.

3. December 14, 2017, Order Discharging Debtors is entered.

4. October 9, 2018, Amended A/B [and C] filed disclosing the IRA with a total value of $52,021.58 and claiming the full amount as exempt.

5. October 18, 2018, Attorney Jackson Kirklin files appearance for the IRS

6. October 18, 2018, IRS files Motion for Relief from Stay for the sole purpose of allowing the IRS to levy on Debtors' IRA Accounts. The IRS noted that the IRA was not disclosed on either the original or two subsequently amended Schedules A/B. The IRA was disclosed in an amendment after the discharge order. The Bankruptcy Court granted the IRS motion for relief.

7. July 10, 2019, Trustee filed motion to sell free and clear
   a. R/E located at 4219 Greenway Drive, Indianapolis
   b. Owned by The One Company, LLC – single asset LLC with D's as the members
   c. D's file limited objection stating that the LLC has other debts that must be paid including past due real estate taxes
   d. Report of Sale - $74,000 with a net of $52,978.49.

8. Trustee also sought motion for turnover of the debtor's residence, claiming that the value listed on Schedule A/B was more than $200,000 less than the actual value.
   a. Debtor objected to the motion for turnover stating that the appraisal at the time of filing was correct, and that even if it was not correct the IRS has a $253,347 secured claim.
   b. Even though the IRS had a fully secured lien on the debtor's property, on January 9, 2020, IRS filed its response in support of motion for turnover stating that the trustee sale would generate more than the IRS would get at public auction, and it was willing to carve out a percentage for unsecured creditors.
   c. On January 27, 2020, the IRS filed a supplemental statement and explained, "if the Court authorizes a sale of the Property by the Trustee under either of the IRS proposals (waiving secured status as to the net proceeds of the Property available to the estate or a carve-out), IRS will credit Debtors' tax debt to the IRS in the full amount of the sale

proceeds distributed to the IRS and other creditors combined. For example, if the sale of the Property were to yield a $150,000 distribution to general unsecured creditors, IRS would receive a pro rata distribution from that amount (i.e., something less than $150,000), but IRS would credit Debtors' outstanding tax debt in the amount of $150,000. Similarly, if a 15% carve-out yielded $22,000 for creditors other than the IRS, that $22,000 would nevertheless be credited to the tax and interest secured by the tax liens."

d. On November 3, 2020, the Court ordered the sale of the residence, and that "the IRS waives its secured status with respect to the net proceeds of the Twin Pointe Property available to the estate and shall be treated as an unsecured creditor with respect to net proceeds to the estate from the sale of the Twin Pointe Property, sharing in the net proceeds pro rata with other general unsecured creditors as agreed by the IRS in the IRS Joinder and the IRS Response."

9. On January 4, 2021, Debtors filed a motion to examine IRS to determine whether and to what extent their unsecured claims would be discharged in the Chapter 7. On February 3, 2021, the IRS filed its objection stating, *inter alia*, to the extent the debtors might want to object to the IRS claim, they do not have standing because there is no possibility of a surplus given that the 2012, 2013, and 2014 liabilities were self-reported, and to the extent debtors seek to investigate dischargeability, that is outside the scope of Rule 2004."

10. December 9, 2021, real estate sold for $720,000.00 and netted $343,149.16 to the estate.

11. On April 28, 2022, the IRS filed a second Proof of Claim, which was intended to be an Amended Proof of Claim, in the total amount of $1,366,042.64 and asserted that the entire amount is unsecured.

12. There is an ongoing argument whether the IRS decision to waive its secured status on residence meant that the debtors were entitled to retain their homestead exemption. On May 23, 2022, the IRS and Debtors filed an agreed entry that:
    a. The IRS is entitled to enforce its federal tax liens on the debtors' claimed exemption in the amount of $38,600
    b. The IRS waives secured status with respect to the bankruptcy estate's interest in the net proceeds received from the sale of 4219 Greenway Drive, Indianapolis, totaling approximately $70,000

13. On July 5, 2022, the IRS filed its Complaint in District Court to reduce to judgment liabilities for federal income tax and interest for tax years 2008 through 2012, and liabilities for federal income tax, penalties, and interest for tax years 2013 and 2014 (excepted from discharge by 11 U.S.C. §§ 523(a)(1)(A) and 523(a)(7)).

14. The IRS <u>alleged</u> that liabilities for tax years 2008-2012 would excepted from the discharge under 11 U.S.C. § 523(a)(1)(C) because Vladimir Mikhov and Angela Mikhov willfully attempted to defeat the taxes by:
    a. Failing to report over $600,000 of their business' gross receipts on their 2008 and 2009 Forms 1040
    b. Comingling funds with their business and claiming personal expenses on their business tax returns for tax years 2008 and 2009
    c. Selling investment properties after the assessment of tax against them for net sale proceeds in excess of $1 million and declining to use any those amounts to pay their past-due federal income tax liabilities
    d. Selling investment properties to insiders at a below-market rate
    e. Failing to disclose assets, including Individual Retirement Accounts, on their original and first amended bankruptcy schedules

15. On July 28, 2022, Debtor's filed a Notice of Removal to try and bring the case back into the bankruptcy court as an adversary. The sole claim asserted by the IRS and every anticipated defense the IRS believes Debtors will assert arises directly out of section 523 of the Bankruptcy Code and addresses the dischargeability of the amounts alleged owed by Debtors to the IRS based on the Bankruptcy Case. It is in essence a complaint to determine dischargeability.

16. On August 4, 2022, the IRS filed its motion to declare that notice of removal is void.

DISCUSSION:

Congress vested all original jurisdiction over bankruptcy cases in the United States District Court. See 28 U.S.C. §1334(a). Congress further provided that the District Court could refer all cases in bankruptcy and any and all related proceedings arising under, in, or related to cases in bankruptcy, to the Bankruptcy Court. 28 U.S.C. §157(a).

The United States District Court for the Southern District of Indiana has referred all cases under the Bankruptcy Code and all proceedings arising under the Bankruptcy Code or arising in or related to cases under the Bankruptcy Code to the United States Bankruptcy Court [**See S.D. Ind. L.R. 83-8(a)** "Consistent with 28 U.S.C. § 157(a), **all cases** and proceedings arising under Title 11 of the United States Code, or relating to a case under Title 11 of the United States Code, are referred to the district's bankruptcy court. **This includes all cases removed under 28 U.S.C. §§ 1441(a) or 1452**." Accordingly, until and unless the reference of jurisdiction to the Bankruptcy Court is withdrawn by an Order of the District Court, all jurisdiction over bankruptcy matters resides with the Bankruptcy Court.

28 U.S.C. §1452(a) [Removal of claims related to bankruptcy cases] provides as follows:

(a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

This provision typically relates to state court causes of action where a bankruptcy is pending in a related matter. Regardless of how it is typically used, the S.D.IN Local Rules are clear that every case *relating* to a case under Title 11 of the United States Code (including a Notice of Removal under Section 1452) are referred to the district's bankruptcy court. Moreover, as discussed in the O'Flynn case (*supra*) once the case is referred to the Bankruptcy Court, the referral can only be within "for cause" [See 11 U.S.C. §157(d)].

So, what happens when a new case (relating to a pending Bankruptcy case) is filed directly in the District Court? The case can be referred to the District Court which would then (under federal law and local rule) *automatically* refer the matter to the bankruptcy court. Typically, the removal pleading is filed directly with the United States Bankruptcy Court for that District. As set forth in both Bankruptcy Rule 9027(a) and 28 U.S.C. §1446(a), the basic pleading to remove a case is a Notice of Removal. Neither a motion nor a court order is required to effect removal of a court action; removal is accomplished by filing a notice of removal with the Clerk of the Bankruptcy Court and a copy of such notice with the Clerk of the Court from which the case is being removed.

Bankruptcy Rule 9027.7 [Removal] provides in part:

(e) Procedure After Removal.
(1) After removal of a claim or cause of action to a district court the district court or, if the case under the Code has been referred to a bankruptcy judge of the district, [**which is automatic under Local Rules**] the bankruptcy judge, may issue all necessary orders and process to bring before it all proper parties whether served by process issued by the court from which the claim or cause of action was removed or otherwise.

ISSUES:

The "new" IRS complaint filed in the District Court was made simply to determine the amount of the tax debt. That figure was dependent solely on whether and to what extent the tax obligations were dischargeable. Specifically, a judge would need to decide three issues: 1) the dischargeability of these particular tax debts (28 U.S.C. §157(b)(2)(I)); the allowance or disallowance of all or part of the IRS claim (28 U.S.C. §157(b)(2)(B)); and after making those decision providing information to the trustee regarding administration of the estate (28 U.S.C. §157(b)(2)(A)).

What are the best procedures to bring the "new" case back before the jurisdiction of the Bankruptcy Court?

Answer: There are no specific Rules or Code sections that deal with a situation where a party in an active case and who has consented to jurisdiction through action [IRS filed appearances, motion for relief from stay, two proofs of claim and participated in no less than 20 events on the court docket] then files a complaint to determine dischargeability of debts with the District Court.

On July 28, 2022, the debtors filed an adversary complaint [No. 22-50061] as a Notice of Removal under 28 U.S.C. §1452(a). On first impression, it may appear to be preposterous to remove a civil case from the District Court to the same District Court. However, when section 1452 combined with Local Rule 83-8 which automatically refers all cases and proceedings arising under Title 11, or relating to a case under Title 11, to the Bankruptcy Court (including all cases removed under 28 U.S.C. §1452), it may be the only procedure. It would appear then that the only element to prove would be whether the complaint to determine the tax claim was somehow related to the pending Chapter 7 bankruptcy in which the debtor was trying to discharge debts, and the Chapter 7 trustee was holding over $350,000 to pay on those claims. Debtors appeared before the Bankruptcy Court and argued that that the Bankruptcy Court had automatic referral jurisdiction under Local Rule Local Rule 83-8 and Bankruptcy Rule 9027.7 then states that the Bankruptcy Judge may issue all necessary orders and process to bring before it all proper parties. The Bankruptcy Court questioned whether it had the authority to "order" the District Court to relinquish jurisdiction (even if that is what the Local Rules Require). Instead, the Bankruptcy Court directed the debtors to get that approval directly from the District Court.

On September 7, 2022, the debtors filed their Motion to Confirm Referral or in the Alternative to Refer the Proceeding to the Bankruptcy Court and had the difficult task of trying to convince a District Court that it did not have or did not want to hear the IRS complaint. From a pragmatic view, however, this request was an impossible task. The District Court has original and exclusive jurisdiction of any title 11 matters (See 28 U.S.C. §1334) and, even if there was a potential argument, could simply withdraw the reference at any time if the District Court wanted to retain jurisdiction.

ISSUE: Does the District Court have jurisdiction to hear the "new" case once the Notice of Removal has been filed and the Bankruptcy Court determines that the new case is related to the underlying bankruptcy case?

Answer: YES

On November 21, 2022, the District Court issued its opinion in the case, *United States v. Mikhov* [Case No. 22-cv-01321-SEB-DLP, S.D.IN Nov. 21, 2022].

The District Court stated that it does retain jurisdiction of the new case and that the plain language of 28 U.S. Code § 1452 is clear; that is, actions are removed to District Court and not away from it. The District Court followed priors holdings that, "Courts concluding that 28 U.S.C. § 1452 does not permit removal from a federal district court directly to the bankruptcy court cite two reasons for that holding: first, the plain language of the statute does not support a contrary conclusion; and second, to interpret the bankruptcy removal statute as [the Mikhovs] urge would thwart the district courts' power to refer matters to bankruptcy courts."

→ QUESTION: Does removal from District Court to Bankruptcy Court really "thwart" the District Court's power to refer matters to the Bankruptcy Court, when it was precisely the District Court that approved S.D. Ind. L.R. 83-8(a) ordering all removed cases be referred to the Bankruptcy Court? In other words, it almost sounds like the District Court is admonishing the debtors not to try to hold the District Court to its own Local Rules.

The District Court continues, "The predicate for the referral power is the bedrock principle that the district courts have jurisdiction over bankruptcy cases and proceedings; the bankruptcy court's jurisdiction over such matters is purely and solely derivative of the district court's jurisdiction." *In re Curtis*, 571 B.R. 441, 445 (B.A.P. 9th Cir. 2017). "And the bankruptcy court's power to hear, or to hear and determine, as the case may be, bankruptcy cases and proceedings is entirely dependent upon the referral by the district court." *Id.* [Again, the author notes parenthetically that it was precisely the District Court that drafted the specific Local Rule automatically referring all cases to the Bankruptcy Court.]

Finally, the District Court held that the debtors' claim that Local Rule 83-3(a) is even relevant is misplaced, because the IRS claim seeking to enter a judgment on the tax obligation arises under the Internal Revenue Code (Title 26) and is not "arising under" or "arising in" Title 11. "We agree with the Government's argument and reiterate that the Mikhovs' stated intention to raise their bankruptcy discharge as a defense to ongoing tax liability does not alter the nature of the proceeding before us, nor does it transform this proceeding into a matter 'arising under' Title 11, such that the Bankruptcy Court would possess jurisdiction."

Unfortunately, the most compelling argument is that the IRS complaint is "related to" the pending Chapter 7 bankruptcy. However, the District Court was able to avoid that provision and simply stated, "The Mikhovs have not argued that this matter is 'related to a case under title 11,' so we will address only whether it 'arises in' or 'arises under' Title 11. While it would have been interesting to see how the District Court would have treated that language, it would likely have not been relevant as the District Court clearly wanted to retain jurisdiction. The bottom line is that Bankruptcy Courts only get any jurisdiction from the District Court which may (or may not) refer Title 11 cases (or "arising in," "arising under," or "related to" a Title 11 case). The District Court agreed with other District Courts when it stated:

> Any interpretation of a statute that would imply that the bankruptcy courts had jurisdiction of bankruptcy cases and proceedings separate and independent from, or even co-equal to, the jurisdiction granted Article III courts, or that would interfere with the Article III courts' exercise of that jurisdiction and judicial power through the system of referral to bankruptcy courts, or that, as here, would permit bankruptcy courts to dispose of matters originating in the district courts in apparent derogation of the power of those courts to control their own proceedings, would be, for reasons described above, a constitutional non-starter. *In re Curtis*, 571 B.R. 441, 447 (B.A.P. 9th Cir. 2017).

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

DAVID ROBERT O'FLYNN, DONALD L. WILHOLD, JAMES ADDISON, and REGINA ADDISON, *on behalf of themselves and others similarly situated*,	)	
	)	No. 1:22-cv-00335-JMS-DLP
Plaintiffs,	)	
vs.	)	
PHH MORTGAGE CORPORATION, OCWEN FINANCIAL CORPORATION, and ALTISOURCE PORTFOLIO SOLUTIONS, SA,	)	
Defendants.	)	

ORDER

Plaintiffs David O'Flynn, James Addison, and Regina Addison were all debtors in Chapter 13 cases filed in the United States Bankruptcy Court for the Southern District of Indiana (the "Bankruptcy Court") and Plaintiff Donald Wilhold was a debtor in a Chapter 13 case filed in the United States Bankruptcy Court for the Southern District of Illinois. Plaintiffs initiated an Adversary Proceeding against Defendants PHH Mortgage Corporation ("PHH"), Ocwen Financial Corporation ("Ocwen"), and Altisource Portfolio Solutions, SA ("Altisource"), by filing a Complaint alleging claims on behalf of themselves and a putative class. [Filing No. 2-1.] As is protocol in this District, the Adversary Proceeding was referred to the Bankruptcy Court and after Defendants filed Motions to Dismiss, United States Bankruptcy Judge Robyn Moberly initiated this action by filing a Recommendation to the District Court to Withdraw the Reference Pursuant to Local Rule B-5011-1(b) (the "Recommendation"). [Filing No. 1.] The Recommendation is now ripe for the Court's consideration.

I.
BACKGROUND

A. The Complaint in the Adversary Proceeding

Plaintiffs – all of whom were Chapter 13 debtors in bankruptcy proceedings – filed a Class Action Complaint against Defendants in the Bankruptcy Court on August 31, 2021. [Filing No. 2-1.] In their Complaint, Plaintiffs allege that Defendants engaged in fraudulent practices in connection with the servicing of home mortgage loans owed by individuals involved in Chapter 13 bankruptcy proceedings. [Filing No. 2-1 at 2.] They allege that Defendants "have engaged in a common scheme involving the creation and collection of fees, costs, charges and other amounts in circumvention of the Bankruptcy Code and in violation of federal consumer protection statutes." [Filing No. 2-1 at 2.] The scheme, they allege, "has resulted in countless borrowers and debtors like [them] completing the rigid requirements of a Chapter 13 bankruptcy only to be denied the 'fresh start' to which they were entitled." [Filing No. 2-1 at 2.]

Plaintiffs set forth claims for: (1) violation of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1962(c) (Count I); (2) violation of RICO and conspiracy to violate RICO, 18 U.S.C. § 1962(d) (Count II); (3) violation of the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. § 1692k (Count III); (4) violation of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2605, *et seq.* (Count IV); (5) contempt and sanctions for violating the discharge injunction provided by 11 U.S.C. § 524(i), violating Federal Rule of Bankruptcy Procedure 3002.1, and violating the automatic stay set forth in 11 U.S.C. § 362(a) (Count V); and (6) unjust enrichment (Count VI). [Filing No. 2-1 at 37-50.]

Plaintiffs bring their claims individually and on behalf of the following class and subclass:

> Chapter 13 Class: All individuals who were debtors in a Chapter 13 bankruptcy proceeding wherein an Order of Discharge was entered from August 27, 2015 to present whose first or second residential mortgage loan was serviced by [Ocwen]

during the pendency of their bankruptcy proceeding, [Ocwen or PHH] at the time the Order of Discharge was entered, and who thereafter received some form of communication from [Ocwen or PHH] regarding any fees, costs, charges, escrow deficiency, or delinquency predating the Order of Discharge.

Unjust Enrichment Subclass: All individuals who were debtors in a Chapter 13 bankruptcy proceeding wherein an Order of Discharge was entered in the Southern or Northern District of Indiana from August 27, 2015 to present whose first or second residential mortgage loan was serviced by [Ocwen] during the pendency of their bankruptcy proceedings, [Ocwen or PHH] at the time the Order of Discharge was entered, and who thereafter paid any amounts to [Ocwen or PHH], whether directly or via refinance, associated with any fees, costs, charges, escrow deficiency, increased principal balance, or delinquency predating the Order of Discharge.

[Filing No. 2-1 at 6.]

B. The Motions to Dismiss in the Adversary Proceeding

On November 22, 2021, Altisource filed a Motion to Dismiss pursuant to Federal Rule of Civil Procedure 12(b)(2) and Federal Rule of Bankruptcy Procedure 7012(b), seeking dismissal of all of Plaintiffs' claims and arguing that the Bankruptcy Court does not have personal jurisdiction over Altisource. [Filing No. 2-3.] Also on November 22, 2021, Ocwen and PHH filed a Motion to Dismiss under Federal Rule of Civil Procedure 12(b)(6) and Federal Rule of Bankruptcy Procedure 7012, setting forth various arguments and seeking dismissal of all of Plaintiffs' claims. [Filing No. 2-6.] The same day, Ocwen and PHH also filed a Motion to Strike Class Allegations, [Filing No. 2-9], and a Motion to Strike Plaintiffs' Jury Demand, [Filing No. 2-10].

C. The Court's January 5, 2022 Order and the Parties' Positions Regarding Withdrawing the Reference

On January 5, 2022, Judge Moberly held a status conference at which she expressed concern regarding the Bankruptcy Court's jurisdiction to adjudicate Counts I through IV and Count VI (the "Non-Discharge Claims") and instructed the parties to either file a motion to withdraw the reference to the Bankruptcy Court or advise the Bankruptcy Court that they would not file such a motion. [Filing No. 40 in *O'Flynn, et al. v. PHH Mortgage Corp., et al.*, Adv. Pro. 21-50079 (Bankr. S.D. Ind.).]

Defendants filed a Joint Statement on Withdrawal of the Reference on January 12, 2022, stating that they were declining to file a motion to withdraw reference and setting forth their reasons for that decision. [Filing No. 2-13.] On January 20, 2022, Plaintiffs filed a Statement on Withdrawal of the Reference in which they stated that they believe the Bankruptcy Court has jurisdiction to rule on the Motions to Dismiss and that withdrawal of the reference is not necessary. [Filing No. 2-14.]

D. The January 28, 2022 Status Conference

On January 28, 2022, Judge Moberly held a status conference to discuss the pending Motions to Dismiss. [Filing No. 4.] She again expressed concern regarding whether the Bankruptcy Court has jurisdiction to rule on the motions, and counsel for the parties advised Judge Moberly that they would need to discuss with their clients the possibility of moving to withdraw the reference to the Bankruptcy Court. [Filing No. 4 at 4-10.] Judge Moberly advised counsel that she would expect them to state their positions within seven days. [Filing No. 4 at 6-10.]

E. Judge Moberly's Recommendation

On February 1, 2022, Judge Moberly initiated this case by filing the Recommendation. [Filing No. 1.] Judge Moberly expressed concern with the potential inability to enter a final judgment if the Motions to Dismiss were granted and recommended that the District Court withdraw its reference for the case "EXCEPT the Defendants' motions to dismiss and all other matters to be decided under Count V of the Class Action Complaint to the extent they pertain exclusively to debtors and plaintiffs David R. O'Flynn, James Addison and Regina Addison, whose bankruptcy cases were resolved by the undersigned." [Filing No. 1 at 2-3.]

More specifically, in the Recommendation, Judge Moberly set forth the history of the Adversary Proceeding and stated:

> Resolution of [the Motions to Dismiss], as well as the underlying causes of action, requires substantial and material consideration of non-Title 11 statutes which are necessary for resolution of the case.
>
> As a result of the status conference held on January 5, 2022, the Defendants on January 12, 2022 filed their joint statement...contending that [the Bankruptcy Court] had the jurisdiction to hear and grant their motions and that they would decline to move the District Court to withdraw the reference to [the Bankruptcy Court]. Despite Defendants' contention that the bankruptcy court has jurisdiction to enter final dismissal orders, the Defendants reserve, in Footnote 2, that "Defendants respectfully reserve their views and positions as to whether [the Bankruptcy Court] may hear or finally adjudicate Plaintiffs' claims at subsequent phases of this case should Defendants' motion to dismiss and related dispositive motions be denied." In other words, unless the bankruptcy court grants the Defendants' motion to dismiss, the Defendants wish to maintain their position that the bankruptcy court does not have jurisdiction to hear the cases and enter a final judgment. While the case is still in the pre-trial stage, a possible outcome at this pre-trial stage is the grant of the Defendants' motions and the resulting dismissal of the Class Action Complaint. Such would be a final order, and without a "complete consent" to [the Bankruptcy Court's] jurisdiction, [the Bankruptcy Court] cannot enter judgment.

[Filing No. 1 at 2-3.] Judge Moberly gave the parties 14 days to supplement their previous statements regarding withdrawing the reference. [Filing No. 1 at 3.] On February 15, 2022, Altisource filed a Supplement to Defendants' Joint Statement on Withdrawal of the Reference. [Filing No. 3.]

F. The April 12, 2022 Status Conference

Magistrate Judge Doris Pryor held a status conference in this case on April 12, 2022. [Filing No. 12.] At the status conference, the parties advised that they all agreed that the Bankruptcy Court has the authority to decide the Motions to Dismiss. PHH and Ocwen advised that they believe that if the Motions to Dismiss are not granted, Count V would need to be decided by the Bankruptcy Court while the other claims would need to be decided by the District Court.

Altisource stated its position that if the Motions to Dismiss are not granted, the referral should be withdrawn. Plaintiffs advised that they will do whatever the Court requires.

II.
LEGAL FRAMEWORK

With certain exceptions not relevant here, the district courts of the United States have "original and exclusive jurisdiction over all cases under title 11." 28 U.S.C. § 1334(a). Congress has divided bankruptcy proceedings into three categories – those that arise under Title 11, those that arise in a Title 11 case, and those that are related to a case under Title 11 – and a district court may refer such cases to the bankruptcy judges in the district. 28 U.S.C. § 157(a). District courts may withdraw a case or proceeding referred to the bankruptcy court "for cause shown." 28 U.S.C. § 157(d).

"The manner in which a bankruptcy judge may act on a referred matter depends on the type of proceeding involved." *Stern v. Marshall*, 564 U.S. 462, 473 (2011). In "core proceedings," bankruptcy judges may "hear and determine all cases" and may "enter appropriate orders and judgments." 28 U.S.C. § 157(b)(1). Parties may appeal final judgments in core proceedings to the district court, which reviews them using traditional appellate standards. *Stern*, 564 U.S. at 474-75. If a bankruptcy judge determines that something is a non-core proceeding but is otherwise related to a case under Title 11, it "shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which a party has timely and specifically objected." 28 U.S.C. § 157(c)(1).

With the consent of all parties, the district court may refer a proceeding related to a cause under Title 11 to a bankruptcy judge to hear, determine, and enter appropriate orders and judgments. 28 U.S.C. § 157(c)(2); *Wellness Intern. Network, Ltd. v. Sharif*, 575 U.S. 665, 678-79

(2015) ("[A]llowing bankruptcy litigants to waive the right to Article III adjudication of *Stern* [non-core] claims does not usurp the constitutional prerogatives of Article III courts.").

III.
DISCUSSION

The parties have filed various reports and briefs related to the issue of whether the Bankruptcy Court has jurisdiction to decide the Motions to Dismiss as they relate to the Non-Discharge Claims and enter final judgment, if appropriate. But the bottom line – and the latest position the parties have taken – is that all parties consented to the Bankruptcy Court deciding the Motions to Dismiss when they met with Magistrate Judge Pryor on April 12, 2022. This is a new circumstance that did not exist when Judge Moberly filed her Recommendation. Accordingly, based on the parties' unanimous consent, the Court **REJECTS** Judge Moberly's Recommendation to the District Court to Withdraw the Reference Pursuant to Local Rule B-5011-1(b). [Filing No. 1].[1]

IV.
CONCLUSION

Because the parties now consent to the Bankruptcy Court deciding the Motions to Dismiss pending in the Adversary Proceeding, Judge Moberly may decide the pending Motions to Dismiss and enter final judgment, if warranted, based on that consent. Accordingly, the Court **REJECTS** Judge Moberly's Recommendation to the District Court to Withdraw the Reference Pursuant to Local Rule B-5011-1(b), [1], and declines to withdraw its reference of this matter to the Bankruptcy Court.

---

[1] Altisource argues that the Bankruptcy Court does not have jurisdiction over Mr. Wilhold's claim for violation of the discharge injunction and the automatic stay because that claim relates to orders entered by the United States Bankruptcy Court for the Southern District of Illinois. [*See* Filing No. 3 at 5-6.] This is an issue to be decided at the motion to dismiss stage, and not in connection with whether the reference to the Bankruptcy Court should be withdrawn.

Date: 5/18/2022

Jane Magnus-Stinson

Hon. Jane Magnus-Stinson, Judge
United States District Court
Southern District of Indiana

Distribution via ECF only to all counsel of record

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

UNITED STATES OF AMERICA, Plaintiff, v. VLADIMIR MIKHOV, ANGELA MIKHOV, COMMERCIAL AND RESIDENTIAL CONSTRUCTION SERVICES, LLC, Defendants.	)	No. 1:22-cv-01321-SEB-DLP

ORDER ON THE PARTIES' MOTIONS REGARDING REMOVAL AND/OR REFERRAL OF THIS PROCEEDING TO THE BANKRUPTCY COURT

After the Government commenced this civil suit against the Defendants seeking to reduce Defendants' federal income tax liabilities to judgment pursuant to 26 U.S.C. § 7402, Defendants attempted to remove it to our Bankruptcy Court based on their anticipatory defense that these claims have previously been discharged in bankruptcy. In response, the Government filed a motion requesting that the Court declare the Defendants' attempted removal void. The Defendants did not respond directly to this motion, filing instead a separate motion asking the Court to confirm that this matter has been referred to the Bankruptcy Court; alternatively, if the matter has not been referred, they request the issuance of an order of referral forthwith. We address these motions[1] in

[1] On November 9, 2022, Defendants filed another motion that: (1) requests the Court confirm referral of this proceeding to the Bankruptcy Court or, alternatively, refer the proceeding to the Bankruptcy Court, and (2) moves to dismiss Count II pursuant to Federal Rule of Civil

turn, concluding, for the reasons explicated below, that jurisdiction over this proceeding in the District Court should continue.

I. PROCEDURAL BACKGROUND

On April 20, 2017, Defendants Vladimir Mikhov and Angela Mikhov filed a Chapter 7 bankruptcy petition in this district for which they received a discharge on December 14, 2017. Five years thereafter, on July 5, 2022, the Government commenced this lawsuit initially only against the Mikhovs, thereafter amending it to add claims against Commercial and Residential Constructions Services, LLC ("C&R"). C&R is a business owned by Ilona Mikhov, the Mikhovs' daughter.[2] Count I of the Amended Complaint is based on 26 U.S.C. § 7402 and seeks an order from the Court to reduce the Mikhovs' federal tax liabilities (plus interest) to judgment. These liabilities cover the tax years 2008 through 2012 as well as tax years 2013 and 2014. The claims in the Government's Amended Complaint for tax years 2008 through 2012 anticipated that the Mikhovs would

---

Procedure 12(b)(6). We deny the first part of this motion regarding the Bankruptcy Court for the same reasons we ultimately deny Defendants' motion at issue here. We will rule on the second part of Defendants' November 9th motion, i.e., their Motion to Dismiss, in due course, following the standard briefing deadlines of Local Rule 7-1(c)(3).

[2] The Government's Amended Complaint filed on September 28, 2022, post-dated the parties' respective motions on whether the Bankruptcy Court has jurisdiction over this case. The language added in the Amended Complaint does not impact our analysis or conclusions on these pending motions.

C&R was established on October 7, 2015. Ilona Mikhov, the Mikhovs' daughter, was listed as the sole member and registered agent of C&R. While C&R was administratively dissolved by the Indiana Secretary of State on April 5, 2018, it continues to be the titleholder of record of the Property. Angela Mikhov has held herself out as a manager of C&R, and Defendants Mr. and Mrs. Mikhov have accessed funds from a bank account in the name of C&R to pay personal expenses. On information and belief, the Government alleges that C&R has failed to adhere to most if not all corporate formalities.

assert a discharge defense based on their 2017 bankruptcy case filed in this district by claiming that the exception to discharge statute, 11 U.S.C. § 523(a)(1)(C), applies here. However, Section § 523(a)(1)(C) excludes from a bankruptcy discharge any tax debt for which a debtor "made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." Regarding tax years 2013 and 2014, the Amended Complaint alleges that these liabilities are "excepted from discharge by 11 U.S.C. §§ 523(a)(1)(A) and 523(a)(7) and the penalties are excepted from discharge under 11 U.S.C. § 523(a)(7) because the returns for those tax years were due after three years prior to the petition date (the due date for the 2013 return having been extended to October 15, 2014, and the return having been filed shortly thereafter)." Docket No. 19, at 3. Count II of the Government's Amended Complaint seeks a determination under 26 U.S.C. § 7402 that the Mikhovs' federal tax liens attach to a parcel of real property ("the Property") in Fishers, Indiana, title to which is listed in the name of C&R.

On July 28, 2022, the Mikhovs filed what they entitled a "Notice of Filing of Notice of Removal," referencing their filing of a Notice of Removal in the Bankruptcy Court, and also seeking to "remov[e] this proceeding to the Bankruptcy Court pursuant to 28 U.S.C. § 1452(a)." Docket No. 8, at 1. On August 4, 2022, the Government filed a Motion to Declare that Notice of Removal is Void, arguing that:

> 28 U.S.C. § 1452(a) only provides for the removal of cases from state courts to federal courts (including bankruptcy courts) or possibly from one district to another (although the [Government] submits that is really a transfer of venue under 28 U.S.C. § 1412 and is within the authority of the court in which the case is commenced).

Docket No. 9, at 1. The Government contends that a civil action such as this "cannot be removed from a federal district court to the bankruptcy court for the same district, and thus the notice of removal is a legal nullity." *Id.* The Government, citing 28 U.S.C. § 1452(a), argues that the statute "only permits removal 'if the district court has jurisdiction of such claim or cause of action under section 1334 of this title,' but this civil action does not fall within 28 U.S.C. § 1334," which places jurisdiction within the district courts over all bankruptcy cases arising under Title 11. *Id.*; *see* 28 U.S.C. § 1334(a). In addition, "[a] suit to reduce to judgment federal tax assessments does not 'arise under title 11' but rather arises under Title 26, and the fact that dischargeability of the debt is a potential defense does not alter that." Docket No. 9, at 1. Thus, according to the Government, "this civil action is also not subject to referral to the Bankruptcy Court for this district under 28 U.S.C. § 157(a) and matters not already automatically referred by Local Rule 83.8 are not subject to 'removal.'" *Id.* at 1–2; *see* S.D. Ind. L.R. 83-8(a) ("Consistent with 28 U.S.C. § 157(a), all cases and proceedings arising under Title 11 of the United States Code, or relating to a case under Title 11 of the United States Code, are referred to the district's bankruptcy court. This includes all cases removed under 28 U.S.C. §§ 1441(a) or 1452.").

The Mikhovs have not responded directly to the Government's motion; instead, on September 7, 2022, they filed their "Motion to Confirm Referral of Proceeding to Bankruptcy Court or, in the Alternative, to Refer Proceeding to Bankruptcy Court." Their motion asserts that the Court has already automatically referred this lawsuit to the Bankruptcy Court, pursuant to our Local Rules, and requests that we confirm that referral; the Mikhovs, albeit inconsistently, also contend that they possess the right to remove the action to the Bankruptcy Court. "[T]o the extent this proceeding has not already been referred to the Bankruptcy Court," say the Mikhovs, the "Court should expressly make such a referral," arguing that this cause of action both "arises under" and "arises in" the Bankruptcy Code. Docket No. 10, at 15.

II. FACTUAL BACKGROUND

In Count I, the Government's Amended Complaint alleges that the Mikhovs' tax liabilities for the years 2008 through 2012 were excepted from discharge in the bankruptcy proceeding, pursuant to 11 U.S.C. § 523(a)(1)(C), because the Mikhovs were accused of willfully attempting to defeat the taxes in one or more of the following ways, including but not limited to:

- Failing to report over $600,000 of their business's gross receipts on their 2008 and 2009 Forms 1040 (combined).
- Selling investment properties in 2014-2016 (after all the assessment of tax against them) for net sale proceeds in excess of $1 million and declining to use any those amounts to pay their past-due federal income tax liabilities.
- Selling investment properties to insiders at a below-market rate.
- Using business bank accounts for personal expenses, including payment of the mortgage on their residence and purchases of airline tickets, fine wines, and expensive clothing.
- Failing to disclose assets, including Individual Retirement Accounts, on their original and first amended bankruptcy schedules.
- Transferring the operation of their business to C&R, of which their daughter is the sole member owner (though continuing to operate that business) in order to avoid IRS collection efforts.
- Not fully paying their taxes through nearly adequate estimated prepayments during each tax year despite having adjusted gross income of $707,013 in 2008, $540,533 in 2009, $381,791 in 2010, $891,920 in 2011, $678,453 in 2012, $342,401 in 2013, and $317,557 in 2014.
- Not paying the already reported and assessed taxes in succeeding years from the similarly more-than-sufficient income year after year.

- Fraudulently transferring funds to One Plus Two LLC to acquire the Property in its name in 2011.
- Causing One Plus Two LLC to fraudulently transfer the Property to Vladimir Mikhov's sister in 2016 even though he owned 99.9% of One Plus Two while his sister owned only 0.1% as described in Count II below.

Docket No. 19, at 3–4. Regarding tax years 2013 and 2014, the Government alleges the Mikhovs' tax liabilities were excepted from discharge under 11 U.S.C. §§ 523(a)(1)(A) and 507(a)(8), and the penalties from discharge under 11 U.S.C. § 523(a)(7), because of their belated filing of the returns which were due three years prior to the Mikhovs' bankruptcy petition date. Thus, despite proper notice and demand, the Mikhovs failed, neglected, or refused to fully pay the liabilities and, after the application of all abatements, payments, and credits, they remain liable, jointly and severally, to the United States in the amount of $1,403,527.46, plus statutory additions and interest accruing from and after June 30, 2022. That amount, the Government contends, will be decreased by any distributions received from the bankruptcy estate after July 5, 2022.

As for Count II, the Government's Amended Complaint alleges that on August 18, 2011, before most of the tax assessments at issue were made but after the Mikhovs had been notified that the Internal Revenue Service had opened an investigation into their 2008 and 2009 tax returns, Margaret Culberson conveyed the Property to One Plus Two, LLC, an entity owned 99.9% by Mr. Mikhov and 0.1% by his sister, Ellena Mikhov Kayyod. On May 10, 2016, One Plus Two LLC conveyed full title to the Property by Warranty Deed to Ms. Kayyod. The Government has averred, based on information and belief, that the transfer of property from One Plus Two to Ms. Kayyod on May 10, 2016, was directed by Mr. Mikhov and/or Mrs. Mikhov. On January 12, 2018, Ms. Kayyod conveyed the Property by Quitclaim Deed to C&R for zero net dollars; this transfer was made for the stated consideration of $100,000, but all closing costs (including $5,865.66 to Hamilton County, Indiana, to pay Spring 2016 and delinquent property taxes) were paid from that $100,000, making the actual amount paid to the seller the amount of $92,472.50. Mr. Mikhov then directed payment of $92,472.50 to a bank account in the name of Two Plus One, LLC, which was another company of which he was the owner/president. Over the course of the ensuing four months, the $92,472.50 was distributed through a combination of withdrawals executed by Mrs. Mikhov and transfers to or for the benefit of other entities controlled by the Mikhovs. Moreover, One Plus Two reported the sale in the amount of only $10,000, claiming a capital loss corresponding to that amount that passed through to the Mikhovs' personal tax return. Thus, according to the Government, the Mikhovs' federal tax liens attach to the Property, either because the liens had attached to it when it was held by Mr. Mikhov's nominee, One Plus Two LLC, or, in the alternative, because the initial acquisition of the property by One Plus Two was made with funds supplied by Mikhov, making all subsequent transfers of the property fraudulent. The Government therefore requests a declaration under 26 U.S.C. § 7402 that the Mikhovs' tax liens attach to the Property.

III. DISCUSSION AND DECISION

We begin our analysis of the parties' respective motions mindful of the following controlling legal principles. First, "[t]he jurisdiction of the bankruptcy courts, like that of other federal courts, is grounded in, and limited by, statute." *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 (1995). "Title 28 U.S.C. § 1334(b) provides that 'the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.'" *Id.* "The district courts may, in turn, refer 'any or all proceedings arising under title 11 or arising in or related to a case under title 11 ... to the bankruptcy judges for the district.'" *Id.* (quoting 28 U.S.C. § 157(a)). "The predicate for the referral power is the bedrock principle that the district courts have jurisdiction over bankruptcy cases and proceedings; the bankruptcy court's jurisdiction over such matters is purely and solely derivative of the district court's jurisdiction." *In re Curtis*, 571 B.R. 441, 445 (B.A.P. 9th Cir. 2017).

A. GOVERNMENT'S MOTION TO DECLARE THAT NOTICE OF REMOVAL IS VOID

The Mikhovs have attempted to remove this action to the Bankruptcy Court, pursuant to 28 U.S.C. § 1452(a), but "numerous trial courts have concluded that 28 U.S.C. § 1452 does not permit removal of cases from federal district court to bankruptcy court." *Curtis*, 571 B.R. at 445 (collecting cases); *see, e.g., Wellness Int'l Network v. J.P. Morgan Chase Bank, N.A. (In re Sharif)*, 407 B.R. 316 (Bankr. N.D. Ill. 2009). "There are virtually no published decisions to the contrary."[3] *Curtis*, 571 B.R. at 445. "Courts concluding that 28

[3] In *Curtis*, the Ninth Circuit noted that the only arguable exceptions to this rule are *Philadelphia Gold Corp. v. Fauzio (In re Philadephia Gold Corp.)*, 56 B.R. 87 (Bankr. E.D. Pa. 1985) and *MATV–Cable Satellite, Inc. v. Phoenix Leasing, Inc.*, 159 B.R. 56 (Bankr. S.D. Fla. 1993). *Curtis*, 571 B.R. at 445. In *Philadelphia Gold*, the Bankruptcy Court permitted a debtor in a civil action pending in the U.S. District Court for the Eastern District of Pennsylvania to remove that action to the bankruptcy court in the same district. *Id.* at 448 (citing *Philadelphia Gold*, 56 B.R. at 89–90). "Although the bankruptcy court examined 28 U.S.C. § 1452, its analysis was

U.S.C. § 1452 does not permit removal from a federal district court directly to the bankruptcy court cite two reasons for that holding: first, the plain language of the statute does not support a contrary conclusion; and second, to interpret the bankruptcy removal statute as [the Mikhovs] urge would thwart the district courts' power to refer matters to bankruptcy courts." *Id.* We adopt that reasoning here as well.

The plain language of 28 U.S.C. § 1452 does not authorize removal to a bankruptcy court; rather, it authorizes removal "to the district court for the district where such civil action is pending," if the district court has jurisdiction under 28 U.S.C. § 1334. *Id.* Indeed, "it is illogical to interpret the bankruptcy removal statute to authorize removal *from* a district court *to* the district court in the same district." *Id.* (citing *Mitchell v. Fukuoka Daiei Hawks Baseball Club (In re Mitchell)*, 206 B.R. 204, 209 (Bankr. C.D. Cal. 1997) ("It violates the plain language of 28 U.S.C. § 1452(a) to say that an action can be removed 'to district court' when it is already pending in district court, because the words 'to district court' by necessity involve the concept of bringing the action to district court from some other forum."). "Numerous cases have held, correctly, that a reading of 28 U.S.C. § 1452 that would permit a matter to be removed from a district court to a

---

perfunctory and did not take into account the plain language of the statute or the constitutional concerns raised by its interpretation." *Id.* As many other courts before us, we find this decision and its analysis unpersuasive. *See Thomas Steel Corp. v. Bethlehem Rebar Industries, Inc.*, 101 B.R. 16, 19–20 (Bankr. N.D. Ill. 1989) (explicitly rejecting *Philadelphia Gold* and its analysis). "Without making a definitive ruling on the issue of whether 28 U.S.C. § 1452 authorized the removal of a case from federal district court," the district court in *MATV-Cable Satellite* denied a motion to strike a notice of removal to the bankruptcy court "on practicality grounds." *Curtis*, 571 B.R. at 448. "Accordingly, *MATV–Cable Satellite* does not provide a solid basis for interpreting 28 U.S.C. § 1452 to authorize removal from a federal district court to bankruptcy court, as urged by Debtors." *Id.*

bankruptcy court would impermissibly undermine the district court's power to refer matters to the bankruptcy court (or to withdraw the reference)." *Id.* at 447. This referral power reflects "the Article III supervision that Congress intended as a remedy for the defects found by the Supreme Court in *Marathon*." *Thomas Steel Corp. v. Bethlehem Rebar Indus., Inc.*, 101 B.R. 16, 19–20 (Bankr. N.D. Ill. 1989) (citing *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) (holding the jurisdictional grant of the Bankruptcy Reform Act of 1978 violated the Constitution's separation of powers doctrine insofar as it purported to permit a bankruptcy court, which was not a court established under Article III of the Constitution and lacked the essential attributes of an Article III court, to exercise the judicial power of the United States)).

"[W]e pause here to emphasize a fundamental and crucial point." *Curtis*, 571 B.R. at 447. "The predicate for the referral power is the bedrock principle that the district courts have jurisdiction over bankruptcy cases and proceedings; the bankruptcy court's jurisdiction over such matters is purely and solely derivative of the district court's jurisdiction." *Id.* "And the bankruptcy court's power to hear, or to hear and determine, as the case may be, bankruptcy cases and proceedings is entirely dependent upon the referral by the district court." *Id.* "Any interpretation of a statute that would imply that the bankruptcy courts had jurisdiction of bankruptcy cases and proceedings separate and independent from, or even co-equal to, the jurisdiction granted the Article III courts, or that would interfere with the Article III courts' exercise of that jurisdiction and judicial power through the system of referral to the bankruptcy courts, or that, as here, would permit bankruptcy courts to dispose of matters originating in the district courts in apparent derogation of the power of those courts to control their own proceedings, would be, for the reasons described above, a constitutional non-starter." *Id.* at 447–48. For these reasons, we grant the Government's motion declaring that the Mikhovs' Notice of Removal to the Bankruptcy Court is void.

B. DEFENDANTS' MOTION TO CONFIRM REFERRAL OF PROCEEDING TO BANKRUPTCY COURT OR, IN THE ALTERNATIVE, TO REFER PROCEEDING TO BRANKRUPTCY COURT

The Mikhovs also seek an order transferring this case to the Bankruptcy Court, arguing that: "as with every case and proceeding that arises under or relates to the Bankruptcy Code, this Court has already referred the proceeding initiated by Plaintiff's Complaint to the Bankruptcy Court," and, in the alternative, if this proceeding has not already been automatically referred to the Bankruptcy Court, the Mikhovs request that we now do so because, they say, this proceeding both "arises in" and "arises under" the Bankruptcy Code.[4] Docket No. 10, at 10. The Mikhovs' first argument invokes Local Rule 83-8(a) (mistakenly referenced in the motion as Local Rule 83-3(a)), which provides:

> Consistent with 28 U.S.C. § 157(a), all cases and proceedings arising under Title 11 of the United States Code, or relating to a case under Title 11 of the

4 In addition to their argument that this proceeding has already been referred, the Mikhovs contend that "[e]ven if the referral of jurisdiction to the Bankruptcy Court were withdrawn (which it has not been) or challenged in any way," they "would still have the right to remove this proceeding to the Bankruptcy Court." Docket No. 10, at 11. For all the reasons previously explained we reject this argument; the proceeding has not already been referred to the Bankruptcy Court, and there is no such right to removal *from* this court *to* this court's Bankruptcy Court.

> United States Code, are referred to the district's bankruptcy court. This includes all cases removed under 28 U.S.C. §§ 1441(a) or 1452.

The Mikhovs contend that this referral, "which is automatic and requires no action by the Court, has been reaffirmed time and again by this Court." Docket No. 10, at 10; *see, e.g., Gibson v. Tucker (In re G & S Livestock Co.)*, 478 B.R. 906, 911 n.6 (S.D. Ind. 2012) ("Cases in this District are automatically referred to the United States Bankruptcy Court for the Southern District of Indiana pursuant to Local Rule 83-8."); *GolsonDunlap v. HSBC Capital (USA), Inc. (In re Garrison)*, 2016 WL 454807, at *2 (S.D. Ind. Feb. 5, 2016) ("Congress has granted the district courts authority to refer cases arising under Title 11, proceedings arising in a Title 11 case, or those that relate to a case under Title 11 to the bankruptcy court for the district. In this district, Local Rule 83-8 provides for the automatic referral of all proceedings arising under Chapter 11, consistent with § 157(a)."). "Based on this Court's automatic referral of proceedings such as the one initiated by Plaintiff to the Bankruptcy Court," the Mikhovs argue, "this Court should enter an Order confirming that the proceeding initiated by the Complaint has been referred to the Bankruptcy Court." Docket No. 10, at 12.

The Mikhovs' reliance on this Local rule is entirely misplaced. The case at bar is not a matter arising under Title 11, as we have previously made clear. Thus, it was not automatically referred to the Bankruptcy Court nor will it be. Obviously, if it had been, there would be no need for the Mikhovs to request confirmation of that fact by the court. In truth of fact, this matter is prosecuted under Title 26, U.S.C., to wit, the Internal Revenue Code. The Mikhovs' apparent intention to raise their bankruptcy discharge as a defense to their ongoing tax liability dispute does not alter the statutory basis for this lawsuit. Neither should it be transferred to the Bankruptcy Court on the grounds that it "arises under" and "arises in" the Bankruptcy Code.

"Congress delineated three types of bankruptcy proceedings: those (1) 'arising under title 11,' (2) 'arising in' a title 11 case, and (3) 'related to a case under title 11.'" *In re Ortiz*, 665 F.3d 906, 911 (7th Cir. 2011) (quoting 28 U.S.C. § 157(a)). The Mikhovs have not argued that this matter is "related to a case under title 11," so we will address only whether it is one that "arises in" or "arises under" Title 11. *See* 28 U.S.C. § 157(a). "Congress permits bankruptcy judges to 'hear and determine . . . all core proceedings arising under title 11, or arising in a case under title 11.'" *Ortiz*, 665 F.3d at 911 (citing 28 U.S.C. § 157(b)(1)). "[C]ore proceedings are those that arise in a bankruptcy case or under Title 11." *Stern v. Marshall*, 564 U.S. 462, 476 (2011). The Mikhovs claim that the Government's Complaint seeks a "determination as to the dischargeability of [a] particular debt[]" and thus is a "core proceeding," as defined in 28 U.S.C. §157(b)(2)(I), characterizing the Bankruptcy's discharge of their debt as a proceeding that "both 'arises in' a bankruptcy case and 'arises under' the Bankruptcy Code because the Bankruptcy Code both provides for Debtors' discharge and Plaintiff's alleged right to except its debt from such discharge." Docket No. 10, at 15.

Whether this case "arises under" Title 11 depends on whether it relates to "a right 'created or determined by a statutory provision of title 11.'" *In re Repository Tech., Inc.*, 601 F.3d 710, 719 (7th Cir. 2010) (quoting *CLC Creditors' Grantor Trust v. Sonnenschein Nath & Rosenthal LLP (In re Commercial Loan Corp.)*, 363 B.R. 559, 565

(Bankr. N.D. Ill. 2007)). The Government "does not dispute that free-standing declaratory suits to determine dischargeability of a debt commenced under § 523(c) and/or Bankruptcy Rule 4007 'arise under title 11.'" Docket No. 12, at 4. Rather, the Government stresses that its cause of action against the Mikhovs "does not 'arise under title 11'; it arises under title 26 (the Internal Revenue Code), specifically 26 U.S.C. § 7402." *Id.* at 5. We agree with the Government's argument and reiterate that the Mikhovs' stated intention to raise their bankruptcy discharge as a defense to ongoing tax liability does not alter the nature of the proceeding before us, nor does it transform this proceeding into a matter "arising under" Title 11, such that the Bankruptcy Court would possess jurisdiction.

The Mikhovs' contention that this matter "arises in" bankruptcy—a category "defined generally as 'administrative matters that arise *only* in bankruptcy cases'"—is equally unpersuasive. *Ortiz*, 665 F.3d at 911 (quoting *Repository Tech.*, 601 F.3d at 719). Indeed, a proceeding "arises in" bankruptcy if it "would have 'no existence outside of the bankruptcy,' and [is] thus deemed 'arising in' a bankruptcy case because the claim[] [is] 'predicated on the defendants' participation in' the debtors' bankruptcies." *Id.* (quoting *Repository Tech.*, 601 F.3d at 719); *see also Grausz v. Englander*, 321 F.3d 467, 471–72 (4th Cir. 2003) (finding a debtor's claim against a law firm for malpractice in his bankruptcy within "arising in" jurisdiction because it would have "no practical existence but for the bankruptcy"). Claims "arising in" bankruptcy include "such things as administrative matters, orders to turn over property of the estate and determinations of the validity, extent, or priority of liens." *Repository Tech.*, 601 F.3d at 719 (citation omitted).

Thus, "[i]ts domain is limited to questions that arise during the bankruptcy proceeding and concern the administration of the bankrupt estate, such as whether to discharge a debtor." *Zerand-Bernal Group, Inc. v. Cox*, 23 F.3d 159, 162 (7th Cir. 1994).

Here, the authority to reduce tax assessments to judgments—specifically, the authority granted by 26 U.S.C. § 7402—exists irrespective of whether a taxpayer has been through bankruptcy. We reiterate: the Mikhovs' intention to raise a discharge defense does not transform or alter the nature of this case, nor does it create jurisdiction within the Bankruptcy Court. Indeed, the Mikhovs have cited not a single case in which a district court has referred a suit to the bankruptcy court to reduce to judgment tax liabilities involving whether such liabilities were discharged. Conversely, the Government has cited numerous cases arising in various district courts seeking a tax judgment that involves the issue of whether the tax liabilities were dischargeable. *See, e.g., United States v. Stanley*, 595 Fed. App'x 314, 318 (5th Cir. 2014); *United States v. Storey*, 640 F.3d 739, 741 (6th Cir. 2011); *United States v. Coney*, 689 F.3d 365, 370 (5th Cir. 2012); *United States v. Clayton*, 465 B.R. 72 (M.D.N.C. 2011); *United States v. Hall*, 2002 WL 471800 (S.D. Ind. Feb. 12, 2002).

We further hold that the interests of judicial efficiency are better served by our retention of the instant action on our docket. *In re Varner*, the bankruptcy court declined to reopen a case to permit an adversary complaint by a debtor where the federal Government had brought suit in the district court claiming that the discharge exception applied as part of its complaint. There, the court observed:

> Forcing either party to litigate the dischargeability issue in bankruptcy court, only to present that declaratory judgment to district court, is a waste of resources. District court has original jurisdiction of bankruptcy matters and can review this court's decisions. Allowing it to decide the dischargeability directly makes more sense than piecemeal litigation.

In re Varner, 2021 WL 5312469, *2 (Bankr. N.D. Ohio Nov. 15, 2021).[5] We agree.

Finally, as the Government notes, the Bankruptcy Court would not have jurisdiction over the Government's additional claim against Defendant C&R, which involves property that is not part of the "bankruptcy estate and is titled in the name of a company which is not a debtor (and the shares of such company are also titled in the name of a non-debtor), so the bankruptcy court would thus not have subject matter jurisdiction over any issue with regard to that property." Docket No. 20, at 2–3. "Nor could the property be brought into the estate via a fraudulent transfer claim by the Chapter 7 trustee because the period of limitations to do that has expired." *Id.* at 3 (citing 11 U.S.C. § 546). The District Court possesses the requisite jurisdiction to adjudicate all the claims here presented, while serious questions exist concerning the Bankruptcy Court's jurisdiction to hear the entirety of all the asserted claims. Thus, we shall retain responsibility for managing this litigation without referring it to the Bankruptcy Court. *See Kerger v. United States*, 2020 WL 4570770, at *3 (N.D. Ohio, July 21, 2020). For all these reasons, we deny Defendants'

---

[5] Moreover, because the Bankruptcy Court could at most issue a declaratory judgment, the Government argues that "its jurisdiction would be questionable in light of the prohibition in the Declaratory Judgments Act on declaratory judgments involving federal taxes. Significantly, the same legislation that enacted the modern bankruptcy code in 1978 amended the Declaratory Judgments Act to make an exception to the tax exclusion clause for § 505 of the Bankruptcy Code but did not make such an exception for § 523 (dischargeability)." Docket No. 20, at 6 n.2.

Motion to Confirm Referral of Proceeding to Bankruptcy Court or, in the Alternative, to Refer Proceeding to Bankruptcy Court.

IV. CONCLUSION

Accordingly, we **GRANT** the Government's Motion to Declare that Notice of Removal is Void [Docket No. 9] and **DENY** Defendants Motion to Confirm Referral of Proceeding to Bankruptcy Court or, in the Alternative, to Refer Proceeding to Bankruptcy Court [Docket No. 10].[6]

IT IS SO ORDERED.

Date: 11/21/2022

Sarah Evans Barker

SARAH EVANS BARKER, JUDGE
United States District Court
Southern District of Indiana

Distribution:

Jason R. Burke
BLACKWELL, BURKE & RAMSEY, P.C.
jburke@bbrlawpc.com

Amy Lynn Elson
Blackwell, Burke, & Ramsey P.C.
aelson@bbrlawpc.com

Sarah L. Fowler
Blackwell, Burke & Ramsey, P.C.
sfowler@bbrlawpc.com

[6] As previously mentioned, we partially **DENY** Defendants' Motion filed on November 9, 2022 [Docket No. 30] as it pertains to the issues addressed in this order. That motion remains pending as to the Defendants' request that Count II of the Amended Complaint be dismissed, and nothing in this order shall be construed to affect the standard briefing deadlines set out in Local Rule 7-1(c)(3) for the Motion to Dismiss portion of Defendants' November 9th Motion.

Bradley A. Sarnell
U.S. DEPARTMENT OF JUSTICE - TAX DIVISION (Washington DC)
bradley.a.sarnell@usdoj.gov

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re:

Randall Nelson, Case No. 19-24458-beh

Debtor. Chapter 13

In re:

Wilfredo Ramos, Case No. 20-21169-beh

Debtor. Chapter 13

DECISION AND ORDER ON DEBTORS' REQUESTS TO MODIFY THEIR CONFIRMED CHAPTER 13 PLANS

Does 11 U.S.C. § 1329(c) foreclose the ability of a Chapter 13 debtor to modify his confirmed plan to alter the plan payment amount while maintaining an extended plan period previously approved under (now-expired) 11 U.S.C. § 1329(d)? Debtors Randall Nelson and Wilfredo Ramos have confirmed Chapter 13 plans with payment periods of 84 months and 76 months, respectively. Whether they may modify their plans again while leaving those extended payment periods in place is a question of statutory interpretation.

FACTUAL BACKGROUND

A. Randall Nelson

Debtor Randall Nelson filed a voluntary petition and Chapter 13 plan on May 6, 2019. Case No. 19-24458, ECF Nos. 1 and 2. The Court confirmed his amended 60-month plan on February 21, 2020. ECF No. 39. The debtor filed a proposed modified plan on January 13, 2021, which the Court confirmed on February 17, 2021. ECF No. 59. The modified plan took advantage of then-existing 11 U.S.C. § 1329(d), a provision of the Coronavirus Aid, Relief, and

Economic Security Act ("CARES Act"), Pub. L. 116-136, 134 Stat. 281 (March 27, 2020), and extended the plan payment period to 84 months.

On March 28, 2022—25 months after the debtor's plan was first confirmed—the Chapter 13 trustee filed a motion to dismiss Mr. Nelson's case, based on failure to make plan payments and to supply a copy of his 2020 tax returns. ECF No. 61. The debtor objected and noted his ability to make/catch up on payments due to anticipated receipt of rents. The parties reached a resolution, which included provision for a further modified plan. The Court entered an order on April 25, 2022, denying the trustee's motion to dismiss and, among other things, noting that the debtor had to file a modified plan no later than May 31, 2022.[1] ECF No. 67.

When the modified plan was not filed by that deadline, the trustee certified default, but later withdrew her certification after the debtor filed a modified plan and budget. *See* ECF Nos. 69, 72, 73, and 74. The proposed modification sought to change only the payment amount in section 2.1 of the plan, requiring the debtor to make monthly payments to the trustee of $1,838. The modification further provided: "All remaining terms of the Chapter 13 Plan last confirmed on February 17, 2021 are unaffected." ECF No. 72, at 3. The trustee objected to this proposed modification on the basis that it did not provide for a feasible plan. ECF No. 78. The parties agreed to settle the trustee's objection on the condition that the debtor file a modified feasible plan by August 19, 2022, and the trustee submitted a proposed order imposing this requirement for the Court to sign. Thereafter the Court notified the debtor and trustee via docket entry: "Given that [the] text of s. 1329(c) provides that a court may not approve a [plan payment] period that expires after five years beyond the time the first payment was due, the Court will modify the proposed

---

[1] Given the parties' agreed resolution of the trustee's March 28, 2022 motion to dismiss, which included requiring the debtor to submit a plan modification—after the sunset of § 1329(d)—the Court should have called the question before entering its April 25 order. That oversight does not dilute the salience of the question as it relates to the parties' proposed resolution of the trustee's later objection to confirmation, *see infra*, by requiring a further plan modification by August 19, 2022, and pointedly, not requiring that any further modified plan include a payment term consistent with 11 U.S.C. § 1329(c).

order on the trustee's objection to confirmation by adding the phrase 'compliant with s. 1329(c)' unless the debtor requests a hearing on the matter within 10 business days." The debtor requested a hearing.

Both counsel for the debtor and counsel for the Chapter 13 trustee presented their views on the issue identified by the Court. Namely, the parties recognized that Congress did not amend the text of § 1329(c) (or § 1329(d)) to address whether debtors with existing CARES Act payment period extensions may modify any term of their plans while keeping a previously-confirmed payment period of more than 60 months. After some discussion, the Court allowed counsel for debtor and the trustee to submit letter briefs addressing their positions.

B. Wilfredo Ramos

Debtor Wilfredo Ramos filed his initial Chapter 13 plan on February 28, 2020. *See* Case No. 20-21169, ECF No. 9. The Court confirmed the plan, as amended, on March 1, 2021. *See* ECF Nos. 75 and 80. Shortly thereafter, mortgage lender Deutsche Bank National Trust Company filed a motion for relief from the automatic stay based on the debtor's failure to make post-petition mortgage payments. The Court denied the motion in an order dated June 2, 2021. In doing so, the Court imposed a six-month "doomsday" period during which the debtor was required to make timely mortgage payments or risk Deutsche Bank being granted immediate relief from the automatic stay, and also allowed the bank to file a supplemental claim in the amount of $9,605.60. *See* ECF No. 90. To accommodate the bank's supplemental claim without having to increase his monthly plan payment amount, the debtor elected to extend his plan payment period to 76 months pursuant to 11 U.S.C. § 1329(d). ECF No. 92. The Court confirmed the modified plan on July 20, 2021. ECF No. 94.

Several months later, Deutsche Bank filed an affidavit of default. After a series of hearings on the matter, the parties stipulated to allowing Deutsche Bank to file another supplemental claim for $2,111.52. ECF No. 130. The

Chapter 13 trustee thereafter filed a motion to dismiss for failure to make payments necessary to ensure timely plan completion. ECF No. 132. At this point, the debtor was in the 16th month of his confirmed plan. The trustee withdrew his motion after the debtor filed a further modified plan on July 11, 2022. *See* ECF Nos. 134 and 140. This latest proposed modification would provide for payment of the most recent supplemental claim by increasing the debtor's monthly plan payment from $468 to $520. ECF No. 134. Though no one objected to the proposed plan, the Court held a hearing to consider whether the proposed modification violates 11 U.S.C. § 1329(c), as it would require the debtor to make (increased) plan payments for a period that exceeds five years. After conclusion of additional briefing by counsel for the debtor, the Court took the matter under advisement.

ARGUMENTS OF THE PARTIES

These cases present the same question: Does 11 U.S.C. § 1329(c) foreclose the ability of Chapter 13 debtors to modify their plans in some respect while maintaining an extended payment period previously confirmed under now-expired 11 U.S.C. § 1329(d)?

Debtor Nelson contends that imposing the 60-month limitation of § 1329(c) on debtors wishing to maintain their CARES Act extended periods would yield an absurd result, citing *In re Goodrich*, 587 B.R. 829, 841 (Bankr. D. Vt. 2018) (granting reconsideration to review interpretation of a BAPCPA provision after eleven years of analysis by other courts, and considering the statute's text, context, and purpose). Attempting to demonstrate an absurdity, he hypothesizes a debtor in month 65 of an 84-month plan who needs to modify his payment amount to maintain feasibility. *See* Case No. 19-24458, ECF No. 87. That hypothetical debtor, he argues, would be unable to modify at all if bound by § 1329(c), forcing him to make the difficult choice of allowing his case to be dismissed or to remain in an "unfeasible plan that is destined for failure[.]" *Id.* To avoid such a choice, he points to *In re Mercer,* where a bankruptcy court allowed debtors to modify the payment amount of their

CARES Act plan and maintain their extended payment period, despite the expiration of § 1329(d). *See* 640 B.R. 577, 581 (Bankr. D. Colo. 2022).

Debtor Ramos likewise relies on *Mercer* as authority for allowing him to modify his plan in the manner proposed. *See* Case No. 20-21169, ECF No. 146. He also directs the Court to *In re Carter*, 638 B.R. 379 (Bankr. N.D. Ill. 2022), for the proposition that a plan can be modified to run longer than 60 months. *See* 638 B.R. at 398 ("[Section 1329(c)] is satisfied so long as the modification itself does not expressly alter the plan term to one longer than 60 months, even if the effect of the modification is that a plan may run longer than 60 months.") (citing *Germeraad v. Powers*, 826 F.3d 962, 968 (7th Cir. 2016)). *See* ECF No. 145. *Carter*, however, does not help the debtor, because Mr. Ramos's proposed modification would result in a plan that, by its express terms, provides for a payment period exceeding the 60-month limit of section 1329(c). *See* 638 B.R. at 398 (["[T]he general proposition taken by the court from [*Germeraad*] is more broad: Even after the 60th month of a plan, a court may modify a plan—even if the resulting plan will result by definition in a plan longer than 60 months—so long as the court does not extend the plan term itself beyond 60 months."); *see also Germeraad*, 826 F.3d at 970–71 ("[Section 1329] contains three general limits on the bankruptcy court's power to approve the request. First, modification is allowed only if it will modify the plan in one of the ways specified in § 1329(a)(1)–(4). Second, a modification must comport with the provisions of the Code listed in § 1329(b)(1). *Finally, . . . a modification may not result in a plan providing for payments over a term that is longer than the period specified in § 1329(c) . . . .*") (emphasis added).

Mr. Ramos points out that his extended plan period already is in place and he does not seek further modification of that period, therefore, he argues, he is not asking the Court to "'approve a period that expires after five years [after the time that the first payment under the original confirmed plan was due].'" ECF No. 146, at 2. He asserts that if the Court were to deny a request to modify only his payment amount, that denial would serve as a retroactive denial of his prior, permitted, payment-period extension under § 1329(d). He notes that the Chapter 13 trustees in this district agree that further modifications of payment amounts would not run afoul of § 1329(c). *Id.*

For their part, the trustees argue that restricting debtors with plan period extensions previously approved under § 1329(d) to a 60-month plan on a subsequent modification thwarts the Bankruptcy Code's overall purpose of aiding Chapter 13 debtors to complete their cases. According to the trustees, because § 1329(d) was enacted to allow debtors a longer period to complete their cases, Congress could not have intended now to force those debtors—many of whom remain adversely affected by the COVID-19 pandemic—to revert back to a 60-month plan period. Finally, they contend that §§ 1329(c) and 1329(d) are conflicting provisions that must be harmonized. *See* Case No. 19-24458-beh, ECF No. 88 (incorporating by reference the trustee's letter brief submitted in *In re Lewis*, Case No. 18-26550-beh, ECF No. 134) (cautioning against construing statutory provisions in ways that would lead to absurd results, citing *In re Goodrich,* 587 B.R. at 841, and warning against a statutory construction that would fail to give both provisions full effect, citing *In re Plunkett,* 89 B.R. 776, 782 (Bankr. E.D. Wis. 1988) (concluding that 11 U.S.C. § 541(d) does not prevent a trustee from invoking his strong-arm powers under 11 U.S.C. § 544(a)(3) and reading § 541(d) to avoid making the provision "redundant and mere surplusage")).

DISCUSSION

Since 1978, 11 U.S.C. § 1329(c) has read:

> A plan modified under this section may not provide for payments over a period that expires after the applicable commitment period under section 1325(b)(1)(B) after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, *but the court may not approve a period that expires after five years after such time.*

11 U.S.C. § 1329(c) (emphasis added). The maximum plan period provided by subsection (c) was expanded between 2020 and 2022 by 11 U.S.C. § 1329(d)(2).

The latter, temporary provision allowed qualifying debtors to modify their confirmed Chapter 13 plans to provide for payments up to two additional years:

> A plan modified under paragraph (1) may not provide for payments over a period that expires more than *7 years after the time that the first payment under the original confirmed plan was due.*

11 U.S.C. § 1329(d)(2) (emphasis added). Subsection (d) became effective on March 27, 2020, shortly after the COVID-19 outbreak took hold in this country. From the first, Congress established that this option to prolong plan-length would be available for a limited time. After one extension, the provision was stricken as of March 27, 2022.[2]

With the sunset of § 1329(d), debtors like Mr. Nelson and Mr. Ramos—those who previously obtained CARES Act extensions of their plan periods and now seek to modify another aspect of their plans (like the amount of monthly plan payments) while retaining the extended payment periods—are left without a clear path to confirmation.

One bankruptcy court decision offers mild support for the debtors' view that they may modify their plans as proposed. In *In re Mercer*, a Colorado court allowed debtors who had previously modified their plan to provide for payments over a period of seven years under section 1329(d) to further modify their plan to adjust the payment amount to creditors, while keeping the plan duration at seven years despite the sunset of § 1329(d). The court explained: "It is this Court's view that any plan extension beyond five years that this Court approved before the sunset date should remain in effect despite a subsequent modification to the plan after the sunset date." 640 B.R. at 581. The *Mercer* court supplied no analysis for its view.

---

[2] Subsection (d) was added by the CARES Act on March 27, 2020 to permit extension of a plan up to a total of seven years for debtors experiencing a material financial hardship due to COVID-19 and applied to any case for which a Chapter 13 plan had been confirmed before the enactment date. Congress originally enacted a one-year sunset for this subsection, *see* Pub. L. No. 116-136, §§ 1113(b)(2)(A)(iii) and 1113(b)(2)(B), but then delayed the sunset until March 27, 2022, and expanded eligibility by affording the payment period extension to debtors like Mr. Ramos, whose plans were confirmed before March 27, 2021. *See COVID-19 Bankruptcy Relief Extension Act of 2021*, Pub. L. No. 117-5, 135 Stat 249 (Mar. 27, 2021). This decision refers collectively to each of these plans as "CARES Act" plans.

Another bankruptcy court, in two separate cases decided by the same judge, reached conclusions about the ability to modify a plan post-expiration of § 1329(d), relying on plain statutory text. In *In re Sykes*, 638 B.R. 578 (Bankr. E.D. Mich. 2022), the bankruptcy court denied a post-confirmation request to modify a debtor's plan by extending its term from 60 to 65 months. The request was filed several weeks before March 27, 2022, but the hearing on confirmation fell several days after March 27, meaning § 1329(d) was no longer in effect. Moreover, that district's local rules provided that a proposed post-confirmation plan modification did not become effective until the court entered the confirmation order.[3] For those reasons, the bankruptcy court denied confirmation and similarly denied reconsideration.

In *In re Bohinski*, 638 B.R. 870 (Bankr. E.D. Mich. 2022), the debtor filed a proposed post-confirmation plan modification several days before March 27, 2022. The proposed modification would have changed the Chapter 13 plan period from 64 to 67 months. In mid-April, after the time for objection had passed, the court denied confirmation. It concluded that because § 1329(d) had been stricken, confirming a plan period of 67 months would be contrary to law. The *Bohinski* court reminded that the maximum length of a modified plan is the five-year period described in § 1329(c). *Id.* at 871. Implicitly at least, the *Bohinski* reasoning suggests that the court would not confirm a post-CARES Act plan modification where the changed term is one other than plan duration but the plan duration remains extended beyond 60 months.

[3] *See also* 11 U.S.C. § 1329(d)(1)(B) (" . . . the plan may be modified upon the request of the debtor if— . . . the modification is approved after notice and a hearing"); *compare* 11 U.S.C. § 1329(b)(2) ("The plan as modified becomes the plan unless, after notice and a hearing, such modification is disapproved."); *Germeraad v. Powers*, 826 F.3d 962, 969 (7th Cir. 2016) (section 1329(b)(2) means that the modification is effective, i.e., that the plan is modified, on the date the party requests modification of the plan, unless the court later disapproves it); *In re Mercer*, 640 B.R. at 581 ("It is hard for this Court to imagine what other meaning to give to [section § 1329(d)(1)(B)'s requirement that the modification must be approved] than to hold that § 1329(d) motions to modify are not effective until they are approved. Holding otherwise would render this element superfluous. So, the Court must acknowledge that § 1329(d), unlike § 1329(b)(2), requires approval and not merely a filing that is not later disapproved.").

Bohinski, rather than *Mercer*, better adheres to the plain text of § 1329(c), which provides that "[a] *plan* modified under this section"—not *a modification* under this section—"may not provide for payments over a period that expires after [five years]." 11 U.S.C. § 1329(c) (emphasis added). Although the debtors would like the Court to cabin the applicability of section 1329(c) to the discrete terms of the proposed modification at issue, the statutory text is not so limited. *Compare Germeraad*, 826 F.3d at 971 ("[A] modification may not result in a plan providing for payments over a term that is longer than the period specified in § 1329(c) . . . ."). For the following reasons, this Court makes express what the *Bohinski* court implied, concluding that a request to modify a confirmed plan that expressly results in a plan payment period exceeding 60 months fails to comply with 11 U.S.C. § 1329 and cannot be granted.

A. Section 1329(c) is not ambiguous as applied to the debtors.

While apparently acknowledging that the text of § 1329(c) is plain, the debtors and Chapter 13 trustees contend that § 1329(c) is ambiguous at least as applied to debtors like Mr. Nelson and Mr. Ramos, asserting that Congress could not have intended the sunsetting of § 1329(d) combined with the ongoing application of § 1329(c) to foreclose further plan modifications for debtors wishing to retain their CARES-Act-extended payment periods.

One problem with this ambiguity/conflict argument, which necessarily compares now-stricken § 1329(d) with the continuing § 1329(c), is that statutory interpretation cases most often analyze whether operation of two *co-existing* statutory provisions creates ambiguity. *See, e.g., Goodrich*, 587 B.R. at 838–39 (reconsidering interpretation of BAPCPA provision and canvassing other courts' methodology); *Plunkett*, 89 B.R. at 781–82 (reading Code sections 541(d) and 544(a)(3)—both co-existing—to reconcile alleged conflict). Here, §§ 1329(d) and (c) no longer co-exist. Only § 1329(c) is operative. *See Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) ("The starting point in discerning congressional intent is the existing statutory text, and not the predecessor statutes. It is well established that 'when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.' So we begin with the present statute.") (internal citations omitted).

The converse situation does occur—courts may attempt to interpret current Code provisions by considering prior bankruptcy statutes. *See, e.g., Goodrich*, 587 B.R. at 840 n.11 ("In efforts to decipher the meaning of newly added provisions, three of the four BAPCPA decisions considered pre-BAPCPA bankruptcy statutes and practice.") (citing *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 244 (2010); *Hamilton v. Lanning*, 560 U.S. 505, 515–17 (2010); *Hall v. United States*, 566 U.S. 506, 513–14 (2012)). But the lineage is not direct here; § 1329(c) pre-existed § 1329(d) and continues intact after sunset of the latter.[4]

Assuming § 1329(c) is ambiguous here, the Court could look to legislative history, though it should do so with caution. *See, e.g., Lamie*, 540 U.S. at 536 (instructing that courts should "avoid the pitfalls that plague too quick a turn to the more controversial realm of legislative history"); *Dobbs v. Jackson Women's Health Org.*, 142 S. Ct. 2228, 2256 (2022) ("This Court has long disfavored arguments based on alleged legislative motives," recognizing that inquiries into such motives "are a hazardous matter.") (citing *United States v. O'Brien*, 391 U.S. 367, 383 (1968)). While the parties have not cited it, there is some legislative history of the COVID-19 Bankruptcy Relief Extension Act of

[4] The debtors' and trustees' unintended-consequences argument mirrors the argument made in a case where the debtor sought to extend her plan under the CARES Act, but because the original plan was not confirmed before the March 27, 2020 effective date of § 1329(d)(2), the debtor could not take advantage of the temporary extension window Congress created. *See, e.g., In re Robinson*, Case No. 19-22498-beh, 2020 WL 7234031, at *2 (Bankr. E.D. Wis. Dec. 8, 2020) ("The debtor argues that the statutory language produces a result here that is 'at odds with the manifest intent of the legislature.' Counsel asserts '[t]he debtor was clearly the type of individual that Congress intended to provide relief to, and it would be inequitable to deny her this relief due to a literal reading of the statutory language essentially putting form over function.'") (internal citations omitted). The *Robinson* court acknowledged that while the United States Supreme Court has recognized there can be interpretive exceptions to a plain language read of statutory text, such an exception should be reserved for the "rare case," *see id.* at *3 (citing *Ron Pair Enterprises*, 489 U.S. 235, 242 (1989)). Neither the debtors nor the Chapter 13 trustees argue that either of the debtor's situations here is a "rare case."

2021. That history illumines why the accommodation of § 1329(d) was not permanent, but finite:

> Mr. NADLER. Madam Speaker, H.R. 1651, the COVID-19 Bankruptcy Relief extension Act of 2021, is bipartisan legislation to *temporarily extend,* until March 27, 2022, the COVID-19 bankruptcy relief provisions enacted as part of the CARES Act in the December 2020 omnibus appropriations bill.
>
> Since the bankruptcy provisions of the CARES Act will expire next week, it is urgent for Congress to ensure that families and small businesses do not lose access to these economic lifelines.
>
> These provisions were enacted last year to provide critical relief to families and small businesses forced into bankruptcy because of the ongoing pandemic. For example, they . . . protect individuals and creditors alike from the effects of the pandemic derailing the court-ordered repayment plans that promise a way out of chapter 13 bankruptcy.
>
> . . .
>
> *Extending* these necessary protections *until March of next year* will provide much-needed certainty that the bankruptcy system will remain responsive to debtors and creditors alike *during this extraordinarily disruptive crisis.*
>
> . . .
>
> Mr. ISSA. . . . Madam Speaker, this pandemic, everyone knows, has uprooted lives and caused untold destruction to families, to workers, and to small businesses. And many see the partisan behavior as destructive during this time, and they often do not see the bipartisan behavior.
>
> Today's extension, H.R. 1651, is an example of bipartisan behavior on behalf of the American people. Repeated and lengthy government shutdowns in response to the pandemic have devastated the ability of millions to work, pay bills, and support their families, and keep their small businesses afloat.
>
> . . .
>
> In 2020, Congress passed five bipartisan COVID relief packages. The CARES Act allowed a variety of *temporary relief measures* for families and small business. *When it was passed, we believed that, in fact, once the vaccine was available, that we would be able to put this behind us. But today, when over 10 percent of Americans have received a vaccine, we now know that the road to full recovery is longer ahead of us even after we begin going to work.*

> So allowing . . . debtors to file chapter 13 to modify their payment plans are only some of the critical items that the CARES Act did. Today we are making sure these will continue *until March of 2022*.
>
> This bill also extends through 2022 bankruptcy relief provisions included in the December 2020 COVID relief package. This extension will provide individuals and businesses with certainty and simplicity *as they look at an economic recovery that, although it is underway, may be long*.

167 Cong. Rec. H1389–90 (daily ed. March 16, 2021) (emphasis added).

These statements reflect an intent that the accommodation of § 1329(d) be temporary. They describe a rationale that limited, and not permanent, relief was required because vaccines and other measures would be part of the nation's economic recovery, notwithstanding the recovery process could be long. *See also In re Ritter*, 626 B.R. 35, 40–41 (Bankr. C.D. Cal. 2021) ("Congress passed § 1329(d) in March 2020 in order to allow debtors experiencing financial hardship due to COVID to modify their plans. . . . At the same time, Congress enacted sweeping provisions providing for forbearance on federally insured personal mortgage loans. . . . This combination was intended to keep debtors in their homes and prevent massive foreclosures during a health crisis where the public had been instructed to stay at home to reduce the spread of the disease.").

Moreover, there is no dispute that Congress took some action after the passage of the CARES Act, and even after the sunset of § 1329(d), to remedy new or remaining problems that later came to light. For example, Congress enacted (now-repealed) 11 U.S.C. § 1328(i) in December 2020, months after the CARES Act and passage of § 1329(d), to address the existing issue of mortgage forbearances during the pandemic. As the bankruptcy court in *In re Ritter* explained:

> [Section 1329(d)], however, did not adequately address the situation where a debtor had complied with all requirements of the plan and was ready for a discharge but could not keep up with mortgage payments due to COVID-19 related financial setbacks. . . . Section 1328(i) allows debtors who have suffered COVID-19 related financial distress to still obtain a discharge even

> though they have obtained a forbearance agreement or loan modification for their residential mortgage.

626 B.R. at 41. *See also Bankruptcy Threshold Adjustments and Technical Corrections Act*, Pub. L. 117-151, 136 Stat 1298 (June 21, 2022) (amending 11 U.S.C. § 1182 retroactively to extend the debt limit increase of $7,500,000 under the CARES Act for Subchapter V debtors through 2024, and fixing an apparent mistake by Congress in the CARES Act regarding the eligibility of affiliates of a corporation to file a Subchapter V case). But Congress did not act to amend § 1329(c) so as to separately accommodate existing CARES Act plans.

Well before the COVID crisis arose, courts agreed that § 1329 did not allow an unlimited range of post-confirmation modifications. *See In re Witkowski*, 16 F.3d 739, 745 (7th Cir. 1994) ("modifications under § 1329 are not limitless . . . . Rather, by the express terms of the statute, modifications are only allowed in three limited circumstances [now four circumstances after amendment in 2005]" described in § 1329(a)). With the sunset of § 1329(d), the only Code provision addressing length of payment periods for modified plans is § 1329(c). Congress made a policy choice in § 1329(c) when it set 60 months as the outside duration for a Chapter 13 payment period.

> The legislative history of the Bankruptcy Code indicates that Congress was unhappy with practices that had developed in certain parts of the country under Chapter 13's predecessor that had resulted in debtors remaining under court-supervised repayment plans for seven to ten years, which Congress characterized as being close to indentured servitude.

In re Black, 292 B.R. 693, 700 (B.A.P. 10th Cir. 2003) (citing Congressional Report). Congress temporarily altered that policy choice for a 24-month period, when the country's debtors and creditors were abruptly affected by the COVID-19 outbreak.

Even if the parties' argument strikes one as a practical solution, numerous courts have cautioned against judicial curing of a seeming congressional inadvertence. For example, in *Stearns v. Pratola (In re Pratola)*, 589 B.R. 779 (N.D. Ill. 2018), the district court described the arguments presented to the bankruptcy court as to whether student loan debt was part of the § 109(e) calculus for Chapter 13 eligibility. The *Pratola* court then explained how adherence to plain text must take precedence, notwithstanding compelling policy considerations:

> After noting that ineligibility under § 109(e) is usually cause for dismissal or conversion of a Chapter 13 case but is not an absolute bar, the Bankruptcy Court concluded that it was without clear direction from either the Bankruptcy Code or case law as to whether cause for dismissal under § 1307(c) exists in this situation. *Id.* at 7. Based on this perceived ambiguity, the Bankruptcy Court turned to legislative history and policy considerations regarding educational debt to determine whether Debtor's case should be dismissed. The Bankruptcy Court concluded that based on the history surrounding the debt limits' enactment, Congress could not have intended to exclude someone like Debtor, an otherwise eligible individual exceeding § 109(e)'s unsecured debt limit solely because of educational debt, from Chapter 13 relief. . . .
>
> Based on these considerations, the Bankruptcy Court held that there was no cause for dismissal of Debtor's Chapter 13 case under § 1307(c). The Bankruptcy Court specifically noted that "[d]ismissing [Debtor's] case would not advance the Congressional intent behind the debt limits, and doing so would hinder the principal purpose of the Bankruptcy Code—to grant a 'fresh start' to the honest but unfortunate debtor." *Id.* at 12 (citation omitted). . . .
>
> . . .
>
> The Court is not unsympathetic to the policy concerns raised by the Bankruptcy Court and highlighted by Debtor . . . regarding individuals with large amounts of educational debt, but the power to create such an exception to § 109(e) lies with Congress rather than the courts. . . . . Courts must enforce statutes as written; they cannot "rewrite the statute that Congress has enacted." *Puerto Rico*, 136 S. Ct. at 1949 (quoting *Dodd v. United States*, 545 U.S. 353, 359, 125 S. Ct. 2478, 162 L.Ed.2d 343 (2005)). Creating an exception to Chapter 13's eligibility requirements effectively rewrites the statute, substituting a discretionary substantive standard for the bright-line rule established by Congress.
>
> . . .
>
> . . . Under the plain terms of § 109(e), Debtor exceeds the statutory debt limit and so is ineligible to proceed as a Chapter 13; the nature of his debt is irrelevant. By taking its nature into account and considering potential policy reasons why Congress would not want to

> include such debt in § 109(e)'s debt limits, the Bankruptcy Court interpreted the statute in a way that contravened its plain text.

589 B.R. at 783, 790–91.

Another bankruptcy court adhered to Seventh Circuit guidance when plain statutory text conflicts with a practitioner's or trial court's sense of expediency: "The Seventh Circuit has dispatched a clear message . . . that courts must not engage in judicial legislation, holding that a court of equity does not have 'free floating discretion to redistribute rights in accordance with its personal views of justice and fairness.'" *In re Nieves*, 246 B.R. 866, 872–73 (Bankr. E.D. Wis. 2000) (quoting *Matter of Chicago, Milwaukee, St. Paul & Pacific Railroad*, 791 F.2d 524 (7th Cir. 1986)).

Moreover, application of the construction canon to "avoid absurd results" has been narrowed. *See In re University of Wisconsin Oshkosh Foundation, Inc.*, 586 B.R. 458, 463 (Bankr. E.D. Wis. 2018), citing *Jaskolski v. Daniels*, 427 F.3d 456, 462 (7th Cir. 2005). The *Jaskolski* court explained:

> What Daniels labels "absurd" results are nothing but the rough cuts inevitable with decision by rule. . . . Today the anti-absurdity canon is linguistic rather than substantive. It deals with texts that don't scan as written and thus need repair work, rather than with statutes that seem poor fits for the task at hand. In other words, the modern decisions draw a line between poor exposition and benighted substantive choice; the latter is left alone, because what judges deem a "correction" or "fix" is from another perspective a deliberate interference with the legislative power to choose what makes for a good rule. Admit the propriety of "fixing mistakes" and you allow a general power to *identify* "mistakes," which means a privilege to make the real substantive decision.

427 F.3d at 462 (emphasis in original).

Here, the debtors and trustees ask the Court to "fix the mistake" of Congress and conclude that Congress, when it enacted § 1329(d) and its one-year extension, inadvertently failed to provide that CARES Act plans need not abide by § 1329(c) for any future modifications. But such a "fix" by this Court would deliberately interfere with the legislative power to fashion the rules. It would appropriate to the Court the power to substantively override Congress' earlier determination that a 60-month maximum strikes the best balance against possible "indentured servitude." It would appropriate to the Court the power to veto what may well have been Congress' vision, in March 2020 and March 2021, that economic concessions to a pandemic must have some limitation, some concrete stopping point. Respecting the plain text of § 1329(c) as applied to modifications of CARES Act plans is not "hyperliteral and contrary to common sense," *see Ritter*, 626 B.R. at 42 (citing *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012)). Respecting and applying the plain text of § 1329(c) here recognizes that "Congress is very capable of limiting and conditioning the relief it fashions," *In re Gilbert*, 622 B.R. 859, 864 (Bankr. E.D. La. 2020),[5] and that Congress did not condition § 1329(c) following the sunset of § 1329(d).

In sum, the Court does not find the language of section 1329(c) ambiguous, either on its own or applied to debtors Nelson and Ramos. Because the statutory text is plain, the Court is bound to enforce it as written, and it cannot confirm Mr. Ramos's proposed modification, nor require Mr. Nelson to file a modified plan that would expressly require a payment period exceeding 60 months.

B. Subsection 1329(a), on its own, does not require confirmation of a modified plan.

As a separate but related argument, the Chapter 13 trustees assert that failing to allow debtors like Mr. Nelson and Mr. Ramos to modify the payment amount in their extended-period plans would run afoul of § 1329(a), which states: "At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon the request of the debtor . . . to . . . ." This argument is not well-taken. While § 1329(a) permits a

[5] The court in *Gilbert* acknowledged that "modification under § 1329 has its limits, . . . [and] [i]f an unexpected event occurs late in the life of the debtor's plan, the debtor may be without recourse." 622 B.R. 859, 862 n.1 (Bankr. E.D. La. 2020). Although Mr. Ramos argues that a plain reading of § 1329(c) would work as a retroactive denial of his earlier plan-period extension under § 1329(d), applying the restrictions of § 1329(c) now does not equate to going back in time and denying the prior extension. Mr. Ramos's current request to modify his plan is a new development that now leaves him "with little recourse."

debtor to modify a confirmed plan to "increase or reduce the amount of payments on claims of a particular class provided for by the plan," subsection (a) is but one part of that statutory section. Another part, subsection (c), must be read in the conjunctive—that is, as a limitation—on modifications allowed by § 1329(a) because it refers to all modifications under this *section*:

> A plan modified under this section may not provide for payments over a period that expires after the applicable commitment period under section 1325(b)(1)(B) after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, but the court may not approve a period that expires after five years after such time.

11 U.S.C. § 1329(c).

C. Applying § 1329(c) to CARES Act plans does not result in a manifest injustice.

Finally, the Chapter 13 trustees contend that interpreting § 1329(c) to require a previously extended plan period to be reduced to 60 months would "result in a limitation constituting a manifest injustice." They cite *In re Gentry*, Case No. 15-20990-BEH, 2020 WL 2479662, at *4, 2020 Bankr. LEXIS 1265, at *11-12 (Bankr. E.D. Wis. May 13, 2020), generally for avoidance of manifest injustice.

This argument is undeveloped. The concept of "manifest injustice" discussed in *Gentry* concerned revisiting a prior decision that was clearly erroneous and where failure to correct it would result in a manifest injustice. The Chapter 13 trustees are not seeking reconsideration of a prior order, nor do they argue that any prior orders of the Court were clearly erroneous. Consequently, this argument is unavailing. *See Tyler v. Runyon*, 70 F.3d 458, 464 (7th Cir. 1995) ("[A] litigant who fails to press a point by supporting it with pertinent authority, or by showing why it is sound despite a lack of supporting authority, forfeits the point.") (internal quotation marks omitted).

CONCLUSION AND ORDER

While the Court recognizes the frustration of these CARES Act debtors who seek further modifications after the temporary window of § 1329(d) has closed, the plain language of that sunset provision and the plain language of on-going § 1329(c) require this Court to apply them as written.

Accordingly,

IT IS THEREFORE ORDERED that the Chapter 13 trustee's objection to confirmation of debtor Randall Nelson's June 13, 2022 request to modify his confirmed plan is sustained, with the requirement that the debtor file a modified feasible plan that complies with 11 U.S.C. § 1329(c), as interpreted by this Court, no later than **30 days from the date of this order.**

IT IS FURTHER ORDERED that debtor Wilfredo Ramos's July 11, 2022 request to modify his confirmed Chapter 13 plan is DENIED.

Dated: October 11, 2022

By the Court:

Beth E. Hanan
United States Bankruptcy Judge

ANNUAL BANKRUPTCY ROUNDUP

Written by: Mark S. Zuckerberg
Amanda K. Quick

I. U.S. SUPREME COURT CASES

***TransUnion LLC v. Ramierz*, 141 S.Ct. 2190, 210 L.Ed.2d 568 (2021)**

Class of 8,185 consumers with alerts in their credit files maintained by credit reporting agency, indicating that the consumer's name was a “potential match” to a name on a list maintained by the United States Treasury Department's Office of Foreign Assets Control (OFAC) of terrorists, drug traffickers, and other serious criminals, brought action against agency under the Fair Credit Reporting Act (FCRA), alleging that agency failed to use reasonable procedures to ensure the accuracy of their credit files, that for 1,853 of the class members, agency provided misleading credit reports to third-party businesses, and that certain mailings sent to them by agency contained formatting defects. A trial was held, after which jury returned a verdict in consumers' favor, awarding statutory and punitive damages of more than $60 million for three willful violations of the statute. Agency moved for judgment as matter of law, or in the alternative, for a new trial, remittitur, or an amended judgment. The District Court ruled that all class members had Article III standing on each of the three statutory claims. The jury returned a verdict for the plaintiffs and awarded each class member statutory damages and punitive damages. A divided panel of the Ninth Circuit affirmed in relevant part.

Certiorari was subsequently granted, and the Supreme Court held that only the plaintiffs concretely harmed by a defendant's statutory violation had Article III standing to seek damages against the private defendant in federal court. Article III confines the federal judicial power to the resolution of “Cases” and “Controversies” in which a plaintiff has a “personal stake.” To have Article III standing to sue in federal court, a plaintiff must show, among other things, that the plaintiff suffered concrete injury in fact. Central to assessing concreteness is whether the asserted harm has a “close relationship” to a harm “traditionally” recognized as providing a basis for a lawsuit in American courts. That inquiry asks whether plaintiffs have identified a close historical or common-law analogue for their asserted injury. Physical or monetary harms readily qualify as concrete injuries under Article III, and various intangible harms—like reputational harms—can also be concrete.

“Article III standing requires a concrete injury even in the context of a statutory violation.” The Court has rejected the proposition that “a plaintiff automatically satisfies the injury-in-fact requirement whenever a statute grants a person a statutory right and purports to authorize that person to sue to vindicate that right.” An injury in law is not an injury in fact.

The Court applied the fundamental standing requirement of concrete harm to this case. In their reasonable-procedures claim, all 8,185 class members maintained that TransUnion did not do enough to ensure that misleading OFAC alerts labeling them as potential terrorists were not included in their credit files. See § 1681e(b). TransUnion provided third parties with credit reports containing OFAC alerts for 1,853 class members (including the named plaintiff Ramirez). Those 1,853 class members therefore suffered a harm with a "close relationship" to the harm associated with the tort of defamation. Under longstanding American law, a person is injured when a defamatory statement "that would subject him to hatred, contempt, or ridicule" is published to a third party. The Court had no trouble concluding that the 1,853 class members suffered a concrete harm that qualifies as an injury in fact

The credit files of the remaining 6,332 class members also contained misleading OFAC alerts, but the parties stipulated that TransUnion did not provide those plaintiffs' credit information to any potential creditors during the designated class period. The mere existence of inaccurate information, absent dissemination, traditionally has not provided the basis for a lawsuit in American courts. The plaintiffs could not demonstrate that the misleading information in the internal credit files itself constitutes a concrete harm.

The plaintiffs advanced a separate argument based on their exposure to the risk that the misleading information would be disseminated in the future to third parties. The Court has recognized that material risk of future harm can satisfy the concrete-harm requirement in the context of a claim for injunctive relief to prevent the harm from occurring, at least so long as the risk of harm is sufficiently imminent and substantial. But TransUnion advanced a persuasive argument that the mere risk of future harm, without more, cannot qualify as a concrete harm in a suit for damages. The 6,332 plaintiffs did not demonstrate that the risk of future harm materialized. Nor did those plaintiffs present evidence that the class members were independently harmed by their exposure to the risk itself. The risk of future harm could not supply the basis for their standing.

In two other claims, all 8,185 class members complained about formatting defects in certain mailings sent to them by TransUnion. But the plaintiffs did not demonstrate that the format of TransUnion's mailings caused them a harm with a close relationship to a harm traditionally recognized as providing a basis for a lawsuit in American courts.

The plaintiffs argued that TransUnion's formatting violations created a risk of future harm, because consumers who received the information in the dual-mailing format were at risk of not learning about the OFAC alert in their credit files and thus not asking for corrections. The risk of future harm on its own was not enough to support Article III standing for their damages claim. In any event, the plaintiffs here made no effort to explain how the formatting error prevented them asking for corrections to prevent future harm.

The United States as *amicus curiae* asserted that the plaintiffs suffered a concrete "informational injury" from TransUnion's formatting violations. But the plaintiffs here did not allege that they failed to receive any required information. They argued only that they received the information in the wrong format. Moreover, an asserted informational injury that causes no adverse effects does not satisfy Article III.

***City of Chicago v. Fulton*, 141 S.Ct. 585, 208 L.Ed.2d 384 (2021)**

Under 11 U.S.C. § 541(a), the filing of a petition under the Bankruptcy Code automatically creates an estate that, with some exceptions, comprises "all legal or equitable interests of the debtor in property as of the commencement of a case." The filing of a bankruptcy petition also automatically "operates as a stay, applicable to all entities," of efforts to collect prepetition debts outside the bankruptcy forum under 11 U.S.C. §362(a). This includes "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate. 11 U.S.C. § 362(a)(3).

In this case, each debtor-respondent filed for bankruptcy relief and requested the City of Chicago to return his or her vehicle, which had been impounded pre-petition for failure to pay parking tickets and other fines for motor vehicle infractions. In each case, the City of Chicago's refusal to return the vehicle was held by the bankruptcy court to violate the automatic stay. The Seventh Circuit affirmed, concluding that by retaining possession of the vehicles the City of Chicago had acted "to exercise control over" respondents' property in violation of 11 U.S.C. § 362(a)(3).

In a unanimous opinion, the Supreme Court held that an entity's mere retention of estate property after the filing of a bankruptcy petition does not constitute an act to exercise control over property of the estate in violation of the Bankruptcy Code's automatic stay. The judgment of the 7th Circuit Court of Appeals was vacated, and the case was remanded.

II. CHAPTER 13 CASES

***In re Foust*, 636 B.R. 788 (N.D. Ind. 2022)**

District court held that clerk's office receipt of the proof of claim after the deadline meant that the filing was untimely. "The filing deadlines for proofs of claim in Chapter 13 bankruptcy cases are as rigid as a schoolmarm. Unlike run-of-the-mill litigation, Chapter 13 proceedings have a lot of moving parts. There is both a legal and burdensome administrative component to processing a Chapter 13 petition." The proof of claim "filing is either timely or it is not. To hold otherwise would be to introduce substantial uncertainty into an already complicated endeavor." The district court's general order authorizing filing upon mailing in its own proceedings did not mention or apply to the bankruptcy court. The general order could not supercede Bankruptcy Rule 3002. Even if it did, the postmarked date is the date stamped by the postal service; its postmark trumps the private meter postmark. "A lot of things get blamed on COVID-19 these days. [Creditor's] missed deadline can't be one of them."

***In re Carter*, 638 B.R. 379 (Bankr. N.D. Ill. 2022)**

In 56th month of plan, Chapter 13 trustee filed motion to dismiss case for failure of debtor to comply with tax-turnover requirement of confirmation order. Debtor filed motion to modify plan to allow it to complete without further payment. In siding with the debtor, the bankruptcy court found that the debtor did turnover all his tax returns. Although he received refunds totaling $31,129, the funds were never turned over to the trustee. The trustee had filed motions to dismiss earlier in the case for failure to turnover returns and refunds, but mistakenly withdrew them once it got the returns although the refunds were never paid. The court denied the trustee's motion on the basis of the Court's inherent power under 11 U.S.C. § 105(a) to forgive the tax refund provision. The court also granted relief under Rule 60(b)(5) for equitable grounds.

***In re Cordova*, 635 B.R. 321 (Bankr. N.D. Ill. 2021)**

Debtors whose vehicles had been impounded prepetition by city for unpaid vehicle infraction fines brought putative class action, alleging that city violated the automatic stay and turnover provisions in the Bankruptcy Code by not returning their vehicles when they filed for Chapter 13 bankruptcy. City filed motion to dismiss adversary proceeding. The bankruptcy court denied the majority of the city's motion where debtors in a putative class action alleged damages under 11 U.S.C. §§ 362(a)(4), (6) and 542(a) where city pre-*Fulton* demanded secured claims and money before agreeing to give back impounded cars. The court held that *Fulton* only decided § 362(a)(3), and that there may be a possibility of a claim under § 362(a)(4) or (6). Finally, the court rejected the city's argument that § 542(a) requires an adversary for turnover, and rules it is "self-executing" and a creditor has an "express statutory obligation" to return the vehicle.

III. DISCHARGEABILITY

***Osicka v. Office of Lawyer Regulation*, 25 F.4th 501 (7th Cir. 2021)**

Debtor-attorney challenged bankruptcy court's ruling that costs of his attorney disciplinary proceedings imposed by the Wisconsin Supreme Court were not dischargeable under 11 U.S.C. § 523(a)(7) as a fine, penalty or forfeiture. District court upheld the ruling and the 7th Circuit affirmed. Operating expenses to pursue disciplinary investigation were not an actual pecuniary loss for purposes of this exception to discharge. A pecuniary loss results from the destruction of property, a loss of money or something having monetary value, or a dimunition in value due to damage to something of value. Budgeted operating expenses did not fall into those categories. The cost order was akin to a sanction that federal courts impose on vexatious litigants which also survive bankruptcy. Section 523(a)(7) prevented discharge of the cost order because it was a punishment and did not make the disciplinary committee whole for actual loss.

***Matter of Mance*, 31 F.4th 768 (7th Cir. 2022)**

This appeal is a continuation in the long-term effort by the City of Chicago to collect parking fines and other traffic fees from drivers who seek bankruptcy protection. Some of the City's tactics have worked and others have not. *See In re Fulton,* 926 F.3d 916, 924 (7th Cir. 2019) (City's refusal to turn over vehicles to petitioners during bankruptcy proceedings violated automatic stay); *City of Chicago v. Fulton,* 141 S. Ct. 585 (2021); *In re Steenes,* 942 F.3d 834, 839 (7th Cir. 2019) (vehicular tickets incurred during course of a Chapter 13 bankruptcy are administrative expenses that must be paid in full). The issue in this appeal is whether the City's possessory lien on a vehicle that it impounds due to unpaid tickets should be deemed a "judicial lien" or a "statutory lien" under the Bankruptcy Code. If the lien is judicial, all parties agreed, it is avoidable in bankruptcy under 11 U.S.C. § 522(f). Alternatively, if the lien is instead deemed statutory.

The 7th Circuit agreed with the bankruptcy and district courts that the City's possessory lien on impounded vehicles was properly classified as judicial and therefore avoidable. The classification of a lien as statutory or judicial depends upon the events that must occur before the lien attaches. The pertinent inquiry is what is necessary for the lien to arise. A statutory lien arises "solely" because specific conditions are met. A judicial lien requires some type of legal process, judgment, levy or sequestration. The quasi-judicial procedures the City of Chicago had to go through in order to authorize the impoundment of the vehicle made it a judicial lien, *e.g.* a lien obtain by other legal or equitable process or proceedings.

***In re Harshaw*, 26 F.4th 768 (7th Cir. 2022)**

Debtor and his ex-wife agreed to binding arbitration in their divorce proceedings. In an unusual arbitration award, the arbitrator awarded ex-wife $435,000, plus post-judgment interest, which represented a portion of the debtor's retirement savings. Debtor subsequently filed bankruptcy and argued that the award was one for a money judgment and thus subject to discharge. His ex-wife opposed his claim, arguing that the arbitrator had awarded her an interest in specific property. The bankruptcy court sided with the ex-wife and the district court reversed. The 7th Circuit agreed and affirmed its judgment. The arbitration award could be satisfied either through an assignment of retirement benefits, by a Qualified Domestic Relations Order, and/or any other manner acceptable to the parties. Thus, it was a dischargeable money judgment. The award did not contain property-division language, post-judgment interest is applicable only to money judgments and not awards of property interests, and the obligor was able to choose the manner in which he would satisfy the award. The award specified it was not dischargeable, however this was not controlling as federal law governs what is and is not dischargeable.

IV. SANCTIONS

***Kemp v. United States*, 142 S.Ct. 1856, 213 L.Ed.2d 90 (June 13, 2022)**

A judge's errors of law are considered mistakes under Federal Rule of Civil Procedure 60(b)(1) which allows relief from a final judgment due to "mistake, inadvertence, surprise, or excusable neglect." The applicability of Federal Rule of Civil Procedure 60(b)(6), which is "for any other reason that justifies relief," is available only when Rules 60(b)(1) through (b)(5) do not apply.

***In re Cook Medical Inc.*, 27 F.4th 539 (7th Cir. 2022)**

"Rule 60(c) embodies a mandatory claims-processing rule, not one limiting a district court's subject matter jurisdiction." However, it must be enforced if the rule is properly invoked. Federal Rule of Civil Procedure 60(b)(1) for excusable neglect and Rule 60(b)(6) for any other reason that justifies relief, are "mutually exclusive, such that a party who failed to take timely action due to 'excusable neglect' may not seek relief more than a year after the judgment by resorting to subsection (6)."

V. MISCELLANEOUS

***Archer-Daniels-Midland Co. v. Country Visions Co-Op*, 29 F.4th 956 (7th Cir. 2022)**

Country Visions held a right of first refusal on real estate purchased, free and clear of all interests, pursuant to a confirmed chapter 11 plan in 2011. However, it was not scheduled as a creditor or made a party to the bankruptcy proceedings, and the bankruptcy court was never told about its interest in the property. When the purchaser subsequently attempted to sell the property to a third party, Country Visions sued in state court seeking compensation for the violation of its right of first refusal. The purchaser then sought to reopen the bankruptcy case to enforce "free-and-clear sale" aspect of debtors' plan and confirmation in order to bar the state-court lawsuit. It based the request on 11 U.S.C. § 363(m) which provides that, without a stay, the validity of a sale to a good faith purchaser is not affected by reversal or modification of the sale order on appeal.

The language of 11 U.S.C. § 363(m) "has been read broadly to protect the interests of any good-faith purchaser." The court concluded "that someone who has both actual and constructive knowledge of a competing interest, yet permits the sale to proceed without seeking the judge's assurances that the competing interest-holder may be excluded from the proceedings, is not acting in good faith." The purchaser had constructive knowledge of both the recorder right and through a title search. As such, the 7th Circuit held that the purchaser was not a good-faith purchaser and thus not entitled to protection under 11 U.S.C. § 363. *Cf. Matter of Chicago, Rock Island and Pacific Railroad Co.*, 794 F.2d 1182 (7th Cir. 1986) ("That some land was once owned by a bankrupt does not supply federal jurisdiction of disputes concerning the land…").

***In re Ramirez*, 2022 WL 168204 (Bankr. N.D. Ind. 2022) & *In re Chandler*, 2022 WL 168205 (Bankr. N.D. Ind. 2022)**

Chapter 7 debtor was not *ipso facto* entitled to unclaimed funds deposited with the bankruptcy court for the benefit of a creditor that did not cash its distribution check. "The unclaimed funds deposited by the trustee in the court's registry fund are held in trust for the person legally entitled to the same. Unclaimed funds do not become 'surplus funds' when they are not claimed by a creditor who did not cash the check. The creditor retains a property interest in the unclaimed funds."

***Consumer Financial Protection Bureau v. Consumer First Legal Group, LLC*, 6 F.4th 694 (7th Cir. 2021)**

Several bankruptcy attorneys established a company which advertised as a national law firm that provided high-volume, national mortgage-assistance relief services. The majority of the work was completed by 30-40 "intake specialists" that would work with clients while reading from a script. In-house lawyers would listen to a brief portion of the calls, but the intake specialists were largely responsible for the services provided. The modification agreements would then be forwarded to local counsel who would conduct a "perfunctory" review of the documents. The Consumer Financial Protection Bureau brought a civil enforcement action against the company, and the company argued that it was engaged in the practice of law and therefore beyond the

Bureau's authority. The district court disagreed and ordered the company to pay $21.7 million in restitution. It also barred the bankruptcy attorneys from providing "debt relief services."

Although not a bankruptcy case, the Seventh Circuit applied the definition of the "practice of law" that is used in the bankruptcy arena. Attorneys "licensed in an d operating out of one state . . . are entitled to advise clients in other states in which they are not licensed, so long as they affiliate themselves with local counsel." It adopted the district court's definition of "practicing law," *e.g.* a lawyer is practicing law if the lawyer's work involves "[t]he application of legal principles and judgment to a particular set of facts." Accordingly, the Seventh Circuit held the attorneys were not "practicing law" since their work was perfunctory, opposed to substantive. The company was therefore subject to the Bureau's authority, but the case was remanded in order to recalculate the sanctions.

***Ocwen Loan Servicing, LLC v. Chambliss*, 166 N.E.3d 926 (Ind. Ct. App. 2021)**

Eight (8) years after homeowner completed her Chapter 13 bankruptcy plan, she filed a quiet title action against the mortgage refinancing company which owner her mortgage. The debtor argued that her Chapter 13 bankruptcy discharge had extinguished her mortgage. The lender alleged the mortgage was still valid because the debtor continued making payments on it after the discharge and negotiated to modify the loan. The superior court granted the debtor's motion and the company appealed. The court of appeals held that the bankruptcy court, not the state court, was the proper forum for the debtor's quiet title action and ultimately the determination as to whether the mortgage was discharged. The court opined that it is not the purpose or function of a state court to construe bankruptcy laws. Bankruptcy law is exclusively federal, and therefore it must be left for the bankruptcy courts to decide.

Section Three

Update From the United States Trustee

Nancy J. Gargula
United States Trustee, Region 10
Indianapolis, Indiana

Section Three

ICLEF Ancel Bankruptcy Institute

UPDATE FROM THE UNITED STATES TRUSTEE

Nancy J. Gargula, United States Trustee

December 22, 2022

Update From the U.S. Trustee

STAFFING AND TRUSTEE UPDATES

Update From the U.S. Trustee

- **ACTING DIRECTOR, EOUST RAMONA ELLIOTT**
- **SOUTH BEND TRIAL ATTORNEY BRIAN TUINENGA**
- **INDIANAPOLIS TRIAL ATTORNEY MATTHEW MILLER**

Update From the U.S. Trustee

- CH 7 TEE DOUGLAS ADELSPERGER
- CH 7 TEE LORI FISHER
- CH 7 TEE TASHA REED OUTLAW
- CH 7 TEE CHRIS SCHMIDGALL

Update From the U.S. Trustee

- CH 7 TEE SARAH FOWLER
- CH 7 TEE CHRISTINE JACOBSON
- CH 7 TEE NICALE RECTOR

Update From the U.S. Trustee

PANDEMIC PIVOT and RETURN TO OFFICE

Update From the U.S. Trustee

AMERICAN RESCUE ACT OF 2021

Update From the U.S. Trustee

BANKRUPTCY THRESHOLD ADJUSTMENT AND TECHNICAL CORRECTIONS ACT

Update From the U.S. Trustee

NEW LANGUAGE INTERPRETER –

AD ASTRA

ETHICAL AND LEGAL CONSIDERATIONS OF PRACTICING LAW IN A HYBRID ENVIRONMENT

RULES OF PROFESSIONAL CONDUCT

Rule 1.1 Competence

Rule 1.2. Scope of Representation and Allocation of Authority

Rule 1.3 Diligence

Rule 1.5 Fees

Rule 1.6 Confidentiality

Update From the U.S. Trustee

RULES OF PROFESSIONAL CONDUCT

Rule 1.7 Conflicts of Interest

Rule 1.15. Safekeeping Property

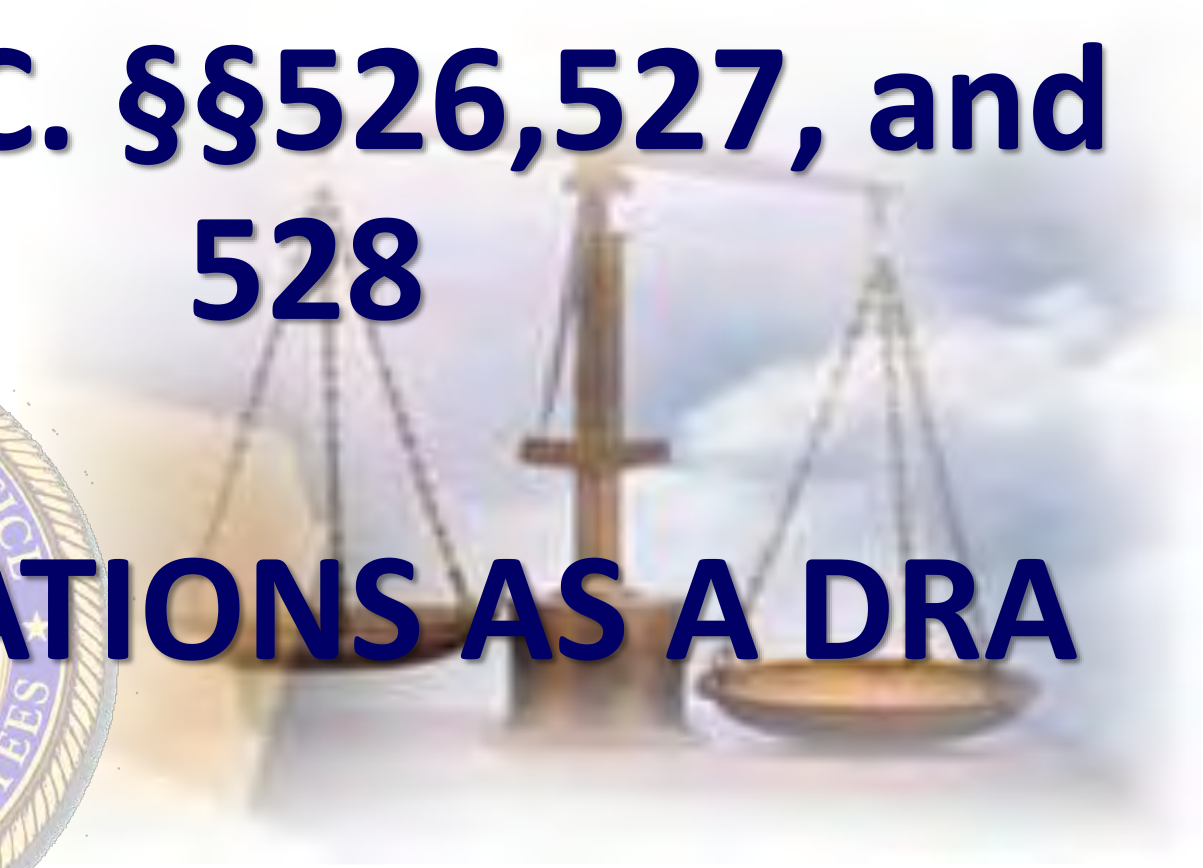
Rule 3.3 Candor Toward the Tribunal

Rule 4.1 Truthfulness in Statements Made to Others

Rule 5.3 Responsibilities Regarding Non-Lawyer Assistance

Update From the U.S. Trustee

11 U.S.C. §§526,527, and 528



OBLIGATIONS AS A DRA

Update From the U.S. Trustee

ATTESTATION OF COUNSEL

SECTION 707(b)(4)

RULE 9011

Update From the U.S. Trustee

FUTURE OF 341 MEETINGS – VIDEO 341 MEETINGS

Update From the U.S. Trustee

PROFESSIONAL AND ETHICAL CONSIDERATIONS OF VIDEO §341 MEETINGS

Update From the U.S. Trustee

CYBER
FRAUD UPDATE

Update From the U.S. Trustee

ETHICAL CONSIDERATIONS RELATED TO CYBERFRAUD THREATS

Update From the U.S. Trustee

UNDER-PERFORMING CONSUMER ATTORNEYS

UNDER-PERFORMING CONSUMER ATTORNEYS (cont'd)

Update From the U.S. Trustee

USTP BIFURCATION AGREEMENT GUIDELINES

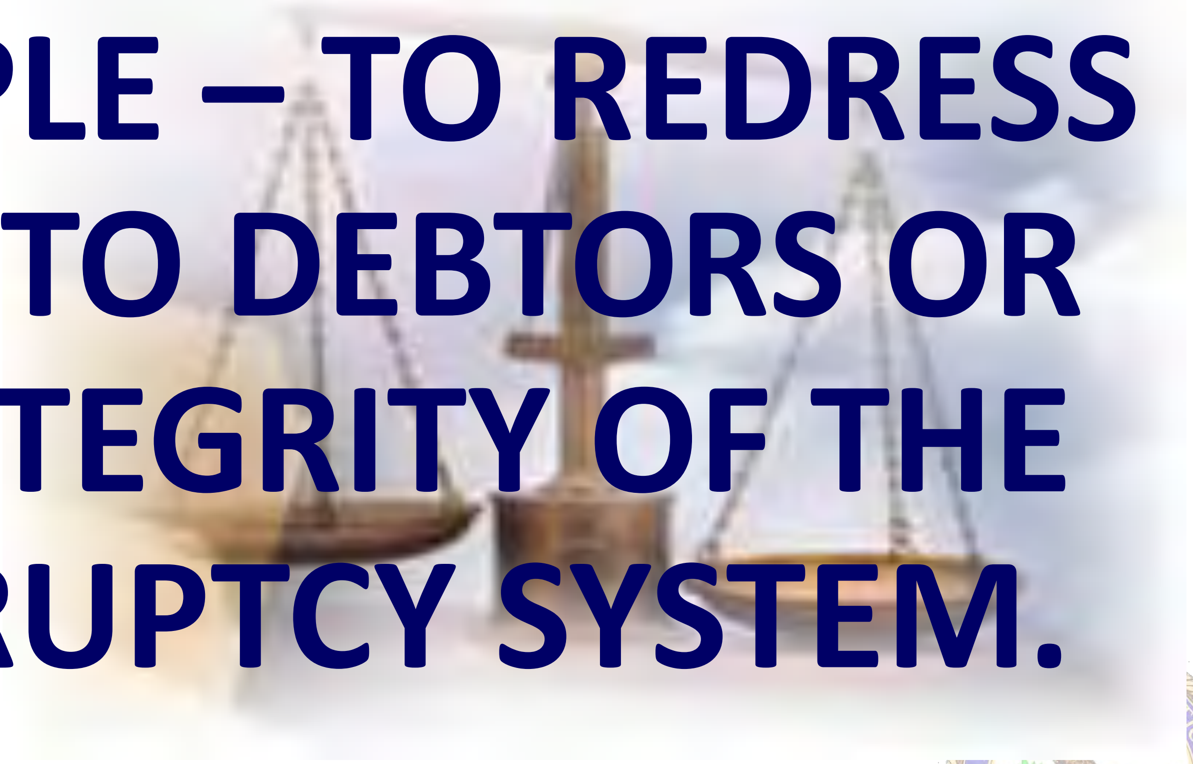
USTP POSITION: PERMISSIBLE PROVIDED 3 CRITERIA ARE MET

CRITERIA #1
FEES MUST BE FAIR AND REASONABLE

CRITERIA #2:

ADEQUATE DISCLOSURES TO CLIENTS AND INFORMED CONSENT BY CLIENTS

CRITERIA #3:
SUFFICIENT PUBLIC DISCLOSURES RELATED TO THE FEE AGREEMENT



USTP GUIDING PRINCIPLE – TO REDRESS HARM TO DEBTORS OR THE INTEGRITY OF THE BANKRUPTCY SYSTEM.

Update From the U.S. Trustee

USTP CRIMINAL REFERRAL REPORT TO CONGRESS FY2021

Update From the U.S. Trustee

UPDATE ON THE U.S. TRUSTEE'S EFFORTS TO PROTECT THE INTEGRITY OF THE BANKRUPTCY SYSTEM

Update From the U.S. Trustee

SBRA UPDATES

- USTP POSITIONS ON SELECT LEGAL ISSUES
- PUBLIC REPORTS

Update From the U.S. Trustee

UPDATES ON THE NEW MORs AND PCRs

Update From the U.S. Trustee

QUESTIONS?

ICLEF Ancel Bankruptcy Institute

UPDATE FROM THE UNITED STATES TRUSTEE

Nancy J. Gargula, United States Trustee

December 22, 2022

OVER THE PHONE INTERPRETATION
DEPARTMENT OF JUSTICE

OPI Languages

Acehnese	On Demand 24/7	**Azerbaijani**	On-Demand 24/7
Achi (Rabinal, Calbulco)	Hold times may vary	**Azeri (Cyrillic)**	Hold times may vary
Acoli	On-Demand 24/7	**Azeri (Latin)**	Hold times may vary
Aderi	Hold times may vary	**Azeri (Turkish)**	Hold times may vary
African Creole (Krahn)	Hold times may vary	**Badini**	On-Demand 24/7
Afrikaans	Hold times may vary	**Bahasa (Malaysian)**	Hold times may vary
Aguateco	Hold times may vary	**Bajuni**	Hold times may vary
Akan	On-Demand 24/7	**Balochi**	Hold times may vary
Akateko	Hold times may vary	**Bamanankan**	Hold times may vary
Albanian	On-Demand 24/7	**Bambara**	Hold times may vary
Algerian	Hold times may vary	**Basa Sunda**	On-Demand 24/7
Amharic	On-Demand 24/7	**Bashkir**	Hold times may vary
Anuak	Hold times may vary	**Basque (Euskera)**	Hold times may vary
Arabic	On-Demand 24/7	**Bassa**	Hold times may vary
Arakanese	Hold times may vary	**Belarusian**	Hold times may vary
Aramaic	Hold times may vary	**Bengali**	On-Demand 24/7
Armenian	Hold times may vary	**Berber**	Hold times may vary
Asante	Hold times may vary	**Bosnian**	On-Demand 24/7
Ashanti	On-Demand 24/7	**Breton**	Hold times may vary
Assamese	Hold times may vary	**Bulgarian**	On-Demand 24/7
Assyrian	Hold times may vary	**Burmese**	On-Demand 24/7

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

www.ad-astrainc.com

OVER THE PHONE INTERPRETATION

DEPARTMENT OF JUSTICE

OPI Languages

Croatian	On-Demand 24/7	**French-Albanian**	Hold times may vary
Czech	On-Demand 24/7	**French-Arabic**	Hold times may vary
Danish	Hold times may vary	**French-Italian**	Hold times may vary
Dari	On-Demand 24/7	**French-Spanish**	Hold times may vary
Diola	Hold times may vary	**Frisian**	Hold times may vary
Dinka	Hold times may vary	**Fukienese Chinese**	Hold times may vary
Divehi	Hold times may vary	**Fulani**	Hold times may vary
Dutch	Hold times may vary	**Fuqing**	On-Demand 24/7
Dyula	Hold times may vary	**Fuzhou**	Hold times may vary
Edo	Hold times may vary	**Ga**	On-Demand 24/7
Estonian	Hold times may vary	**Galician**	Hold times may vary
Ethiopian	Hold times may vary	**Garre**	Hold times may vary
Ewe	Hold times may vary	**Georgian**	Hold times may vary
Falam Chin	On-Demand 24/7	**German**	On-Demand 24/7
Fante	Hold times may vary	**Ghulfan (Arabic)**	Hold times may vary
Farsi	On-Demand 24/7	**Greek**	On-Demand 24/7
Filipino (Tagalog)	On-Demand 24/7	**Greenlandic**	Hold times may vary
Finnish	Hold times may vary	**Guarani**	Hold times may vary
Flemish	Hold times may vary	**Guere**	Hold times may vary
French	On-Demand 24/7	**Guinea-Bissau Creole**	Hold times may vary
French Canadian	On-Demand 24/7	**Gujarati**	Hold times may vary
French Creole	On-Demand 24/7	**Hainanese**	Hold times may vary

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

www.ad-astrainc.com

OVER THE PHONE INTERPRETATION
DEPARTMENT OF JUSTICE

OPI Languages

Haitian Creole	On-Demand 24/7	**Japanese**	On-Demand 24/7
Hakha Chin	Hold times may vary	**Jawanese**	Hold times may vary
Hakka Chinese	Hold times may vary	**Jiangsu**	Hold times may vary
Hassaniya Arabic	Hold times may vary	**Jola-Fonyi**	On-Demand 24/7
Hausa	Hold times may vary	**Jordanian**	Hold times may vary
Hebrew	Hold times may vary	**Kabiye**	On-Demand 24/7
Hindi	On-Demand 24/7	**Kachin**	Hold times may vary
Hmong	On-Demand 24/7	**Kannada**	Hold times may vary
Hunan	On-Demand 24/7	**Kaqchikel**	Hold times may vary
Hungarian	On-Demand 24/7	**Karen**	On-Demand 24/7
Igbo	Hold times may vary	**Karenni (Kayah)**	On-Demand 24/7
Ilocano	Hold times may vary	**Karen Pow**	Hold times may vary
Ilonggo	Hold times may vary	**Kazakh**	Hold times may vary
Indonesian	On-Demand 24/7	**Khmer (Cambodian)**	On-Demand 24/7
Inuktitut	Hold times may vary	**Kibajuni**	On-Demand 24/7
Iranian Farsi	On-Demand 24/7	**K'iche**	Hold times may vary
Irish	Hold times may vary	**Kikongo**	Hold times may vary
Isixhosa	Hold times may vary	**Kikuyu**	Hold times may vary
Isizulu	Hold times may vary	**Kinkani**	Hold times may vary
Italian	On-Demand 24/7	**Kinyamulenge**	On-Demand 24/7
Italian-Romanian	Hold times may vary	**Kinyarwanda**	On-Demand 24/7
Jakaltek	Hold times may vary	**Kirghiz**	Hold times may vary

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

www.ad-astrainc.com

OPI Languages

Kirundi	On-Demand 24/7	**Loma (Liberian)**	Hold times may vary
Kiswahili	On-Demand 24/7	**Lower Sorbian**	Hold times may vary
Kituba	Hold times may vary	**Luganda**	On-Demand 24/7
Korean	On-Demand 24/7	**Luo**	On-Demand 24/7
Kosraean	Hold times may vary	**Luxembourgish**	Hold times may vary
Kotokoli	Hold times may vary	**Maay Maay**	On-Demand 24/7
Kpelle	Hold times may vary	**Macedonian**	On-Demand 24/7
Krahn	Hold times may vary	**Madi**	Hold times may vary
Krio	Hold times may vary	**Malay**	Hold times may vary
Kunama	Hold times may vary	**Malayalam**	Hold times may vary
Kurdish	On-Demand 24/7	**Malaysian**	On-Demand 24/7
Kurdish (Bahdini)	Hold times may vary	**Maldivian**	Hold times may vary
Kurdish (Kurman)	Hold times may vary	**Malinke**	Hold times may vary
Kurdish (Sorani)	Hold times may vary	**Maltese**	Hold times may vary
Kurmanji	On-Demand 24/7	**Mam**	Hold times may vary
Kyrgyz	Hold times may vary	**Mandarin**	On-Demand 24/7
Laotian	On-Demand 24/7	**Mandingo**	On-Demand 24/7
Latvian	Hold times may vary	**Mandinka**	Hold times may vary
Lebanese (Arabic)	Hold times may vary	**Maori**	Hold times may vary
Leta	Hold times may vary	**Mapudungun**	Hold times may vary
Lingala	On-Demand 24/7	**Mara Chinn**	Hold times may vary
Lithuanian	On-Demand 24/7	**Marathi (Indian)**	Hold times may vary

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

OVER THE PHONE INTERPRETATION
DEPARTMENT OF JUSTICE

OPI Languages

Kirundi	On-Demand 24/7	**Loma (Liberian)**	Hold times may vary
Kiswahili	On-Demand 24/7	**Lower Sorbian**	Hold times may vary
Kituba	Hold times may vary	**Luganda**	On-Demand 24/7
Korean	On-Demand 24/7	**Luo**	On-Demand 24/7
Kosraean	Hold times may vary	**Luxembourgish**	Hold times may vary
Kotokoli	Hold times may vary	**Maay Maay**	On-Demand 24/7
Kpelle	Hold times may vary	**Macedonian**	On-Demand 24/7
Krahn	Hold times may vary	**Madi**	Hold times may vary
Krio	Hold times may vary	**Malay**	Hold times may vary
Kunama	Hold times may vary	**Malayalam**	Hold times may vary
Kurdish	On-Demand 24/7	**Malaysian**	On-Demand 24/7
Kurdish (Bahdini)	Hold times may vary	**Maldivian**	Hold times may vary
Kurdish (Kurman)	Hold times may vary	**Malinke**	Hold times may vary
Kurdish (Sorani)	Hold times may vary	**Maltese**	Hold times may vary
Kurmanji	On-Demand 24/7	**Mam**	Hold times may vary
Kyrgyz	Hold times may vary	**Mandarin**	On-Demand 24/7
Laotian	On-Demand 24/7	**Mandingo**	On-Demand 24/7
Latvian	Hold times may vary	**Mandinka**	Hold times may vary
Lebanese (Arabic)	Hold times may vary	**Maori**	Hold times may vary
Leta	Hold times may vary	**Mapudungun**	Hold times may vary
Lingala	On-Demand 24/7	**Mara Chinn**	Hold times may vary
Lithuanian	On-Demand 24/7	**Marathi (Indian)**	Hold times may vary

ad astra

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

www.ad-astrainc.com

OPI Languages

Marshallese	Hold times may vary	**Nuer**	Hold times may vary
Masalit	Hold times may vary	**Occitan**	Hold times may vary
Matu Chin	Hold times may vary	**Oriya**	Hold times may vary
Mbay	Hold times may vary	**Oromifa**	Hold times may vary
Mende	Hold times may vary	**Oromo**	On-Demand 24/7
Micronesian Pohnpheian	Hold times may vary	**Pahari**	On-Demand 24/7
Mien	On-Demand 24/7	**Palau**	Hold times may vary
Mina (Togolese)	Hold times may vary	**Pampango**	Hold times may vary
Mirpuri	Hold times may vary	**Pangasinan**	Hold times may vary
Mixteco Alto	Hold times may vary	**Papamiento**	Hold times may vary
Mizo (Chinn)	Hold times may vary	**Pashto**	On-Demand 24/7
Mohawk	Hold times may vary	**Patois (Jamaican)**	Hold times may vary
Moldovian	On-Demand 24/7	**Persian**	On-Demand 24/7
Mongolian	On-Demand 24/7	**Pidgin**	Hold times may vary
Montenegrin	Hold times may vary	**Pohnpheian**	Hold times may vary
Mushunguli	Hold times may vary	**Polish**	On-Demand 24/7
Navajo	Hold times may vary	**Portuguese (Brazilian)**	On-Demand 24/7
Neapolitan	On-Demand 24/7	**Portuguese (Continental)**	On-Demand 24/7
Nepali	On-Demand 24/7	**Portuguese Creole**	Hold times may vary
Nigerian	On-Demand 24/7	**Pulaar**	Hold times may vary
Ningbo	Hold times may vary	**Punjabi**	On-Demand 24/7
Norwegian	Hold times may vary	**Q'anjob'al**	Hold times may vary

ad astra

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

OVER THE PHONE INTERPRETATION
DEPARTMENT OF JUSTICE

OPI Languages

Qeqchi	Hold times may vary	**Slovak**	On-Demand 24/7
Quechua	Hold times may vary	**Slovenian**	Hold times may vary
Quiche	Hold times may vary	**Smi (Skolt)**	Hold times may vary
Rahkine	Hold times may vary	**Smi (Southern)**	Hold times may vary
Rohingya	On-Demand 24/7	**Somali**	On-Demand 24/7
Romanian	On-Demand 24/7	**Soninke**	Hold times may vary
Russian	On-Demand 24/7	**Sorani**	On-Demand 24/7
Sami (Inari)	Hold times may vary	**Sotho**	Hold times may vary
Sami (Lule)	Hold times may vary	**Spanish**	On-Demand 24/7
Sami (Northern)	Hold times may vary	**Spanish-Italian**	Hold times may vary
Samoan	On-Demand 24/7	**Spanish-Portuguese**	Hold times may vary
Sango	Hold times may vary	**Spanish-Romanian**	Hold times may vary
Sanskrit	Hold times may vary	**Sri Lankan (Tamil)**	On-Demand 24/7
Saraiki	Hold times may vary	**Sudanese Arabic Creole**	On-Demand 24/7
Scottish Gaelic	Hold times may vary	**Swahili**	On-Demand 24/7
Serbian	On-Demand 24/7	**Swedish**	Hold times may vary
Sethang	Hold times may vary	**Sylheti**	On-Demand 24/7
Setswana	Hold times may vary	**Syriac**	Hold times may vary
Shona	Hold times may vary	**Tachew**	Hold times may vary
Sichuan	Hold times may vary	**Tahitian**	Hold times may vary
Sicilian	Hold times may vary	**Taiwanese**	Hold times may vary
Sinhalese	Hold times may vary	**Tajik**	On-Demand 24/7

ad astra

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

www.ad-astrainc.com

OPI Languages

Tamazight	Hold times may vary	**Urdu**	On-Demand 24/7
Tamil	On-Demand 24/7	**Uzbek**	Hold times may vary
Tatar	Hold times may vary	**Vietnamese**	On-Demand 24/7
Tedim Chin	Hold times may vary	**Visayan**	Hold times may vary
Telugu	On-Demand 24/7	**Walloon**	Hold times may vary
Teochew	On-Demand 24/7	**Welsh**	On-Demand 24/7
Thai	On-Demand 24/7	**Wolof**	On-Demand 24/7
Tibetan	On-Demand 24/7	**Yakut**	Hold times may vary
Tigre	Hold times may vary	**Yapese**	Hold times may vary
Tigrinya	On-Demand 24/7	**Yi**	Hold times may vary
Toisanese	Hold times may vary	**Yiddish**	Hold times may vary
Tongan	On-Demand 24/7	**Yoruba**	On-Demand 24/7
Tosk	Hold times may vary	**Yupik**	Hold times may vary
Trique	On-Demand 24/7	**Zomi**	Hold times may vary
Trukese	Hold times may vary	**Zulu**	Hold times may vary
Tshiluba	Hold times may vary	**Zophei Chinn**	Hold times may vary
Turkish	On-Demand 24/7		
Turkman	On-Demand 24/7		
Twi	Hold times may vary		
Ugyhur	Hold times may vary		
Ukrainian	On-Demand 24/7		
Upper Sorbian	Hold times may vary		

ad astra

Ad Astra, Inc.
8701 Georgia Ave. Suite #808
Silver Spring, MD 20910

Primary Phone #: 301-408-4242
Monday-Friday, 8:00am- 9:00pm
Secondary Phone #: 202-302-3379
Nights, Weekends, Holidays

UST UPDATE HANDOUT #3 – SELECTED INDIANA RULES OF PROFESSIONAL CONDUCT

Rule 1.1. Competence

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Rule 1.2. Scope of Representation and Allocation of Authority Between Client and Lawyer

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. . . .

. . .

(c) A lawyer may limit the scope and objectives of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

. . .

Rule 1.3. Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

Rule 1.5. Fees

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

. . .

Rule 1.6. Confidentiality of Information

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

. . .

Rule 1.7. Conflict of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Rule 1.15. Safekeeping Property

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation. . . .

Rule 3.3. Candor Toward the Tribunal

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

Rule 4.1. Truthfulness in Statements to Others

In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Rule 5.3. Responsibilities Regarding Nonlawyer Assistants

With respect to a nonlawyer employed or retained by or associated with a lawyer:

(a) a partner, and a lawyer who individually or together with other lawyers possess comparable managerial authority in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer;

(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and

(c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:

(1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the person is employed, or has direct supervisory authority over the person, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

U.S. Department of Justice

Executive Office for United States Trustees

Office of the Director *Washington, DC 20530*

June 10, 2022

MEMORANDUM

TO: United States Trustees

FROM: Ramona D. Elliott
Acting Director

SUBJECT: Guidelines for United States Trustee Program (USTP) Enforcement Related to Bifurcated Chapter 7 Fee Agreements

I. Introduction

In our role as the "watchdog" of the bankruptcy process, one of the USTP's core responsibilities is to protect and preserve the integrity of the bankruptcy system. In doing so we seek to promote fair access to the bankruptcy system while ensuring that no participant is treated improperly. Enhancing access to justice not only includes removing barriers to entry but also ensuring that all debtors who seek bankruptcy protection in good faith and comply with the Bankruptcy Code's requirements receive the relief the law affords them. This includes ensuring that debtors are properly and adequately represented by their attorneys, who in turn are negotiating the terms of their fee arrangements and representation in good faith.

The Bankruptcy Code's[1] statutory framework generally prohibits postpetition payment of attorney's fees arising from prepetition retention agreements in chapter 7 cases. The Supreme Court held in *Lamie v. United States Trustee*[2] that chapter 7 debtors' attorney's fees may not be paid out of the bankruptcy estate, and almost all courts that have considered the issue have held that attorney's fees owing under a prepetition retainer agreement are a dischargeable debt.[3] As a

[1] 11 U.S.C. §§ 101 *et seq.*
[2] 540 U.S. 526, 537 (2004). The Court's reasoning was that 11 U.S.C. § 330(a) only authorizes compensation to professionals employed under § 327, which does not include the debtor's attorney in a chapter 7 case unless employed by the trustee under § 327(e).
[3] *See, e.g.*, *Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005).

result, the traditional model for representation in chapter 7 cases is payment of the entire attorney's fee for the case[4] in full before the case is filed.

"Bifurcated" fee agreements—which split an attorney's fee between work performed prior to the filing of a bankruptcy petition and work performed postpetition—have become increasingly prevalent in chapter 7 consumer bankruptcy cases.[5] Bifurcated agreements are generally structured so that minimal services—limited to those essential to commencing the case—are performed under a prepetition agreement for a modest (or no) fee, while all other services are performed postpetition, under a separate postpetition retention agreement, arguably rendering those fees nondischargeable.

Courts and stakeholders in the bankruptcy community have expressed differing views on the propriety of bifurcated fee agreements.[6] Some courts have held that bifurcation by its nature violates certain local rules governing the professional responsibilities of counsel owed to their debtor clients.[7] Other courts have held that nothing is inherently improper about bifurcation, provided that certain guardrails are obeyed.[8]

Absent contrary local authority, it is the USTP's position that bifurcated fee agreements are permissible so long as the fees charged under the agreements are fair and reasonable, the agreements are entered into with the debtor's fully informed consent, and the agreements are adequately disclosed. Bifurcated agreements provide an alternative under the current statutory framework to the traditional attorney's fee model, which some have noted present a barrier to accessing the bankruptcy system for debtors who may need relief but are unable to pay in full before filing. The benefits these type of agreements provide—increasing access and relief to those in need—must be balanced against the risk that these fee arrangements, if not properly structured, could harm debtors and deprive them of the fresh start afforded under the Bankruptcy Code.

---

[4] Typically, a flat fee for all services essential to the successful completion of the case.

[5] This Memorandum only addresses enforcement guidelines for bifurcated fee arrangements. The exclusion from these guidelines of other alternative fee arrangements—such as the practice of filing chapter 13 cases solely to pay attorney's fees over time—should not be construed as acceptance of the propriety of such arrangements. When any fee arrangement violates the Bankruptcy Code or Rules, the USTP will take enforcement actions as appropriate.

[6] *See, e.g.,* Terrence L. Michael, *There's A Storm A Brewin: The Ethics and Realities of Paying Debtors' Counsel in Consumer Chapter 7 Bankruptcy Cases and the Need for Reform*, 94 AM. BANKR. L.J. 387 (2020); Adam D. Herring, *Problematic Consumer Debtor Attorney's Fee Arrangements and the Illusion of "Access to Justice"*, ABI JOURNAL, Vol. XXXVII, No. 10, Oct. 2018; Daniel E. Garrison, *Liberating Debtors from "Sweatbox" and Getting Attorneys Paid*, ABI JOURNAL, June 2018, at 16. *See also* Adam D. Herring, "Great Debates" at the ABI Consumer Practice Extravaganza (Nov. 5, 2021).

[7] *See, e.g., In re Baldwin*, No. 20-10009, 2021 WL 4592265 (Bankr. W.D. Ky. Oct. 5, 2021); *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), *rev'd and remanded* No. 9:21-cv-01082-JMC, 2022 WL 766352 (D.S.C. Mar. 14, 2022).

[8] *See, e.g., In re Kolle*, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021); *In re Brown*, 631 B.R. 77, 101 (Bankr. S.D. Fla. 2021); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019).

The USTP's enforcement approach to bifurcated agreements balances these concerns. The USTP will review bifurcated fee agreements to ensure that they harm neither the debtors who rely on the bankruptcy system to obtain relief nor the integrity of the system. When appropriate, we will bring enforcement actions to address these harms. This document sets forth general guidelines that United States Trustees and their staff should use to assist them in determining whether to take enforcement action with respect to bifurcated fee agreements.

II. Attorney's Fees Under Bifurcated Agreements Must Be Fair and Reasonable

When reviewing attorney fee agreements in consumer cases, our first consideration is to ensure that the agreements serve the best interests of clients, not their professionals. This tension is most evident—and the potential for the greatest harm to debtors exists—in the structuring of fees under bifurcated agreements. The three most common fee-related issues we see in cases involving bifurcated fee agreements relate to the allocation of fees and services, the reasonableness of the fees, and third-party financing.

First, it is important to ensure that there is a proper allocation of prepetition and postpetition fees and services. This issue commonly arises in no- or low-money down cases. It is the USTP's position that fees earned for prepetition services must be either paid prepetition or waived, because the debtor's obligation to pay those fees is dischargeable. This is particularly important to ensure—and to clearly document—that debtors receive appropriate prepetition consultation and legal advice, including with respect to exemptions and chapter selection.[9] Debtors who enter into bifurcated fee agreements should receive the same level of representation as debtors who enter into traditional fee agreements. Bifurcation must not foster cutting corners in properly preparing the case for filing by eliminating tasks that should be performed prepetition or postponing all or some of those services until after the petition is filed to ensure that the attorney can bill for those services postpetition. Additionally, fees for postpetition services must be rationally related to the services actually rendered postpetition,[10] so that a flat postpetition fee is not a disguised method to collect fees for prepetition services. Attorneys also should not advance filing fees and seek their reimbursement postpetition. Advanced filing fees are generally held to be dischargeable prepetition obligations.[11]

Second, attorney's fees charged to debtors in bifurcated cases—as in all cases—must be reasonable.[12] Bifurcated fee agreements should not be viewed as an opportunity to collect higher fees than those collected from clients who pay in full, before filing. For example, it would be inappropriate for an attorney to offer a debtor a fee of $1,500 if they pay upfront, and $2,000 if they pay over time postpetition, particularly given that fees for prepetition work should have been paid or waived.

---

[9] The Bankruptcy Code requires attorneys to certify, by signing the petition, that they have performed a reasonable investigation into the facts and circumstances of the case and that the attorney, after performing an adequate inquiry, has no knowledge that the information in the schedules is incorrect. 11 U.S.C. §§ 707(b)(4)(C–D).
[10] *See Brown*, 631 B.R. at 93 (citing *Hazlett*, 2019 WL 1567751).
[11] *See, e.g., Matter of Riley*, 923 F.3d 433, 439-40 (5th Cir. 2019); *Brown*, 631 B.R. at 102-03.
[12] 11 U.S.C. § 329(b).

Third, arrangements that employ outside parties to finance bifurcated fee agreements, including (but not limited to) factoring, assignment of the attorney's accounts receivable, and direct lending to clients, warrant significant additional scrutiny. The particulars of arrangements under which a third party finances the debtor's postpetition attorney's fees must be fully disclosed under Bankruptcy Rule 2016(b), including the details of the attorney's relationship with the entity providing the financing. The nature of these arrangements may incentivize overcharging, because the attorney generally receives only a percentage of the total fee charged or otherwise incurs financing costs. It is improper for an attorney using third-party financing to pass along the cost of that financing to their clients. Third-party financing arrangements may also create unwaivable conflicts of interest between the attorney and their clients and may violate applicable state ethical rules.[13]

The USTP should bring enforcement actions where bifurcated fee agreements adversely affect the client's representation, seek recovery of unreasonable fees, improperly allocate fees or services, improperly burden debtors with financing costs, or otherwise result in conflicts of interest.

III. Ensuring Adequate Attorney Disclosure and Fully Informed Debtor Consent to Bifurcated Agreements

In addition to ensuring that bifurcated agreements are fair and reasonable, courts examining and permitting bifurcated agreements have emphasized the importance of adequate disclosure and the client's fully informed consent. One court permitting the use of bifurcated agreements noted that "the propriety of using bifurcated fee agreements in consumer chapter 7 cases is directly proportional to the level of disclosure and information the attorney provides to the client and the existence of documentary evidence that the client made an informed and voluntary election to enter into a postpetition fee agreement."[14] Similarly, professional conduct standards governing fee sharing and limited scope representation[15] reinforce the need for disclosure and informed consent. The requirement of informed consent to bifurcated agreements is derived directly from the Bankruptcy Code's requirements that attorneys representing consumer debtors deal forthrightly and honestly with their clients, that they not make misrepresentations about the services they will provide or the benefits and risks of filing bankruptcy, and that they make certain disclosures and promptly enter into a clear and conspicuous written contract explaining the services the attorney will render and the terms of any fee agreement.[16]

The following disclosure and consent factors can assist your review of bifurcated fee agreements and determination whether an enforcement action is appropriate:

- Whether the attorney has clearly disclosed the services that will be rendered prepetition and postpetition, and the corresponding fees for each

[13] *Brown*, 631 B.R. at 99, n. 34.
[14] *In re Hazlett*, No. 16-30360, 2019 WL 1567751 at *8 (Bankr. D. Utah Apr. 10, 2019).
[15] *See, e.g.,* Model Rules of Prof. Conduct R. 1.2(c), 5.4(a) (AM. BAR ASS'N 1983).
[16] 11 U.S.C. §§ 526–528.

segment of the representation, including that certain listed services may not arise in a particular case.

- Whether the attorney has disclosed their obligation to continue representing the debtor regardless of whether the debtor executes a postpetition agreement, unless the bankruptcy court permits the attorney's withdrawal.

- Whether the attorney has clearly disclosed that the client is being provided the option to choose a bifurcated fee agreement, any difference in the total attorney's fee between the bifurcated fee agreement and a traditional fee agreement,[17] and the client's options with respect to the postpetition fee agreement.[18]

- Whether the agreement includes clear and conspicuous provisions explaining the options, costs, and consequences of entering into a bifurcated fee agreement and providing the debtor with an option to rescind the agreement.

The disclosure and consent considerations described above are not exhaustive and should not be mechanically applied, but instead qualitatively assessed to determine whether adequate disclosures were made and whether those disclosures permit a consumer debtor considering a bifurcated fee agreement to give informed consent. Additionally, when applying these criteria we must consider local authority and act accordingly where local rules or jurisprudence have imposed other clear standards for adequate client disclosures and conditions of informed consent—whether more or less stringent.[19]

IV. Ensuring Adequate Public Disclosure

The Bankruptcy Code and Rules also require public transparency in professionals' dealings with their clients, and the USTP regularly enforces these requirements. All attorneys representing debtors must promptly file disclosures of the particulars of their fee agreements and the amounts they have been paid under section 329(a) of the Bankruptcy Code and Bankruptcy

[17] As discussed *supra*, it is the USTP's position that fees under bifurcated agreements should not be higher than those under traditional fee agreements for the same services.
[18] Generally, these options are for the client to sign the postpetition agreement for the attorney's continued representation; to hire other counsel; or to proceed in the case *pro se*.
[19] We are aware that some courts have found that bifurcation is impermissible under local rules governing representation of debtors. *See, e.g., Baldwin*, 2021 WL 4592265; *Prophet*, 628 B.R. 788. The existence and wording of such local rules varies, and bankruptcy courts within a district may interpret them differently. In determining whether to take an enforcement action with respect to a bifurcated fee arrangement, the USTP will consider and follow applicable local authority but also should be mindful to exercise discretion in accordance with these guidelines to focus on those cases where the debtor is harmed or the integrity of the bankruptcy process is jeopardized.

Rule 2016(b).[20] The nature of bifurcated agreements requires detailed disclosures in order to satisfy the Bankruptcy Code's standards. Failure to make adequate public disclosures required under the Bankruptcy Code and Rules may be a basis to bring an enforcement action.[21]

V. Conclusion and Important Notes

It is vital that the USTP acts consistently across jurisdictions in these and other legal matters. Please ensure that all staff who engage in civil enforcement in consumer cases are familiar with these guidelines. Each case will have unique facts that should be considered in a manner consistent with these guidelines.

Please consult the Office of the General Counsel if there are any questions regarding these guidelines or their application in specific cases. This memorandum is an internal directive to guide USTP personnel in carrying out their duties, but the final determination of whether a bifurcated fee agreement complies with the Bankruptcy Code and Rules resides solely with the court. Nothing in this memorandum has any force or effect of law or imposes on parties outside the USTP any obligations beyond those set forth in the Bankruptcy Code and Rules.[22]

Thank you for your continued cooperation and diligence in this important area of responsibility.

---

[20] The default remedy for failure to make proper disclosures under section 329(a) is return of all fees. *See, e.g., SE Prop. Holdings, LLC v. Stewart*, 970 F.3d 1255, 1266 (10th Cir. 2020).

[21] Postpetition attorney's fee installment payments should be disclosed as monthly expenses on the debtor's Schedule J. This allows courts and the USTP to quickly evaluate whether the debtor can actually afford the attorney's fees charged under the postpetition contract, which is a factor in determining whether the bifurcated agreement is in the debtor's best interest. However, note that we do not take the position that Rule 2016(b) requires that attorneys using bifurcated agreements file a supplemental compensation disclosure each time they receive a postpetition payment, provided that the terms of the postpetition agreement have been previously disclosed and there have been no material changes.

[22] Additionally, nothing in this memorandum: (1) limits the USTP's discretion to request additional information, conduct examinations under Bankruptcy Rule 2004, or conduct discovery with respect to its review of a particular fee arrangement; (2) limits the USTP's discretion to take action with respect to any particular fee arrangement; or (3) creates any private right of action on the part of any person enforceable against the USTP, its personnel, or the United States.

United States Department of Justice
Executive Office for United States Trustees

Report to Congress:

Criminal Referrals by the United States Trustee Program Fiscal Year 2021

(As required by Section 1175 of the Violence Against Women and Department of Justice Reauthorization Act of 2005, Public Law 109-162)

August 2022

Table of Contents

EXECUTIVE SUMMARY

The Director of the Executive Office for United States Trustees (EOUST) is required to submit an annual report to Congress under the provisions of Section 1175 of the Violence Against Women and Department of Justice Reauthorization Act of 2005 (Pub. L. 109-162). Section 1175 states:

> The Director of the Executive Office for United States Trustees shall prepare an annual report to the Congress detailing—(1) the number and types of criminal referrals made by the United States Trustee Program; (2) the outcomes of each criminal referral; (3) for any year in which the number of criminal referrals is less than for the prior year, an explanation of the decrease; and (4) the United States Trustee Program's efforts to prevent bankruptcy fraud and abuse, particularly with respect to the establishment of uniform internal controls to detect common, higher risk frauds, such as a debtor's failure to disclose all assets.

The United States Trustee Program (USTP or Program) made 2,244 bankruptcy and bankruptcy-related criminal referrals during Fiscal Year (FY) 2021. This represents a 9.8 percent decrease from the 2,489 criminal referrals made during FY 2020. This decline may be attributable to multiple factors, most notably the dramatic decline in bankruptcy filings during the COVID-19 pandemic.

The five most common allegations contained in the FY 2021 criminal referrals involved tax fraud, false oaths or statements, identity theft or use of false/multiple Social Security numbers, a bankruptcy fraud scheme, and concealment. Of the 2,244 criminal referrals, as of August 31, 2022, formal criminal charges had been filed in connection with 15 of the referrals, 1,233 of the referrals remained under review or investigation, 992 of the referrals were declined for prosecution, and 4 were administratively closed.

In FY 2021, despite ongoing challenges associated with the COVID-19 pandemic, the USTP continued to strengthen its partnerships with law enforcement through participation on bankruptcy fraud working groups and other specialized task forces; through the development and presentation of joint training programs; and by assisting in the investigation and prosecution of bankruptcy and bankruptcy-related crimes, including serving as Special Assistant United States

Attorneys (SAUSAs), consulting on bankruptcy law, and testifying as expert, process, or fact witnesses. The Program also continued to receive valuable information through its Internet email "Hotline," which offers a convenient means for individuals to report suspected bankruptcy crimes.

INTRODUCTION

Section 1175 of the Violence Against Women and Department of Justice Reauthorization Act of 2005 (Pub. L. 109-162) requires the Director of the EOUST to submit a "report to Congress detailing—(1) the number and types of criminal referrals made by the United States Trustee Program; (2) the outcomes of each criminal referral; (3) for any year in which the number of criminal referrals is less than for the prior year, an explanation of the decrease; and (4) the United States Trustee Program's efforts to prevent bankruptcy fraud and abuse, particularly with respect to the establishment of uniform internal controls to detect common, higher risk frauds, such as a debtor's failure to disclose all assets."

The Program is the component of the Department of Justice whose mission is to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders—debtors, creditors, and the public. It consists of 21 regions with 90 field offices nationwide and an Executive Office in Washington, DC. Each field office is responsible for carrying out numerous administrative, regulatory, and litigation responsibilities under title 11 (the Bankruptcy Code) and title 28 of the United States Code.[1/]

The USTP has a statutory duty to refer matters to the United States Attorneys' offices (USAOs) for investigation and prosecution that "relate to the occurrence of any action which may constitute a crime" and to assist the United States Attorney in "carrying out prosecutions based on such action." 28 U.S.C. § 586(a)(3)(F). In addition, 18 U.S.C. § 158 requires designation of a prosecutor and a Federal Bureau of Investigation (FBI) agent in each district to address bankruptcy-related crimes, affirming the importance of the partnership between the USTP and law enforcement in protecting the integrity of the bankruptcy system.

[1/] The Program has jurisdiction in all federal judicial districts except those in Alabama and North Carolina.

I. NUMBER AND TYPES OF CRIMINAL REFERRALS

The Program tracks criminal referrals using its internal automated Criminal Enforcement Tracking System (CETS). Program personnel enter information into CETS as each case progresses and review the status of all referrals at least once every six months. The system is designed to provide an accurate measure of criminal enforcement actions, assist in trend identification, and facilitate management improvements.

In FY 2021, the USTP made 2,244 bankruptcy and bankruptcy-related criminal referrals. Each referral may be sent to multiple agencies, but it is counted only once in CETS. Similarly, each referral may contain multiple allegations. The breadth of allegations involved in criminal referrals is evident in Table 1, with referral allegations in 50 separate categories. The five most common allegations contained in the FY 2021 criminal referrals involved tax fraud (52.0%), false oaths or statements (24.2%), identity theft or use of false/multiple Social Security numbers (21.5%), a bankruptcy fraud scheme (20.9%), and concealment (19.8%).

Table 1: Criminal Referrals by Type of Allegation[1]

Type of Allegation	Referrals	
	Number	Percent[2]
Tax Fraud [26 U.S.C. § 7201, *et seq.*]	1,167	52.0%
False Oath/Statement [18 U.S.C. § 152(2) and (3)]	544	24.2%
Identify Theft or Use of False/Multiple SSNs	483	21.5%
Bankruptcy Fraud Scheme [18 U.S.C. § 157]	470	20.9%
Concealment [18 U.S.C. §§ 152(1) and (7)]	445	19.8%
Mail/Wire Fraud [18 U.S.C. §§ 1341 and 1343]	293	13.1%
Perjury/False Statement	190	8.5%
Concealment/Destruction/Withholding of Documents [18 U.S.C. § 152(8) and (9)]	154	6.9%
Bank Fraud [18 U.S.C. § 1344]	113	5.0%
Mortgage/Real Estate Fraud	102	4.5%
Forged Document	93	4.1%
Destruction, Alteration, or Falsification of Documents in Federal Investigations and Bankruptcy [18 U.S.C. § 1519]	89	4.0%
Federal Program Fraud	88	3.9%
Paycheck Protection Program Fraud [COVID-19 Related]	66	2.9%
Disregard of Bankruptcy Law/Rule by Bankruptcy Petition Preparer [18 U.S.C. § 156]	64	2.9%
Conspiracy [18 U.S.C. § 371]	55	2.5%
Embezzlement [18 U.S.C. § 153]	32	1.4%
State Law Violation	32	1.4%
Post-Petition Receipt of Property [18 U.S.C. § 152(5)]	28	1.2%

Type of Allegation	Number	Percent
Obstruction of Justice	24	1.1%
Money Laundering [18 U.S.C. §§ 1956 and 1957]	20	0.9%
Corporate Fraud	18	0.8%
Serial Filer	18	0.8%
Investor Fraud	14	0.6%
Criminal Contempt [18 U.S.C. § 402]	12	0.5%
False Claim [18 U.S.C. § 152(4)]	12	0.5%
Bribery [18 U.S.C. § 152(6)]	8	0.4%
Corporate Bust-Out/Bleed-Out	8	0.4%
Misuse of Seals of Courts; Seals of Departments or Agencies [18 U.S.C. §§ 505/506]	8	0.4%
Credit Card Fraud/Bust-Out	7	0.3%
Internet Fraud	7	0.3%
Insurance Fraud	6	0.3%
Professional Fraud	6	0.3%
Threat of Violence	6	0.3%
Extortion	5	0.2%
Health Care Fraud [18 U.S.C. § 1347]	4	0.2%
Immigration Offense	2	0.1%
Embezzlement and Theft from Indian Tribal Organizations [18 U.S.C. § 1163]	1	<0.1%
Bribery of Public Official and Witnesses [18 U.S.C. § 201]	1	<0.1%
Prohibited Acts (Tampering with Air Pollution System) and Civil Penalties [42 U.S.C. §§ 7522(a)(3)(A) and 7524(a)]	1	<0.1%
Abusive Reaffirmation of Debt/Creditor Abuse	1	<0.1%
Adverse Interest and Conduct of Officers [18 U.S.C. § 154]	1	<0.1%
Child Pornography [18 U.S.C. § 2252A]	1	<0.1%
Drug Offense	1	<0.1%
Public Money, Property or Records/Embezzlement [18 U.S.C. § 641]	1	<0.1%
Fee Agreements in Cases Under Title 11 and Receiverships [18 U.S.C. § 155]	1	<0.1%
Odometer Tampering	1	<0.1%
Racketeer Influenced and Corrupt Organizations Act	1	<0.1%
Structuring	1	<0.1%
Firearms [18 U.S.C. Chapter 44] and Unlawful Acts [18 U.S.C. § 922]	1	<0.1%

[1] Allegation information can change over time. Table 1 reflects information contained within CETS as of August 31, 2022.
[2] Percent based on 2,244 referrals. One referral often contains more than one allegation, so the sum of the percentages for referrals will exceed 100 percent.

II. OUTCOMES OF CRIMINAL REFERRALS

Table 2 shows the collective outcome/disposition of the 2,244 criminal referrals the Program made during FY 2021 as of August 31, 2022.[2/] Of those referrals, 1,233 are under review by the USAOs (43.2%) or with an investigative agency (11.7%), 15 referrals (0.7%) resulted in formal charges, 992 referrals (44.2%) were declined for prosecution, and 4 were administratively closed (0.2%).

Table 2: Outcome/Disposition of FY 2021 Referrals[1]

Outcome/Disposition	Referrals	
	Number	Percent[2]
Under Review in United States Attorney's Office	970	43.2%
With Investigative Agency	263	11.7%
Formal Charges Filed (Case Active)	13	0.6%
Formal Charges Filed (Case Closed)	2	0.1%
– At least One Conviction or Guilty Plea	2	
– At least One Pre-trial Diversion	0	
– At least One Dismissal	0	
– At least One Acquittal	0	
Prosecution Declined by United States Attorney	992	44.2%
Administratively Closed	4	0.2%

[1] Outcome and disposition information will change over time. The information contained within Table 2 reflects information contained within CETS as of August 31, 2022.
[2] Rounded percent based on 2,244 referrals.

The 15 cases referenced in Table 2 in which formal charges were filed between October 1, 2020, and August 31, 2022, are prosecutions that originated from an FY 2021 referral as derived from CETS.[3/] It is important to note that white-collar criminal referrals like those

[2/] The Program is not the source of official disposition information. CETS is designed primarily to track referrals made by the USTP to United States Attorneys. While Program staff work with local USAOs to update disposition information semi-annually, delays in reporting, as well as differences in tracking systems, may result in reporting variances between the agencies.

[3/] Table 2 reflects only disposition information related to referrals the USTP made in FY 2021. It does not reflect the entirety of prosecutions with bankruptcy charges brought by the Department of Justice in FY 2021. A reporting of all prosecutions would include those that originated from Program referrals in prior fiscal years, as well as prosecutions related to referrals not made by the Program.

made by the Program often require significant time and resources to investigate. As a result, it generally takes more than two years before there is a reportable action in CETS. Therefore, it is reasonable that a high percentage of cases referred in FY 2021 are still under investigation or review.

III. COMPARISON WITH CRIMINAL REFERRALS MADE IN PREVIOUS YEAR

As shown in Table 3, the number of criminal referrals made during FY 2021 represents a 9.8 percent decrease from the number of referrals made in FY 2020. Prior to FY 2021, the Program experienced seven consecutive years of growth in the number of bankruptcy and bankruptcy-related criminal referrals it made. The decline in FY 2021 may be attributable to multiple factors, most notably the dramatic decline in bankruptcy filings during the COVID-19 pandemic (44 percent overall since FY 2019 and 29 percent from FY 2020 to FY 2021). With that said, FY 2021 referrals were comparable to FY 2020 as a percentage of overall filings.

Table 3: Comparison Between Criminal Referrals in FY 2020 and FY 2021		
FY 2020	**FY 2021**	**Percent Change**
2,489	2,244	-9.8%

IV. USTP EFFORTS TO PREVENT BANKRUPTCY FRAUD AND ABUSE

The USTP is committed to identifying and referring for investigation and prosecution bankruptcy fraud and bankruptcy-related crimes. The EOUST's Office of Criminal Enforcement oversees and coordinates the Program's enforcement efforts and has strengthened its ability to detect, refer, and assist in the prosecution of criminal violations. Through issuing guidance and resource materials, participating in working groups and task forces, collaborating with its law enforcement partners, and providing extensive training, the USTP has established the necessary systems to detect fraud schemes and to combat fraud and abuse that threaten the integrity of the bankruptcy system.

Following are some highlights of the Program's criminal enforcement efforts in FY 2021.

Bankruptcy Fraud Working Groups and Other Specialized Task Forces. The Program participates in approximately 50 local bankruptcy fraud working groups and other specialized task forces throughout the country. Members of these working groups and task forces include representatives from the USAOs, FBI, United States Postal Inspection Service, Internal Revenue Service-Criminal Investigation, and offices of the Inspector General for the Social Security Administration, the Department of Housing and Urban Development, the United States Secret Service, and the Federal Housing Finance Agency.

Working groups and task forces provide an effective forum for consultation between the USTP and its law enforcement partners and allow the Program to draw on the collective expertise of the groups to investigate and effectively address fraud and abuse in the bankruptcy system. One example of a success of these collaborations involves the Central District of California's Bankruptcy Fraud Working Group. The USTP's Riverside office referred to law enforcement an individual who, despite bankruptcy court orders and injunctions barring him from acting as a bankruptcy petition preparer (BPP) due to multiple prior violations of the Bankruptcy Code provision governing BPPs, continued to prepare bankruptcy documents for debtors for a fee. To conceal his involvement, the enjoined preparer directed his consumer clients to falsely claim that no one had assisted them with their cases and he repeatedly failed to disclose his involvement in the cases. The preparer pleaded guilty in May 2021 to one felony count of making a false statement during a bankruptcy proceeding and was sentenced in August 2021 to one year and one day in prison, followed by three years of supervised release, and ordered to pay $84,005 in restitution to be shared by his 30 victims. The United States Attorney's press releases on this matter recognized the substantial investigative assistance provided by the USTP.

Special Assistant United States Attorneys (SAUSAs). Nearly two dozen Program attorneys in field offices across the country are designated as SAUSAs to assist USAOs in the investigation and prosecution of bankruptcy and bankruptcy-related crimes. For example, in the District of Utah, a USTP Salt Lake City trial attorney served as a SAUSA in a matter referred by the Program that resulted in the defendant, an attorney, being sentenced to 12 months and one day in federal prison after pleading guilty to bankruptcy fraud. The defendant also was ordered to serve two years of supervised release and pay $266,843 in restitution to the victims of his crimes. In his plea agreement, the defendant admitted that before filing bankruptcy cases for two of his clients, he facilitated transfers totaling $288,843 from them to his client trust account, telling the clients he would pay his attorney's fees of $22,000 from the funds and hold the rest in the trust account to "keep it safe," and then return the remaining $266,843 to them after their bankruptcy cases were closed. The defendant then used about $259,000 of the fund for his business and personal benefit without the clients' permission. He filed three separate bankruptcy cases for his clients that failed to disclose the clients' interest in the funds. Thereafter, the defendant filed two of his own bankruptcy cases in an effort to hide and conceal the fact that he embezzled the money and used it for his business and personal use**.**

Other Staff Support. Nationally, the EOUST's Office of Criminal Enforcement regularly coordinates with USAOs and other members of law enforcement on cases referred by the Program. Staff at the field office level also are frequently relied on to provide post-referral assistance. The following examples illustrate the types of support the Program provides to its partners.

In July 2021 the former general counsel of a big law firm pleaded guilty in the Eastern District of Virginia to obstructing an official proceeding in connection with his attempts to derail a 2019 investigation by the USTP's Richmond office into his fraudulent conduct while serving as a post-confirmation liquidating plan trustee in a chapter 11 bankruptcy case. In 2019, several years after the bankruptcy case was closed by the bankruptcy court, the Richmond office received a tip alleging that the defendant had misappropriated funds of the debtors' post-confirmation trust account. The office initiated an inquiry that substantiated the allegations and referred the matter to law enforcement and provided significant post-referral assistance. The ensuing criminal investigation uncovered multiple instances of embezzlement from the liquidating trust between 2015 and 2018, totaling approximately $800,000. It also revealed that the defendant had manipulated the budget for the company's post-bankruptcy wind down period that enabled him to siphon away more than $3.2 million for personal payments to himself and others, depleting the trust account more than two years before the end of the wind down period. The defendant was sentenced in November 2021 to 44 months in prison followed by three years of supervised release. The U.S. Attorney's press release recognized the substantial assistance provided by the USTP.

Another example of assistance involved a matter referred by the USTP's Tyler office to law enforcement in the Eastern District of Texas that resulted in a successful prosecution. On January 21, 2021, the defendant was sentenced to 42 months in federal prison followed by three years of supervised release after pleading guilty to bankruptcy fraud, wire fraud, and aggravated identity theft. The defendant admitted that, in an effort to stop an eviction action pending against her, she engaged in a scheme to defraud an apartment complex where she resided by filing a false bankruptcy case using the name and Social Security number of a third-party without the person's knowledge or permission. The U.S. Attorney's press release thanked the USTP's Tyler office for its work on the case. In addition to the criminal referral, the U.S. Trustee previously had filed a motion to dismiss the case with prejudice, which was granted by the bankruptcy court and enjoined the defendant from filing any bankruptcy case for five years and barred her from discharging any debts listed in the fraudulent filing in any future cases.

In addition to the support provided on matters that are referred by the Program, in FY 2021, staff also responded to more than 200 requests for assistance from USAOs, the FBI, and other law enforcement agencies on matters not originating from a Program referral. In the Western District of Missouri, for example, the USTP's Kansas City office supported law enforcement in its successful prosecution of a defendant who pleaded guilty to one count of bankruptcy fraud and one count of wire fraud. The defendant admitted that she impersonated her ex-spouse to illegally obtain his Social Security benefits while he was residing outside of the country. She also admitted that she failed to disclose in multiple bankruptcy cases she filed the receipt of these funds and the financial account in which she deposited them. At sentencing, a USTP Kansas City trial attorney testified that the defendant violated her plea agreement by continuing to engage in fraud after her guilty plea, including attempting to sell property of the bankruptcy estate without court approval. The defendant was sentenced in November 2020 to two years of incarceration followed by three years of supervised release.

Training. During FY 2021, the Program sponsored more than 60 bankruptcy and bankruptcy-related fraud training programs that reached about 3,300 federal, state, and local law enforcement personnel; private bankruptcy trustees; USTP staff; and members of the bar and other professional associations throughout the country. Each program is customized to maximize impact and a variety of educational formats are utilized, including in-person presentations, online meeting technology, and video teleconferences.

Included among the programs this year was the resumption of a series of joint training programs in partnership with the Economic Crimes Unit of FBI Headquarters designed to provide law enforcement with an overview of the bankruptcy process, the information available from bankruptcy documents, and the value of building strong partnerships with the USTP. Two remote training sessions were provided to approximately 275 FBI and USTP staff located in the Eastern and Central parts of the country.

Bankruptcy Fraud Internet "Hotline." In FY 2021, the USTP documented nearly 400 Hotline submissions from the public via its National Bankruptcy Fraud Hotline email box (USTP.Bankruptcy.Fraud@usdoj.gov). The Hotline offers a convenient means for individuals to report suspected bankruptcy fraud and provide supporting documentation and specific factual information that may be useful in pursuing allegations. In FY 2021, 118 referrals resulted from a Hotline submission made in either FY 2021 or a prior fiscal year. While not all submissions rise to the level of a criminal referral, they may lead to a civil enforcement action.

SUMMARY

The United States Trustee Program's criminal enforcement program remained robust in FY 2021, despite the challenges presented by the pandemic. By detecting and referring fraud schemes, collaborating with its law enforcement partners, and providing specialized training, the USTP continues to prioritize its enforcement efforts to combat fraud and abuse and to protect the integrity of the bankruptcy system.

AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

On Our Watch

By Daniel J. Casamatta and Michael J. Bujold

The USTP's Positions on Select SBRA Legal Issues

Daniel J. Casamatta
U.S. Trustee Program
Kansas City, Mo.

Michael J. Bujold
U.S. Trustee Program
Washington, D.C.

Daniel Casamatta is Acting U.S. Trustee for Region 13 (Arkansas/Missouri/Nebraska) and is based in Kansas City, Mo. Michael Bujold is associate general counsel for General and Administrative Law with the U.S. Trustee Program in Washington, D.C.

On Feb. 19, 2020, the Small Business Reorganization Act (SBRA)[1] became effective and dramatically changed the way most chapter 11 small business debtors reorganize. The SBRA has resulted in a more efficient and cost-effective process for distressed small business owners and creditors alike[2] that, by all current measures, works as Congress intended.[3]

Consistent with its mission to promote the integrity and efficiency of the bankruptcy system, the U.S. Trustee Program (USTP) plays an important and active role in the administration of subchapter V cases.[4] U.S. Trustees not only select and supervise subchapter V trustees,[5] they also enforce bankruptcy laws and ensure that those involved in the subchapter V process, including debtors, creditors, attorneys and other professionals, fulfill their legal obligations.

This article highlights several significant legal issues that have arisen since the SBRA became effective, and details the USTP's interpretative and enforcement efforts. In particular, subchapter V confers significant benefits on the debtor, including eliminating a creditors' committee unless the court directs the appointment for cause, and allowing the owners of the business to retain their interests and confirm a plan without paying a dissenting class of creditors in full. Thus, the USTP works to preserve the integrity of the bankruptcy process and prevent abuse by ensuring that debtors who elect subchapter V satisfy the statutory requirements for eligibility. The USTP also provides guidance to subchapter V trustees, including on the timing of termination after confirmation and on the ability to receive retainer payments.

Subchapter V Debtor-Eligibility Requirements

To be eligible to proceed under the SBRA, a debtor must be a person[6] (1) engaged in commercial or business activities; (2) whose primary activity is not the business of owning single-asset real estate (SARE); (3) with aggregate noncontingent, liquidated secured and unsecured debts at filing not exceeding the debt limit of $7.5 million[7] (excluding debts owed to one or more affiliates or insiders); and (4) having debts, of which 50 percent or more arise from commercial or business activities.[8] In addition, such a debtor *does not* include the following: (1) any member of a group of affiliated debtors that has aggregate noncontingent, liquidated secured and unsecured debts that do not exceed the debt limit of $7.5 million (excluding debts owed to one or more affiliates or insiders); (2) any debtor that is a publicly traded corporation; or (3) any debtor that is an affiliate of a publicly traded corporation.[9]

Although new to subchapter V, some of these statutory requirements utilize definitions long seen elsewhere. For example, the exclusion for holders of SARE means that the existing body of law on SARE debtors directly informs subchapter V eligibility determinations. Therefore, the USTP has objected

1 Pub. L. No. 116-54, 133 Stat. 1079 (codified in 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.).
2 These SBRA cases will be referred to as subchapter V cases in the body of this article.
3 The USTP's data reflects that through June 30, 2022, nearly 4,000 debtors have elected subchapter V, and these cases have been confirmed at twice the rate and dismissed at half the rate of other small business cases. In addition, the median time to confirmation has been four months faster for subchapter V cases than for other small business cases, and approximately 70 percent of confirmed plans in these subchapter V cases have been consensual.
4 Chapters 1-4, *United States Trustee Program Legal Manual.*
5 11 U.S.C. § 1183(a) and 28 U.S.C. § 586.
6 The term "person" generally includes individuals, partnerships and corporations. 11 U.S.C. § 101(41).
7 Under the Bankruptcy Threshold Adjustment and Technical Corrections Act, Pub. L. No. 117-151, 136 Stat. 1298, the debt limit was raised to $7.5 million through June 20, 2024, after which the debt limit will revert to the amount previously applicable under 11 U.S.C. § 101(51D), which is approximately $2.7 million.
8 11 U.S.C. § 1182(1)(A).
9 11 U.S.C. § 1182(1)(B).

to improper subchapter V designations from SARE debtors when necessary to uphold the eligibility limitations imposed by Congress.[10]

"Engaged in Commercial or Business Activities" as a Present Requirement

In enacting the SBRA, Congress specifically intended to support "[s]mall businesses — typically family-owned businesses, startups, and other entrepreneurial ventures [that] form the backbone of the American economy."[11] Congress designed the SBRA to allow debtors "to remain in business, which not only benefits the owners, but employees, suppliers, customers, and others who rely on that business."[12] Consequently, the law expressly requires that a subchapter V debtor be "engaged in commercial or business activities."

Consistent with the plain meaning and well-worn interpretations of similar language in other statutes, the USTP's position is that eligibility requires present commercial or business activities. In other words, the mere fact that a debtor once engaged in such business before the petition date does not itself satisfy the law's eligibility requirements. The USTP litigates to uphold this standard by objecting to and moving to strike improper subchapter V designations when necessary.[13]

Most courts have adopted the USTP's balanced interpretation and have held that a debtor must be presently engaged in commercial or business activities at filing to proceed under subchapter V.[14] In the first prominent decision addressing the issue,[15] the bankruptcy court agreed with the USTP and expressly departed from earlier contrary decisions.[16] There, the court held that debtors who sold a business and had no intention to return to it were ineligible. Unlike the earlier decisions, the court confronted the fact that several existing Bankruptcy Code provisions (such as 11 U.S.C. § 101(19A)'s definition of "family fisherman") and numerous other federal statutes use similar "engaged in" language, which courts have consistently interpreted to require current and active involvement under a plain-meaning analysis.[17] Any other interpretation "renders the phrase 'engaged in commercial or business activities' superfluous" because 11 U.S.C. § 1182(1)(A) separately specifies that the relevant debts arise from commercial or business activities.[18] Fortunately for the debtors, the finding of ineligibility did not preclude reorganization under chapter 11's non-subchapter V provisions.[19]

Even as a present requirement, courts have also confronted difficult factual questions in determining whether a debtor is engaged in commercial or business activities. While some have concluded that the presence of wind-down activities may alone suffice,[20] the USTP rejects the notion that any economic activity equates to engagement in commercial or business activities. For example, the USTP successfully moved to strike the subchapter V designation of an individual debtor who was working as a full-time employee for a business she did not own following the shuttering of several prior business enterprises that she had no intention of reactivating.[21] In agreeing with the USTP, the court rejected contrary *dicta* and stated that it "does not believe that in common language an individual who has a job as an employee for someone else would be understood as thereby engaging in a commercial or business activity."[22] The court rightly observed that any broader reading of the phrase "threatens to virtually drain it of any meaning."[23]

These examples provide a mere sampling of the eligibility disputes that have arisen since the SBRA's enactment. Other debtors have sometimes taken aggressive and untested positions on other eligibility requirements, such as companies who enter subchapter V with ties to larger corporate conglomerates and large debts owed to affiliates. The USTP will continue meeting its watchdog role in the bankruptcy system by reviewing the facts in each case and taking a balanced approach to ensure that subchapter V remains open for the small businesses that Congress intended to support.

Termination of Subchapter V Trustees After Confirmation

The USTP adheres to the Code's clear rules in determining when a subchapter V trustee is terminated in a case. The timing generally turns on whether the court confirmed a consensual plan under § 1191(a) or a nonconsensual plan under § 1191(b). The trustee's services terminate upon the substantial consummation of a consensual plan.[24]

By contrast, the Code requires that the trustee remain in place for the life of every nonconsensual plan.[25] This is true even when a nonconsensual plan's terms or confirmation order relieves the trustee from the obligation to make plan payments.[26] In those cases, trustees must ensure that debtors commence making timely plan payments[27] and be heard on any efforts to modify the plan after confirmation.[28] These trustees also must remain in service in the event that a debtor fails to perform on its plan obligations and is removed from possession as provided by statute.[29] By only providing for a trustee's reappointment in cases with consensual plans,[30] Congress presumed that the Code already dictated that trustees remain in service in all other cases. For all of these reasons, the USTP insists that subchapter V trustees remain in place until the completion of every nonconsensual plan.

Retainers for Subchapter V Trustees

The USTP has separately worked to develop consistent and predictable guidance to subchapter V trustees so that

10 *See, e.g., In re Manhattan Student Housing*, No. 22-20010-11 (Bankr. D. Kan. filed Jan. 10, 2022).
11 H.R. Rep. No. 116-171, at 1 (2019).
12 *Id.* at 4 (internal quotations omitted).
13 *See infra.*
14 *In re RS Air LLC*, 638 B.R. 403, 409 (B.A.P. 9th Cir. 2022).
15 *In re Thurmon*, 625 B.R. 417 (Bankr. W.D. Mo. 2020) (retired owners of closed pharmacies were not "engaged" in business at filing and therefore were not eligible to be subchapter V debtors).
16 *In re Wright*, 2020 WL 2193240 (Bankr. D.S.C. 2020); *In re Bonert*, 619 B.R. 248 (Bankr. C.D. Cal. 2020); *In re Blanchard*, 2020 WL 4032411 (Bankr. E.D. La. 2020).
17 *Thurmon*, 625 B.R. at 421-23.
18 *Id.* at 423.
19 *Id.* at 424-25.
20 *See, e.g., In re Ikalowych*, 629 B.R. 261 (Bankr. D. Colo. 2021); *In re Offer Space LLC*, 629 B.R. 299 (Bankr. D. Utah 2021).
21 *In re Rickerson*, 636 B.R. 416 (Bankr. W.D. Pa. 2021).
22 *Id.* at 426.
23 *Id.*
24 11 U.S.C. § 1183(c)(1).
25 11 U.S.C. § 1183(b).
26 11 U.S.C. § 1194(b).
27 11 U.S.C. § 1183(b)(3)(C).
28 11 U.S.C. § 1183(b)(4).
29 11 U.S.C. § 1185(a) ("[The] court shall order that the debtor shall not be a debtor in possession for cause, including ... failure to perform the obligations of the debtor under a plan.").
30 11 U.S.C. § 1183(c)(1).

they may receive compensation for their important work. To that end, the USTP's *Chapter 11 Legal Manual*[31] sets forth its legal position on compensating case-by-case subchapter V trustees:[32]

> Subchapter V case-by-case trustees are compensated through section 330(a)(1)(A), which allows for "reasonable compensation for actual, necessary services rendered by the trustee ... and by any paraprofessional person employed by any such person." The trustee may also be reimbursed for "actual, necessary expenses" pursuant to section 330(a)(1)(B).
>
> These section 330 compensation provisions apply regardless of whether the case-by-case trustee makes disbursements of estate funds. [The] SBRA specifically excludes all subchapter V trustees from section 326(a), which sets limits on other chapter 11 trustees' compensation based on the moneys they disburse or turn over. Pub. L. No. 116-54, § 4(a)(4)(A). And subchapter V case-by-case trustees are not subject to the section 326(b) limitation of compensation to 5 percent of plan payments that is applicable to standing chapter 12 and 13 case trustees. *See* 11 U.S.C. § 326(b), as amended by Pub. L. No. 116-54, § 4(a)(4)(B).[33]

Of course, subchapter V trustees will only be paid in cases if sufficient funds exist to pay them. Attempts to address this concern have involved providing subchapter V trustees with reasonable retainers or advance payments during the case to ensure that funds will be available to pay them, especially if the debtor is later determined to be ineligible to proceed under subchapter V, or the case gets dismissed.

Just as trustee fees must be reasonable, retainers likewise must be reasonable and comport with the law. The USTP offers the following parameters when determining trustee retainers:

1. Subchapter V trustee retainers or advanced payments should be approved by the court or by local rule. Because professional fees must be approved by the court under § 330, so should advance payments or retainers to trustees. Some courts have entered scheduling or standing orders to require debtor's counsel to pay monthly retainers to subchapter V trustees as a condition of operation,[34] and some have also required that debtors include anticipated trustee fees in cash-collateral budgets or pay the fees as a condition of dismissing a case.
2. A retainer or advanced payment should not be in an amount that adversely affects the debtor's cash flow or its ability to reorganize. Subchapter V is intended to allow "debtors to file [for] bankruptcy in a timely, cost-effective manner."[35] Paying trustee retainers or advanced fees that are prohibitive to a debtor's ability to reorganize would defeat this purpose.
3. Retainers should not be drawn down by the subchapter V trustee without court approval and should be deposited in a trust account and remain property of the estate until fees are paid. Just like for any other estate-paid professional, retainers remain property of the estate until the court approves a corresponding fee request under § 330.
4. Trustee retainers or advanced payments should not keep the debtor from paying administrative expenses over time in the case of a nonconsensual plan under § 1191(e). One advantage given to a subchapter V debtor that confirms a nonconsensual plan is to allow the payment of certain administrative expenses over a period of time extending beyond the effective date. Therefore, requiring the debtor to pay significant monthly retainers or trustee fees may obviate or infringe upon these rights.

Taken together, these guideposts promote the dual goals of ensuring that subchapter V trustees receive payment for their important work while maintaining professional accountability consistent with statutory requirements.

Conclusion

The USTP has undertaken extensive efforts to support the SBRA through the development of robust guidance and through litigation when necessary. The USTP will continue to monitor this new law's progress, analyze case data and adjust as appropriate to ensure that subchapter V practice adheres to the plain meaning and the overall objectives dictated by Congress. To these ends, the USTP has started posting a public report with SBRA case data that will be updated regularly.[36] abi

Reprinted with permission from the ABI Journal, Vol. XLI, No. 11, November 2022.

31 Section 3-17.15.2, *United States Trustee Program Legal Manual*, *available at* justice.gov/ust/file/volume_3_chapter_11_case_administration.pdf/download (unless otherwise specified, all links in this article were last visited on Oct. 4, 2022).

32 While the statute permits the USTP to appoint standing or case trustees, the USTP has only appointed case trustees.

33 Section 326(b) provides, in part, that the court may allow reasonable compensation to case trustees in chapter 12 and 13 cases, not to exceed 5 percent upon all payments under the plan. The SBRA amended § 326(b) to make it clear that the court may not award compensation to subchapter V standing trustees under § 330(a), but the SBRA did not further revise § 326(b) to provide that the 5 percent cap on plan payments expressly applies to subchapter V case-by-case trustees. Instead, the 5 percent cap remains effective only as to chapter 12 and 13 case-by-case trustees appointed under §§ 1202(a) and 1302(a), respectively. As a result, there appears to be no express statutory limit on the compensation that can be awarded to subchapter V case-by-case trustees beyond the general "reasonableness" requirement imposed by § 330(a).

34 *See, e.g.,* Order Prescribing Procedures in Chapter 11 Subchapter V Case, Setting Deadline for Filing Plan, and Setting Status Conference (Bankr. M.D. Fla.).

35 H.R. Rep. No. 116-171, at 4.

36 To view the most recent subchapter V public report, *see* justice.gov/ust/chapter-11-information.

Section Four

You Don’t Notice Me Anymore

Jason R. Burke-Moderator
Blackwell, Burke & Ramsey, P.C.
Indianapolis, Indiana

Jeffrey M. Hester
Hester Baker Krebs LLC
Indianapolis, Indiana

Jason W. Cottrell
Stuart & Branigin LLP
Lafayette, Indiana

Elizabeth M. Little
Faegre Drinker Biddle & Reath LLP
Indianapolis, Indiana

Section Four

You Don't Notice Me Anymore……………………Jason R. Burke-Moderator
Jeffrey M. Hester
Jason W. Cottrell
Elizabeth M. Little

JEFFREY M. HESTER

Hester Baker Krebs, LLC
Suite 1330 One Indiana Square
Indianapolis, IN 46204
317.608.1129
jhester@hbkfirm.com

PROFILE

Member, Hester Baker Krebs, LLC.

Practice areas: business and individual Chapter 7, 11, 11subV, 12 and 13 bankruptcy, reorganizations, litigation, in-Court and out-of-Court work-outs for debtors, creditors' rights, receiverships, transactions, and commercial law.

Board Certified Business Bankruptcy Law from the American Board of Certification.

Named to the list of Indiana Super Lawyers.

An author and lecturer at ICLEF, IBA on a multitude of bankruptcy and insolvency issues.

In continuous bankruptcy practice since 1999.

EDUCATION

Licensed to practice in Indiana and Hawaii.

Received B.A. in English and East Asian Language and Literature from Indiana University, Bloomington, In.,1995.

Received J.D. from Indiana University School of Law, Indianapolis, In., 1998.

Also attended the University of Hawaii School of Law, Manoa, Hawaii, and the University of Hong Kong School of Law, Hong Kong, P.R.C.

PROFESSIONAL ASSOCIATIONS

Indiana Association for Corporate Renewal, Past Board Member.

Indianapolis Bar Association, Commercial and Bankruptcy Section, Past President.

American Bankruptcy Institute.

Jason R. Burke
(317) 635-5005
jburke@bbrlawpc.com

Jason R. Burke began his legal career as an Assistant State Attorney in Florida prosecuting criminal cases. Jason moved to Indiana in 1996 and began representing corporations in Chapter 11 Bankruptcy proceedings. In 2000, Jason began primarily representing creditors in state court proceedings and in bankruptcy cases. Born in West Point, NY, Jason attended the University of Georgia for his undergraduate degree (cum laude, Phi Beta Kappa) and Washington & Lee University for his law degree (cum laude). Jason has been recognized as a "Super Lawyer" by an annual survey of peers published by Indianapolis Monthly magazine, and has the highest professional rating (AV) by Martindale Hubbell.

Professional Experience:

- Represents debtors and creditors in bankruptcy cases, including litigation involving claims of fraudulent transfers, preferences and subordination and reclassification issues.
- Represents businesses, banks, and individuals in commercial litigation.
- Represents financial institutions and borrowers regarding workouts, loan documentation and related business matters.

Bar Admissions:

- Florida (inactive), 1994
- Indiana, 1997
- U.S. District Court for the Southern District of Indiana, 1997
- U.S. District Court for the Northern District of Indiana, 2000

Educational Background:

- University of Georgia, A.B., cum laude, 1991, Phi Beta Kappa
- Washington & Lee University School of Law, J.D., cum laude, 1994

Professional and Charitable Organizations:

- Indianapolis Bar Association (Board of Directors, Commercial and Bankruptcy Law Section)
- Indiana State Bar Association (Member, Bankruptcy Law Section)
- American Bankruptcy Institute
- Indiana Association for Corporate Renewal

To see full profile visit www.bbrlawpc.com

Jason Cottrell

765.428.7081
jwc@stuartlaw.com

Education

- Indiana University Maurer School of Law, J.D.
- Purdue University – Krannert School of Management, B.S.

Jason heads Stuart + Branigin's Creditor's Rights Practice where he represents small businesses and financial institutions across the state.

To see his full profile please visit www.stuartlaw.com or scan below.

Bar Admissions

- Indiana
- U.S. District Court, Northern and Southern Districts of Indiana
- U.S. District Court, Western District of Michigan
- U.S. Bankruptcy Court, Northern and Southern Districts of Indiana
- U.S. Bankruptcy Court, Western District of Michigan
- U.S. Bankruptcy Court, Western District of New York

faegre drinker

faegredrinker.com

Elizabeth M. Little

Associate

elizabeth.little@faegredrinker.com

Elizabeth Little is an associate with the firm's finance and restructuring practice that provides integrated and strategic legal counsel on a full range of financial matters — complex financial transactions, corporate debt restructurings and related litigation matters — to clients with operations worldwide.

Contact Information

600 E. 96th Street, Suite 600
Indianapolis, Indiana 46240
D: +1 317 569 4608
F: +1 317 569 4800

Services & Industries

- Finance & Restructuring
  - Corporate Restructuring
  - Finance & Bankruptcy Litigation

Education

Indiana University Robert H. McKinney School of Law
J.D., summa cum laude, *Indiana Law Review* (executive notes editor) (2016)

Indiana University - Purdue University Indianapolis
B.A. (2011)

Bar Admissions

Indiana

Court Admissions

U.S. District Court for the Northern District of Indiana

U.S. District Court for the Southern District of Indiana

U.S. Court of Appeals for the Seventh Circuit

Honors

- Faegre Drinker – Pro Bono Honor Roll, 2020
- Faegre Baker Daniels — Pro Bono Honor Roll, 2015, 2017, 2019
- IUPUI Chancellor's Scholar for the Robert H. McKinney School of Law, 2016

Professional Organizations

- American Bar Association
- Indianapolis Bar Association

You Don't Notice Me Anymore

I. Notice Basics

Jeffrey M. Hester
Hester Baker Krebs LLC
One Indiana Square, Suite 1330
211 North Pennsylvania Street
Indianapolis, Indiana 46204
(317) 608-1129
jhester@hbkfirm.com

II. General Failure to List Assets, Creditors, and Contracts

Jason R. Burke
Blackwell, Burke & Ramsey, P.C.
101 West Ohio Street, Suite 1700
Indianapolis, Indiana 46204
(317) 635-5005
jburke@bbrlawpc.com

III. Sales

Jason W. Cottrell
Andrew Heisz
Stuart & Branigan LLP
300 Main Street, Suite 900
Lafayette, Indiana 47902
(765) 428-7081
jwc@stuartlaw.com
aah@stuartlaw.com

IV. Plans

Elizabeth M. Little
Faegre Drinker Biddle & Reath LLP
600 E. 96th Street, Suite 600
Indianapolis, Indiana 46240
(317) 569-4608
elizabeth.little@faegredrinker.com

NOTICE BASICS

I. Appropriate Notice

A. A discussion of notice starts with 11 U.S.C. §102(a):

In this title—
(1) "after notice and a hearing", or a similar phrase—

(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but

(B) authorizes an act without an actual hearing if such notice is given properly and if—

(i) such a hearing is not requested timely by a party in interest; or

(ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act;

11 U.S.C.S. § 102 (LexisNexis, Lexis Advance through Public Law 117-214, approved October 19, 2022).

B. The main Bankruptcy Rule on notice is Fed.R.Bank.P. 2002:

(a) **Twenty-one-day notices to parties in interest.** Except as provided in subdivisions (h), (i), (*l*), (p), and (q) of this rule, the clerk, or some other person as the court may direct, shall give the debtor, the trustee, all creditors and indenture trustees at least 21 days' notice by mail of:

(1)the meeting of creditors under § 341 or § 1104(b) of the Code [11 USCS § 341 or 1104(b)], which notice, unless the court orders otherwise, shall include the debtor's employer identification number, social security number, and any other federal taxpayer identification number;

(2) a proposed use, sale, or lease of property of the estate other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice;

(3) the hearing on approval of a compromise or settlement of a controversy other than approval of an agreement pursuant to Rule 4001(d), unless the court for cause shown directs that notice not be sent;

(4) in a chapter 7 liquidation, a chapter 11 reorganization case, or a chapter 12 family farmer debt adjustment case, the hearing on the dismissal of the case or the conversion of the case to another chapter, unless the hearing is under § 707(a)(3) or § 707(b) [11 USCS § 707(a)(3) or (b)] or is on dismissal of the case for failure to pay the filing fee;

(5) the time fixed to accept or reject a proposed modification of a plan;

(6) a hearing on any entity's request for compensation or reimbursement of expenses if the request exceeds $ 1,000;

(7) the time fixed for filing proofs of claims pursuant to Rule 3003(c);

(8) the time fixed for filing objections and the hearing to consider confirmation of a chapter 12 plan; and

(9) the time fixed for filing objections to confirmation of a chapter 13 plan.

(b) Twenty-eight-day notices to parties in interest. Except as provided in subdivision (*l*) of this rule, the clerk, or some other person as the court may direct, shall give the debtor, the trustee, all creditors and indenture trustees not less than 28 days' notice by mail of the time fixed (1) for filing objections and the hearing to consider approval of a disclosure statement or, under § 1125(f), to make a final determination whether the plan provides adequate information so that a separate disclosure statement is not necessary; (2) for filing objections and the hearing to consider confirmation of a chapter 9 or chapter 11 plan; and (3) for the hearing to consider confirmation of a chapter 13 plan.

Fed.R.Bankr.P. 2002

C. **Seventh Circuit.** The seminal case for handling a notice issues in the Seventh Circuit is *Fogel v. Zell*, 221 F. 3d 955 (7th Cir. 2000). In *Fogel* the Court concluding that not having received the notice to which it was entitled in the debtor's bankruptcy proceeding, appellant had the right to file a late claim and participate in the estate equally with the other unsecured creditors. In reaching this conclusion, the Court looked at the standards for content and delivery. The Court starts its inquiry with Section 102. In respect of 102, the Court advised:

> [a]ll the statute says is that the notice must be "appropriate in the particular circumstances," 11 U.S.C. § 102(1)(A), but the bankruptcy rules, a little more helpfully, provide that "the court may order notice by publication if it finds that notice by mail is impracticable." Bankr. R. 2002(l). The cases sensibly assume that the general norms of fair notice, as set forth in *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 94 L. Ed. 865, 70 S. Ct. 652 (1950); *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478, 489-91, 99 L. Ed. 2d 565, 108 S. Ct. 1340 (1988); *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 797-800, 77 L. Ed. 2d 180, 103 S. Ct. 2706 (1983), and other such cases, apply to bankruptcy as to other settings in which a person's legal right is extinguished if he fails to respond to a pleading. *In re Savage Industries,* supra, 43 F.3d at 721; *In re Auto-Train Corp.*, 258 U.S. App. D.C. 151, 810 F.2d 270, 278 (D.C. Cir. 1987).

Id. at 962. The Court then turns to content and delivery:

> [f]air or adequate notice has two basic elements: content and delivery. If the notice is unclear, the fact that it was received will not make it adequate. *Mullane v. Central Hanover Bank & Trust Co.*, supra, 339 U.S. at 314, 318; *Folger Adam Security, Inc. v. DeMatteis/MacGregor, JV*, 209 F.3d 252, 265 (3d Cir. 2000); *In re Barton Industries, Inc.*, 104 F.3d 1241, 1245-46 (10th Cir. 1997); *In re Linkous*, 990 F.2d 160, 162-63 (4th Cir. 1993); *In re Auto-Train Corp.*, supra, 810 F.2d at 279.

Id. at 962-63. As to delivery (or "means") the Court advised

> unless received, the notice was inadequate unless the means chosen to deliver it was reasonable . . . If his name and address are reasonably ascertainable, he is entitled to have that information sent directly to him, but, if not, then publication of the information in the newspaper or other periodical that he's most likely to see is permitted.

*Id. (*citation omitted).

D. **Flexibility.** Section 102 provides the Court flexibility: "[t]he goal is to provide flexibility and fairness—both the notice and the opportunity for a hearing should be 'appropriate in the particular circumstance.'" 2 Collier on Bankruptcy ¶ 102.2 [1](Richard Levin & Henry J. Sommer ends., 16th ed). This flexibility may provide for shortened notice, no notice (think of motions for rule 2004 and motions requiring the debtor to file tax returns), and even no hearing. On appeal, the bankruptcy court's exercise of this secretion will be reviewed for abuse of discretion. *Id.* at 102.2[2].

II. Southern District Noticing

A. **The start to any noticing issue is Code §102.** An applicable Code section should also be consulted. Some Code sections contain noticing provisions.

B. **The next text to be consulted should be the bankruptcy rules.** Start with the general provisions in Fed.R.Bank.P. 2002, 9006, 9007. Then more direct sections should be consulted. Very often, noticing issues will be addressed.

C. **After reviewing appropriate federal rule, the applicable local rules should be reviewed**. Start with the general rules at S.D.Ind. B-2002-1. Then consult the particular rule with the corresponding federal rule you reviewed.

D. **The procedures manual happens to be a major source of information on filing pleadings and notices.** It may even be the case that information in the PM is the only place to locate certain information.

E. **The instructions contained in the ECF filing menus themselves can sometimes contain vital information.**

F. **Pre-approval?**

1. Court review of notices is often the rule in chapter 11 and 12. This is a helpful procedure; however, filing party has ultimate responsibility for content and delivery.

2. Actual order approving notice. This used to be more common. Now perhaps only used in claims bar date notice in non-subV chapter 11s.

G. Motion combined with notice. Court approval not required. Very convenient. Provided for in Court form motions on website. Disadvantage is the added cost of notice and must make sure to get dates right.

B-2002-1. NOTICES TO CREDITORS, EQUITY SECURITY HOLDERS, AND UNITED STATES TRUSTEE

(a) Obtaining Service of Pleadings and/or Notices

Parties or their counsel who wish to receive copies of pleadings and documents – other than proofs of claim – shall file with the Clerk and serve the Debtor with an appearance in compliance with S.D. Ind. B-9010-1. A "Request for Notice" or similar pleading will be considered a request under Fed.R.Bankr.P. 2002(g) and will not entitle the filer to service of pleadings or of notices other than those to which the filer is already entitled.

(b) Notices Prepared and Distributed by Parties

A notice prepared and distributed by a party shall:

(1) be signed by the party, not the Clerk or the Judge, unless its form has been approved by the Court;

(2) instruct recipients to file pleadings with the Bankruptcy Clerk and provide the correct address of the division of the Bankruptcy Clerk's Office where pleadings should be delivered; and

(3) be docketed separately unless included in another pleading.

(c) Notices in Chapter 11 Cases in Which A Committee Has Been Appointed

Under Fed.R.Bankr.P. 2002(i) and unless otherwise ordered by the Court, the notices required by Fed.R.Bankr.P. 2002(a)(2)(excluding those related to the sale of substantially all of a debtor's assets), (3), and (6) may by served only on the Service List.

(d) Limited Notice in a Voluntary Case

In a voluntary Chapter 7, 12 or 13 case, 70 days following entry of the order for relief or the date of the order converting the case to Chapter 12 or 13, all notices required by Fed.R.Bankr.P. 2002(a), except the notice of the final report and of dismissal or denial of discharge, shall be mailed only to the Debtor, the trustee, the UST, creditors who have filed claims, and creditors who are still permitted to file claims by reason of an extension granted under Fed.R.Bankr.P. 3002(c)(1) or (2). In a Chapter 7 case where notice of insufficient assets to pay a dividend was given, notice can be limited pursuant to this subparagraph 90 days following the mailing of the notice setting a claims bar date.

(e) Limited Notice in an Involuntary Case

In an involuntary Chapter 7 case, after 90 days following entry of the order for relief, all notices required by Fed.R.Bankr.P. 2002(a) shall be mailed only to the Debtor, the trustee, the UST, creditors who have filed claims, and creditors who are still permitted to file claims by reason of an extension granted under Fed.R.Bankr.P. 3002(c)(1) or (2).

(f) Authorization for Chapter 13 Trustee to Recover Noticing Costs from Estate

If the Chapter 13 Trustee uses an independent contractor for noticing, the trustee may recover the actual costs of noticing charged by that contractor from each estate. If noticing is performed by the trustee, the trustee may recover from each estate the actual costs of postage plus $.18 for each notice or as otherwise ordered by the Court. These noticing fees can be recovered from the first and any subsequent funds received from the Debtor, whether before or after confirmation. The Chapter 13 Trustee shall list expenses charged for noticing in each case and separately identify the notices sent in the final report.

(g) Notice of Final Report with Notice of Applications for Compensation

In Chapter 7 cases in which the amount of net proceeds realized exceeds the amount set forth in Fed.R.Bankr.P. 2002(f)(8), or the amount of an application for compensation exceeds the amount set forth in Fed.R.Bankr.P. 2002(a)(6), the Chapter 7 Trustee shall send a 21-day Objection Notice of the trustee's final report and of the applications for compensation and reimbursement of expenses. Trustee shall file a copy of the notice and Certificate of Service.

(h) Returned and Undeliverable Mail

(1) Designation of the Debtor as Return Addressee

The Debtor is designated as the return addressee for orders and notices distributed by the Bankruptcy Noticing Center ("BNC").

(2) Duty to Provide Accurate Address

5

The Debtor shall file a notice of change of address for a creditor or party in interest whose address may not be accurate based either on the Debtor's receipt of returned mail or information received from the BNC. In addition, the Debtor shall distribute the documents required by S.D.Ind. B-1009-1(b)(2) to a creditor with a revised address. If the Debtor is unable to determine a correct address for a creditor or party in interest, the Debtor may file a Notice of Address Unavailability specifying the creditor's name and reporting that a correct address cannot be located.

(3) Returned Mail Received by the Clerk, Inaccurate Addresses Identified by Clerk's Noticing Agent, and Duty to Correct

The Clerk shall docket a returned notice of the Meeting of Creditors, unless the Court orders otherwise. The Debtor shall file a notice of change of address for such a creditor, if the correct address can be identified, shall distribute the documents required by S.D.Ind. B-1009-1(b) to a creditor with a revised address, and shall file a Certificate of Service. All other returned mail received by the Clerk shall be discarded.

III. Northern District Noticing

A. **There is no pre-approval of notices in the Northern District.** You will not find out if your notice is right or wrong until after the notice period is up. This is a substantial difference between the two Indiana districts.

B. **Noticing in the Northern District is less complicated, but the stakes are higher without the help of Court**. The rule itself tells you if the Court requires a hearing or not. There is no similar rule in the Southern District. If you want a hearing in a matter that the Court does not require a hearing, you will need to file a separate motion and ask the Court.

C. The above rule advised which matters the Court requires a hearing.

D. The above rule also discloses which matters the Court will hear on a 14 day notice period (from the federal rules); all others take 21 days. However the Court does not address the certain pleadings that require 28 days notice.

E. You have seven days from the filing of the motion to docket the certificate of service of the notice. In the Northern District you don't so much as docket the notice as you file a certificate of service with the notice attached.

F. **All notices must use the local forms.** This makes noticing easier perhaps than in the Southern District where there is no standard form. The two Northern District forms are:

a) Attach motion, brief description of relief in the notice. This way is easier and more error-proof, but noticing costs are increased.

b) Don't attach motion, but more detailed description. Greater chance for error, but noticing costs are less.

B-2002-2
Notice of Opportunity to Object to Motions
(a)Except as otherwise ordered, the court will consider the following matters without holding a hearing, unless a party in interest files a timely objection to the relief requested:

(1)Motions to approve agreements relating to relief from the automatic stay; providing adequate protection; or prohibiting or conditioning the use, sale or lease of property.

(2) Motions to approve agreements relating to the use of cash collateral.

(3) Motions for authority to obtain credit.

(4) In cases pending under Chapter 7, motions for relief from the automatic stay.

(5) Motions to avoid liens on exempt property.

(6) Motions to redeem personal property from liens.

(7) Applications for administrative expenses, including compensation for services rendered and reimbursement of expenses.

(8) Motions to extend the time for filing claims.

(9) Motions to extend the exclusivity periods established by 11 U.S.C. § 1121 for filing a Chapter 11 plan.

(10) Motions to extend the time to assume or reject executory contracts and unexpired leases.

(11) Motions filed by a trustee or debtor-in-possession to assume or reject executory contracts and unexpired leases.

(12) Motions to approve a modification to a confirmed Chapter 11, Chapter 12 or Chapter 13 plan.

(13) Motions to approve a compromise or settlement.

(14) Motions to transfer a case to another district or to another division in this district.

7

(15) Motions to approve transactions outside the ordinary course of business, except motions for the sale or lease of personally identifiable information.

(16) Motions to sell property free and clear of liens and/or to distribute the proceeds of sale, except motions to sell or lease personally identifiable information.

(17) Motions to abandon property of the estate.

(18) Motions for relief from the co-debtor stay of 11 U.S.C. § 1201 or § 1301.

(19) Motion for the joint administration or substantive consolidation of cases.

(20) Motions to compel the debtor to turnover or deliver property to a trustee.

(21) In cases under Chapter 12 and 13, motions for a discharge prior to the completion of payments under a confirmed plan (motions for hardship discharge).

(22) Motion of a party in interest to enter a final decree in a case under Chapter 11.

(23) Trustees' Application to Employ Professionals after Notice to Creditors filed pursuant to N.D. Ind. L.B.R. B-2014-2(b).

(24) Applications to employ professionals retroactively.

(25) Motions for discharge in individual Chapter 11 cases.

(26) Motions to determine final cure pursuant to FRBP Rule 3002.1(h).

(27) Motions for order declaring lien satisfied pursuant to FRBP Rule 5009(d).

(28) In cases under Chapter 12 and 13, applications to employ professionals, other than debtor's counsel.

(b) Except as otherwise ordered by the court:

(1) no less than fourteen (14) days notice shall be given of the opportunity to file objections to:

(A)motions to approve agreements relating to relief from the automatic stay, providing adequate protection, prohibiting or conditioning the use, sale or lease of property;

(B)) motions to approve agreements relating to the use of cash collateral;

(C) motions for authority to obtain credit;

(D) motions for relief from the automatic stay in cases pending under Chapter 7; and estate.

(E) motions relating to abandonment of property from the estate

(2) no less than twenty-one (21) days notice shall be given of the opportunity to file objections to the other motions subject to this rule.

In all cases, the time within which objections may be filed shall be measured from the date notice of the opportunity to object is served.

(c) Local Bankruptcy Form 3a (LBF-3a), Local Bankruptcy Form 3b (LBF-3b) or another form of notice substantially similar thereto shall be used to give creditors and parties in interest notice of the motion and the opportunity to object thereto. This notice must (1) identify the party seeking relief, (2) state the name of the motion and the date upon which it was filed, (3) briefly and specifically state what you are asking the court to do, (4) contain a brief summary of the ground for the motion or have a copy of the motion attached to it, (5) state the date by which objections to the motion are to be filed, where objections should be filed and upon whom copies should be served, (6) contain a statement to the effect that if no objections are filed by the date due the court may grant the relief requested without holding a hearing, (7) be dated as of the date it is served, and (8) be signed by counsel for the movant or the movant, if pro se, and contain the name, address and telephone number of the individual signing the notice.

(d) The moving party shall be responsible for properly completing the appropriate version of LBF-3 so that it contains the required information, serving it upon the entities required by the United States Bankruptcy Code, the applicable rules of bankruptcy procedure, the local rules of this court,1 and/or any order of the court, and making due proof thereof. The failure to do so within seven (7) days of the date the motion was filed will be deemed to be a waiver of any time limits associated with ruling on the motion, including the time limits set forth in 11 U.S.C. § 362(e).

(e) The appropriate version of LBF-3 may also be adapted for use in those instances, not specifically covered by this rule, where the court directs that particular relief may be granted without a hearing following the expiration of notice to creditors. In those situations, in addition to complying with the other requirements of this rule, the notice shall be accompanied by a copy of the court's order authorizing notice to creditors and establishing the deadline for filing objections.

IV. Notice Times

A. Some rules only require 14 days (cash collateral agreements; motions to obtain credit; motions to abandon; relief from stay agreements).

B. The default time period is at least 21 days (2002 list plus almost everything else).

C. Some pleadings require 28 days (disclosure statement; confirmation of chapter 11 or 13 plan.

D. You can adjustment these time frames (9006). Must plead good cause. S.D. & N.D. Pleading good cause is often over looked. It used to be that every motion filed in a chapter 11 case was done on shortened notice. Judges have definitely tightened up on this and often look for cause. And that cause must be good.

V. Sub V Items

A. First Days. These use standard first days noticing rules.

B. General Notices

1. BNC will do the 341 notice and notice of the Status Conference. This is convenient for the debtor.

2. The Debtor must distribute notice on application to employ; allowance of fees; plan/ballot/confirmation hearing. If the case goes well, that might be all the noticing you need to do.

General Failure to List Assets, Creditors, and Contracts (Jason Burke)

A. Where does the list of parties to receive notice come from?

1. Debtor's Statutory Duties

a. 11 U.S.C. §1106(a)

Pursuant to 11 U.S.C. §1106(a), the debtor in possession has all of the rights and powers and shall perform all the functions and duties of a trustee serving in a case under Chapter 11. As such, 11 U.S.C. §1106(a) requires that the debtor:

1. perform the duties of a trustee as specified in paragraphs 2, 5, 7, 8, 9, 10, 11, and 12 of §704(a) (see below);

2. file the list, schedule, and statement required under §521(a)(1) (see below);

3. investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan; and

4. file a statement of any investigation conducted, including any fact pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate.

b. 11 U.S.C. §704(a)

Therefore, a debtor in possession, pursuant to 11 U.S.C. §704(a), must:

1. be accountable for all property received;

2. examine proofs of claim and object to the allowance of any claim that is improper;

3. furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

4. file with the court, the United States Trustee, and with any governmental unit charged with responsibility for collection or determination of any tax, periodic reports and summaries of the operation of the debtor in possession's business, including a statement of receipts and disbursements, and such other information as the United States Trustee or the court requires; and

5. make a final report and file a final account of the administration of the estate with the court and with the United States Trustee.

c. 11 U.S.C. §521(a)

The debtor in possession's duties also include that the debtor in possession file:

1. a list of creditors;

2. a schedule of assets and liabilities;

3. a schedule of current income and current expenditures; and

4. a statement of the debtor's financial affairs.

In performing its duties, a trustee in bankruptcy owes the estate and its creditors a general duty of loyalty. See, *Mosser v. Darrow*, 341 U.S. 267, 71 S.Ct. 680, 95 L.Ed. 927 (1951). ("Equity tolerates in bankruptcy trustees no interest adverse to the trust . . . exacting from them forbearance of all opportunities to advance self-interest that might bring the disinterestedness of their administration into question.") "A debtor in possession is vested with significant power under the Bankruptcy Code and that power comes with certain responsibilities. A debtor in possession owes a fiduciary duty to its creditors." *In re Ozcelebi*, 639 B.R. 365, 388 (Bankr.S.D.Tex. 2022)(citations omitted).

Implicit in every bankruptcy filing is a duty of good faith from the debtor. "The implicit good faith requirement prevents abuse of the bankruptcy process . . . [and] implies an honest intent and genuine desire on the part of the petitioner to use the statutory process to effect a plan of reorganization and not merely as a device to serve some sinister or unworthy purpose." *In re Ozcelebi*, 639 B.R. 365, 396 (Bankr.S.D.Tex. 2022).

Debtor's attorneys who work with the debtor to manipulate schedules and statements of financial affairs (for example, to minimize creditors' distributions) or to otherwise sign such petitions, lists, schedules, and statements in lieu of the debtor signing may violate Bankruptcy Rule 9011 and/or criminal statutes. *See*, *Handeen v. Lemaire*, 112 F.3d 1339 (8th Cir. 1997) (attorney who intentionally inflated debtor's expenses to minimize a creditor's distribution may have violated the Civil Racketeer, Influenced, and Corrupt Organization Act).

It is the debtor's knowledge of the existence of a creditor rather than the creditor's knowledge of its claim which controls whether the debtor has the duty to list that creditor. *In re Maya Construction Company*, 78 F.3d 1395 (9th Cir. 1996).

2. Debtor's Duties by Rule

a. BR 1007

Within fourteen (14) days of filing the petition, the debtor shall file:

1. schedules of assets and liabilities;
2. a schedule of current income and expenditures;
3. a schedule of executory contracts and unexpired leases;
4. a statement of financial affairs; and
5. copies of all payment advices or other evidence of payment received by an individual debtor from an employer within sixty (60) days before filing.

In addition, in a voluntary case, the debtor shall file:

1. a list containing the name and address of each entity included or to be included on Schedules D, E/F, G, and H;
2. If the debtor is a corporation, a corporate ownership statement containing the information described in BR 7007.1;
3. a list of the debtor's equity security holders of each class of equity showing the number and kinds of interest registered in the name of each holder and the last known address or place of business of each holder; and
4. a list containing the name, address, and claim of the creditors that hold the twenty (20) largest unsecured claims, excluding insiders. This list is for the purpose of selecting a committee of unsecured creditors.

If a list, schedule, or statement is not prepared and filed as required by this Rule, the court may order the trustee, a petitioning creditor, committee, or other party to prepare and file any such list, schedules, and statements within a time fixed by the court. The court may approve reimbursement of the costs incurred in complying with such an order as an administrative expense.

Pursuant to the advisory committee notes, the requirement that the debtor provide a list of names and addresses of the entities to whom notice must be sent, otherwise known as the "**mailing matrix**", is "essential to the operation of the bankruptcy system". The cross reference to the schedules as the source of the names for inclusion in the list ensures that persons such as co-debtors or non-debtor parties to executory contracts will receive appropriate notices in the case.

An attorney for a debtor is under an obligation of integrity to the court and has the duty to make reasonable inquiry into the accuracy of the debtor's petition before the debtor signs the petition, schedules, and statements. *In re Matthews*, 154 B.R. 673, 680 (Bankr.W.D.Tex. 1993). The attorney should ask probing and pertinent questions to illicit full and honest disclosure from the debtor and check the responses in the petition, statements, and schedules to be sure they are consistent. *Id*.

It is the debtor's burden to ascertain and provide correct addresses for the creditors. *In re O'Shaughnessy*, 252 B.R. 722 (Bankr.N.D.Ill. 2000). (See, below). It is incumbent upon the debtor to amend the schedules to reflect all names by which the debtor is known in order to provide notice of a case. *In re Bozeman*, 219 B.R. 253, 254 & Note 2 (Bankr.W.D.Ark., affirmed 226 B.R.627 (BAP 8th Cir. 1998). The debtor has no discretion in determining whether a debt is sufficiently significant to include in the schedules. *In re Weldon*, 184 B.R. 710, 715 (Bankr.D.S.C. 1995). The schedules and statements, requiring full disclosure at the inception of the case, are carefully designed to elicit certain information necessary to the proper administration and adjudication of the case. *Id*. Rule 1007 compels complete and accurate disclosure of financial affairs. *In re Olmstead*, 220 B.R. 986 (Bankr.D.N.D. 1998). **Numerous inaccuracies may warrant denial of discharge**. *Id*. (emphasis added).

Debtors have "an absolute duty to ensure one's schedules and statement of financial affairs is complete and accurate. 'Indeed, the operation of the bankruptcy system depends on honest reporting.' The consequences for playing fast and loose with the Bankruptcy Code's disclosure requirements are severe. Evidence that a debtor withheld financial information may result in a finding of bad faith." *In re Ozcelebi*, 639 B.R. 365, 397-98 (Bankr.S.D.Tex. 2022)(citations omitted)(converting a subchapter V case to Chapter 7 and referring the matter for investigating by the U.S. Attorney due to inaccuracies in debtor's schedules).

b. BR 1008

All petitions, lists, schedules, statements, and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 U.S.C. §1746. 28 U.S.C. §1746 provides that an unsworn verification has the equivalent effect of a verification if the declarant states, in writing, that the information is true under penalty of perjury.

3. Illustrative Case Concerning Failure to Schedule Creditors: *In re O'Shaughnessy*, 252 B.R. 722 (Bankr.N.D.Ill. 2000)

- The court allowed the creditor to file a late proof of claim and an adversary complaint for non-dischargeability notwithstanding the fact that the debtor's amended plan had been confirmed and substantially consummated with payments to unsecured creditors. The court further held open the possibility that the debtor would be sanctioned for its actions in intentionally omitting a creditor from his schedules. *Id*. at 738.
- The court stated that this case pits constitutional procedural due process arguments against the principles of finality and the res judicata effect of a confirmed reorganization plan. It illustrates how important it is for all debtors in bankruptcy cases to properly schedule and list all of their possible creditors so that bar date notices can be served. *Id*. at 727; 732.
- "The purpose of requiring a debtor to list creditors with their proper mailing addresses is to afford those creditors basic due process notice". *Id*. at 729 (citations omitted). "An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Id*. (citations omitted).
- "A party with actual notice of a bankruptcy case must act diligently to protect its interests, despite the lack of formal notice". *Id*. at 730, *citing In re Marino*, 195 B.R. 886, 893 (Bankr.N.D.Ill. 1996) ("a creditor, who knows of the proceeding but has not received formal notice, should be prevented from standing back and allowing the bankruptcy action to proceed . . .."). A creditor's informal, actual knowledge of a pending bankruptcy case is sufficient to satisfy due process. *Id*.; See, *In re Pence*, 905 F.2d. 1107, 1109 (7th Cir. 1990).
- "When applying the Bankruptcy Code and Rules would deny a claimant its procedural due process rights in violation of the 5th Amendment of the

Constitution, then the Constitution must take precedence and the Code and Rules must be set aside or modified in their application . . . as the Seventh Circuit has opined: '[i]t is universally agreed that adequate notice lies at the heart of due process. Unless a person is adequately informed of the reasons for denial of a legal interest, a hearing serves no purpose and resembles more a scene from Kafka than a constitutional process.'" *Id.* at 732 *quoting Chicago Cable Communications v. Chicago Cable Commission*, 879 F.2d 1540, 1546 (7th Cir. 1989).

- "The **debtor bears the burden** (emphasis added) of attempting to ascertain correct addresses for its creditors. See, *In re Robertson*, 13 B.R. 726, 731 (Bankr.E.D.Vir. 1981) ('although a bankrupt is not required to exhaust every possible avenue of information in ascertaining a creditor's address, he must exercise reasonable diligence in accurately scheduling his debts.'). . . . [this case] was started with a voluntary petition by the debtor who was obligated under 11 U.S.C. §521(1) and Federal Rule of Bankruptcy Procedure 1007(A)(1) to list each creditor with address, among other data, and information to be supplied to show the debtor's complete financial situation. Complete and full disclosure is the *quid pro quo* of the substantial benefits obtained by the automatic stay of 11 U.S.C. §362(a) which is subsumed by the discharge provisions of 11 U.S.C. §1141 in a Chapter 11 case. If debtors seek such protection, it is incumbent upon them to list and give notice to all possible creditor claimants, including those whose claims are disputed, unliquidated, or contingent." *Id.* at 734-735.
- **The burden is on the debtors to complete their schedules accurately**. (Emphasis added). *In re Faden*, 96 F.3d. 792, 795 (5th Cir. 1996)(quotation omitted). In addition, the burden of proof rests with the debtor to show that a creditor had notice or actual notice. *Id.* (citation omitted). **"The burden is on the debtor . . . to demonstrate absence of fraud or intentional design."** *Id.* at 796 (*quoting Rion v. Springer (In re Springer)*, 127 B.R. 702, 708 (Bankr.M.D.Fla. 1991)). *Id.* at 738. (Emphasis added).

4. Penalties for Violations

It is a violation of Rule 9011 for an attorney to sign the debtor's name to a petition, list, schedule, and/or statement. The petition and schedules are required to be signed by the debtors themselves, under oath. *In re Beshears*, 196 B.R. 468, 471-72 & Note 2 (Bankr.E.D.Ark. 1996). Rule 9011(A) requires that every petition, pleading, written motion, and other paper be signed by at lease one attorney of record in the attorney's individual name. **The rule, however, excludes lists, schedules, statements, or amendments**

thereto from the requirement that an attorney sign in the attorney's individual name.

Pursuant to 18 U.S.C. §152, a person who knowingly and fraudulently makes a false oath in or in relation to any case under Title 11 or knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under 28 U.S.C. §1746, or in relation to any case under Title 11, is subject to fine and/or imprisonment of not more than five (5) years.

B. Property of the Estate

1. What is property of the estate? - 11 U.S.C. §541(a)

Upon commencement of a case, the bankruptcy estate is comprised of:

- i. all legal or equitable interests of the debtor in property as of the commencement of the case;
- ii. all interests of the debtor and the debtor's spouse in community property;
- iii. certain property recovered post-petition (for example, fraudulently transferred property);
- iv. any interests in property that would have been property of the estate if the interest had been an interest of the debtor on the petition date, which the debtor acquires and becomes entitled to acquire within one hundred eighty (180) days by bequest or inheritance, as a result of a property settlement, or a beneficiary of a life insurance policy; and
- v. any interest in property that the estate acquires after the commencement of the case, including any proceeds, product, offspring, rents, or profits from the property of the estate, excepting post-petition earnings from services performed by an individual debtor after the commencement of the case.

All such property constitutes property of the estate wherever located and by whomever held.

2. Undisclosed Property

The debtor in possession's failure to disclose assets or a cause of action may warrant the application of judicial estoppel precluding the debtor from bringing subsequent action. *See*, *United States ex rel. Gebert v. Transport Administration Services*, 260 F.3d 909 (8th Cir. 2001); *In re Coastal Plains Inc.*, 179 F.3d 197 (5th Cir. 1999); *Barger v. City of Cartersville*, 348 F.3d 1289 (11th

Cir. 2003). Reva Capalla and Mark Capalla v. Wilbert Best and Best Vineyards, LLC 2022 WL 16545539 (Ind.App.Ct. 2022).

The instant a bankruptcy petition is filed, a claim, whether disclosed or not disclosed, becomes property of the estate under §541 and the trustee (debtor in possession) becomes the real party in interest. Such a claim remains property of the estate unless and until the trustee abandons it. *See*, *Parker v. Wendy's International Inc.*, 365 F.3d 1268 (11th Cir. 2004); *Kane v. National Union Fire Insurance Company*, 535 F.3d 380 (5th Cir. 2008).

Even if not disclosed, the property remains property of the estate after the case is closed. This means that the debtor lacks control over the asset, the asset remains subject to the bankruptcy stay, the asset was never abandoned by the trustee, and any action against the asset taken without proper authority or relief from the bankruptcy court is void. *In re Enyedi*, 371 B.R. 327, 336 (Bankr.N.D.Ill. 2007).

3. Undisclosed Executory Contracts

Section 365 of the Bankruptcy Code provides that the debtor may assume or reject an executory contract. An executory contract that is not assumed in a Chapter 11 case is not necessarily deemed rejected. Therefore, an undisclosed executory contract may "ride through" a bankruptcy case and continue to exist after the plan is confirmed and the case is closed. See, *Diamond 2 Trailer, Inc. v. JZ LLC (In re JZ LLC)*, 371 B.R. 412, 422-25 (BAP 9th Cir. 2007). The debtor's obligations under such contract, arising after confirmation, may not have been discharged.

C. Ethical Concerns

Scenario: A longtime client gets stiffed on big project compelling filing a bankruptcy case. It will be a big one. As you are working with the client to put together schedules you come across information that shows the client has not given you a complete list of creditors and/or assets. You bring this to client's attention and client claims it was an oversight. You come away with a deep and abiding belief that the client is not being honest with you and that there are probably other creditors and/or assets being left out for various reasons. What do you do?

Rule 1.3 Diligence: A lawyer shall act with a reasonable diligence and promptness in representing a client. (A lawyer must act with commitment and dedication to the interests of the client).

Rule 2.1 Advisor: In representing a client, a lawyer shall exercise independent, professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social, and political factors that may be relevant to the client's situation. (A client is entitled to straightforward advice expressing a lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront. A lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client).

Rule 3.3(A) Candor Toward the Tribunal: A lawyer shall not knowingly: (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; (2) fail to disclose to the tribunal legal authority and the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or (3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false. (Paragraph (A)(3) requires that the lawyer refuse to offer evidence that the lawyer knows to be false, regardless of the client's wishes. This duty is premised on the lawyer's obligation as an officer of the court to prevent the trier of fact from being mislead by false evidence).

Rule 4.1 Truthfulness in Statements to Others: In the course of representing a client, a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6. (A misrepresentation can occur if the lawyer incorporates or affirms a statement or another person that the lawyer knows is false).

Going, Going, Gone…Maybe- Notice and Its Effect on 11 USC §363(b) sales

By: Jason W. Cottrell and Andrew Heisz
Stuart & Branigin LLP
300 Main Street, Suite 900
Lafayette, Indiana 47902
jwc@stuartlaw.com
aah@stuartlaw.com

Seminar Materials for:
Steven H. Ancel Annual
BANKRUPTCY INSTITUTE
ICLEF Conference Facility
230 E. Ohio St., 5th Floor,
Indianapolis, Indiana 46204

December 22, 2022

<u>Table of Contents</u>

INTRODUCTION

When deciding on a title for this material, I wanted to use something somewhat catchy and whimsical. However, as I started performing the research necessary to populate this material, I began to realize, though the title may accomplish both of my goals, the title captures the potential reality of failing to provide proper notice to a party holding an interest in the item(s) subject to the sale.

I begin this material by providing the relevant bankruptcy statutes and rules one must initially consult when inquiring about the notice required for a sale that is out of the ordinary course of business. While I know my fellow panel members may include some, or all, of these statutes and rules in their material, I wanted to provide all the pertinent information in one location of the seminar material. I do appreciate your patience.

1) **Pertinent Statutes and Bankruptcy Rules.**

   a. **11 USC § 363(b)(1)(A), and (B)**

The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or such lease is consistent with such policy; or
(B) after appointment of a consumer privacy ombudsman in accordance with section 332 [11 USCS § 332], and after notice and a hearing, the court approves such sale or such lease—
(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and
(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

b. 11 USC § 363(f)

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
(2) such entity consents;
(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
(4) such interest is in bona fide dispute; or
(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

c. USCS Bankruptcy R 2002 (a),(c), and (g)

(a) Twenty-one-day notices to parties in interest. Except as provided in subdivisions (h), (i), (l), (p), and (q) of this rule, the clerk, or some other person as the court may direct, shall give the debtor, the trustee, all creditors and indenture trustees at least 21 days' notice by mail of:

(2) a proposed use, sale, or lease of property of the estate other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice;

(c) Content of notice.

(1) Proposed use, sale, or lease of property. Subject to Rule 6004, the notice of a proposed use, sale, or lease of property required by subdivision (a)(2) of this rule shall include the time and place of any public sale, the terms and conditions of any private sale and the time fixed for filing objections. The notice of a proposed use, sale, or lease of property, including real estate, is sufficient if it generally describes the property. The notice of a proposed sale or lease of personally identifiable information under § 363(b)(1) of the Code [11 USCS § 363(b)(1)] shall state whether the sale is consistent with any policy prohibiting the transfer of the information.

(g) Addressing notices.

(1) Notices required to be mailed under Rule 2002 to a creditor, indenture trustee, or equity security holder shall be addressed as such entity or an authorized agent has directed in its last request filed in the particular case. For the purposes of this subdivision—

(A) a proof of claim filed by a creditor or indenture trustee that designates a mailing address constitutes a filed request to mail notices to that address, unless a notice of no dividend has been given under Rule 2002(e)and a later notice of possible dividend under Rule 3002(c)(5) has not been given; and

(B) a proof of interest filed by an equity security holder that designates a mailing address constitutes a filed request to mail notices to that address.

(2) Except as provided in § 342(f) of the Code [11 USCS § 342(f)], if a creditor or indenture trustee has not filed a request designating a mailing address under Rule 2002(g)(1) or Rule 5003(e), the notices shall be mailed to the address shown on the list of creditors or schedule of liabilities, whichever is filed later. If an equity security holder has not filed a request designating a mailing address under Rule 2002(g)(1) or Rule 5003(e), the notices shall be mailed to the address shown on the list of equity security holders.

d. USCS Bankruptcy R 6004 (a),(b), and (c)

(a) Notice of proposed use, sale, or lease of property. Notice of a proposed use, sale, or lease of property, other than cash collateral, not in the ordinary course of business shall be given pursuant to Rule 2002(a)(2), (c)(1), (i), and (k) and, if applicable, in accordance with § 363(b)(2) of the Code [11 USCS § 363(b)(2)].

(b) Objection to proposal. Except as provided in subdivisions (c) and (d) of this rule, an objection to a proposed use, sale, or lease of property shall be filed and served not less than seven days before the date set for the proposed action or within the time fixed by the court. An objection to the proposed use, sale, or lease of property is governed by Rule 9014.

(c) Sale free and clear of liens and other interests. A motion for authority to sell property free and clear of liens or other interests shall be made in accordance with Rule 9014 and shall be served on the parties who have liens or other interests in the property to be sold. The notice required by subdivision (a) of this rule shall include the date of the hearing on the motion and the time within which objections may be filed and served on the debtor in possession or trustee.

e. Local Rules

i. Northern District of Indiana

1. B-2002-2 (a)(15) and (16), (b)(1), and (c) Notice of Opportunity to Object to Motions

   (a) Except as otherwise ordered, the court will consider the following matters without holding a hearing, unless a party in interest files a timely objection to the relief requested:

(15) Motions to approve transactions outside the ordinary course of business, except motions for the sale or lease of personally identifiable information.

(16) Motions to sell property free and clear of liens and/or to distribute the proceeds of sale, except motions to sell or lease personally identifiable information.

(b) Except as otherwise ordered by the court:
(1) no less than fourteen (14) days notice shall be given of the opportunity to file objections to:

(A) motions to approve agreements relating to relief from the automatic stay, providing adequate protection, prohibiting or conditioning the use, sale or lease of property;

(B) Local Bankruptcy Form 3b (LBF-3b) or another form of notice substantially similar thereto shall be used to give creditors and parties in interest notice of the motion and the opportunity to object thereto. This notice **must** (1) identify the party seeking relief, (2) state the name of the motion and the date upon which it was filed, (3) briefly and specifically state what you are asking the court to do, (4) contain a brief summary of the ground for the motion or have a copy of the motion attached to it, (5) state the date by which objections to the motion are to be filed, where objections should be filed and upon whom copies should be served, (6) contain a statement to the effect that if no objections are filed by the date due the court may grant the relief requested without holding a hearing, (7) be dated as of the date it is served, and (8) be signed by counsel for the movant or the movant, if pro se, and contain the name, address and telephone number of the individual signing the notice.

2. B-6004-1 Sales Outside the Ordinary Course of Business

(a) A motion to sell property of the bankruptcy estate outside the ordinary course of business shall be served upon the United States trustee, any committee and/or the entities included on any list required by Fed. R. Bankr. P. 1007(d), and all entities that can be discovered through a reasonably diligent inquiry holding liens upon or having interests in the property to be sold.
(b) Notice of the motion must be given to all creditors and parties in interest, unless the court orders otherwise, in addition to service of the motion itself as required by paragraph (a).

ii. Southern District of Indiana

1. B-6004-1 (a) and (b) Sales Outside the Ordinary Course of Business

   (a) A motion to sell property of the bankruptcy estate outside the ordinary course of business shall be served upon the United States trustee, any committee and/or the entities included on any list required by Fed. R. Bankr. P. 1007(d), and all entities that can be discovered through a reasonably diligent inquiry holding liens upon or having interests in the property to be sold.
   (b) Notice of the motion must be given to all creditors and parties in interest, unless the court orders otherwise, in addition to service of the motion itself as required by paragraph (a).
   (c) Sale of Co-Owned Property A party proposing to sell co-owned property shall satisfy the requirements of S.D.Ind. B-7001-2.
   (d) Procedure; Contents of Motion; Notice A Motion to Sell shall comply with S.D.Ind. B-6004-2 through B-6004-4, depending on the type of sale, unless the Court orders otherwise.

2. B-6004-2(b), (c), and (d) PRIVATE SALE

   (b) Contents of Motion: All Chapters A Motion to Sell by private sale shall have attached a copy of the agreement and identify:
   (1) the property to be sold;
   (2) the amount of a claimed exemption in the property;
   (3) the prospective purchaser ("Prospective Purchaser");
   (4) the sales price and an estimate of the net proceeds to be received by the estate, including a deduction for any exemption;
   (5) a brief summary of all material contingencies to the sale;
   (6) a description of the manner in which the property was marketed for sale, and a description of any other offer to purchase;
   (7) a description of any relationship between the Prospective Purchaser and its insiders and the Debtor and its insiders or the trustee;
   (8) a statement setting forth any relationship or connection the trustee or the Debtor or its insiders will have with the Prospective Purchaser or its insiders after sale consummation;
   (9) a disclosure if the property to be sold contains personally identifiable information and, if so, the measures that will be taken to comply with 11 U.S.C. § 363(b)(1); and
   (10) if the proposed sale seeks to sell property free and clear of liens or other interests under 11 U.S.C. § 363(f), the names of the lien or interest holders.

(c) Contents of Motion: Additional Requirements in Chapter 11 Cases A Motion to Sell by private sale in a Chapter 11 case that proposes the sale of all or substantially all of the Debtor's assets shall include, in addition to the requirements in subparagraph (b) of this rule, a summary of the Debtor's debt structure, including the amount of the Debtor's secured debt, priority claims, and general unsecured claims.

(d) Notice

(1) Distribution; Contents; Certificate of Service Generally The movant shall distribute notice of any hearing or deadline to object to a Motion to Sell, as determined by subparagraphs (d)(2) and (3) of this rule, unless the Court orders otherwise. The notice shall contain all of the information required by subparagraphs (b) and (c) of this rule. The movant shall file a Certificate of Service. The motion, notice, and Certificate of Service may be combined into one document, a sample of which is available on the Court's website.
(2) Chapter 7, 12, and 13 Cases In a Chapter 7, Chapter 12, or Chapter 13 case, the movant shall provide a 21-day Objection Notice of the Motion to Sell, unless the Court orders otherwise.
(3) Chapter 11 Case In a Chapter 11 case, the movant shall contact the courtroom deputy to obtain direction as to whether the Court desires a notice with opportunity to object to the Motion to Sell or a hearing notice. The movant shall distribute the notice and file a Certificate of Service.

3. B-6004-3 (b) and (c). SALE BY AUCTION

(b) Contents of Motion A Motion to Sell by auction shall identify:
(1) the property to be sold;
(2) the amount of a claimed exemption in the property;
(3) the name of and contact information for the entity conducting the auction;
(4) the date, time, and place of the sale, if known, or instructions on how that information can be obtained;
(5) any bid procedures proposed for the sale;
(6) a disclosure if the property to be sold contains personally identifiable information and, if so, the measures that will be taken to comply with 11 U.S.C. § 363(b)(1); and
(7) if the proposed sale seeks to sell property free and clear of liens or other interests under 11 U.S.C. § 363(f), the names of the lien or interest holders.

(c) Notice The movant shall provide a 21-day Objection Notice of the Motion to Sell, unless the Court orders otherwise. The notice shall provide the information required by subparagraph (b) of this rule. The movant shall also file a Certificate of Service. The motion, notice, and Certificate of Service may be combined into one document, a sample of which is available on the Court's website.

4. B-6004-4(b) and (c). SALE WITH PROSPECTIVE PURCHASER IDENTIFIED BUT BIDS CONSIDERED.

(b) Contents of Motion to Sell with Bid Procedures A Motion to Sell to a prospective purchaser but with bids considered shall identify or include:

(1) the property to be sold;
(2) the amount of a claimed exemption in the property;
(3) the prospective purchaser ("Prospective Purchaser");
(4) the sales price and an estimate of the net proceeds to be received by the estate, including a deduction for any exemption;
(5) a brief summary of all material contingencies to the sale, together with a copy of the agreement, if available;
(6) if the proposed sale seeks to sell property free and clear of liens or other interests under 11 U.S.C. § 363(f), the names of the lien or interest holders;
(7) the executory contracts and leases proposed to be assumed or rejected as part of the sale, if any;
(8) a description of the manner in which the property was marketed for sale, and a description of other purchase offers;
(9) a description of any relationship between the Prospective Purchaser and its insiders and the Debtor and its insiders or the trustee;
(10) a statement setting forth any relationship or connection the trustee or the Debtor or its insiders will have with the Prospective Purchaser after the consummation of the sale;
(11) if a fee is proposed to be paid to the Prospective Purchaser and another bidder prevails at the sale, a statement of the conditions under which the fee would be payable and the factual basis on which the seller determined the provision is reasonable;
(12) the identities of any other entity that expressed to the movant an interest in the purchase of all or a material portion of the assets to be sold within 90 days prior to the filing of the sale motion, the offers made by them, if any, and the nature of the offer;
(13) the bid procedures proposed for the sale;

> (14) a disclosure if the property to be sold contains personally identifiable information and, if so, the measures that will be taken to comply with 11 U.S.C. § 363(b)(1); and
> (15) if the case is pending under Chapter 11, and proposes the sale of all or substantially all of the Debtor's assets, the following:
> (A) if schedules have not been filed by the Debtor, a summary of the Debtor's debt structure, including the amount of the Debtor's secured debt, priority claims, and general unsecured claims; and
> (B) if a creditors' committee, or its equivalent, existed pre-petition, the identity of the members of the committee and the companies with which they are affiliated and the identity of any counsel.
>
> (c) Notice of Motion to Sell and to Approve Bid Procedures The movant shall prepare, for Court review, a notice of the Motion to Sell and of the proposed bid procedures that contains the information required by subparagraph (b) of this rule. The movant shall provide a 21-day Objection Notice of the Motion to Sell or the Court may instead direct the issuance of a hearing notice and will provide the movant with a hearing date and time and any objection deadline that shall be included in the notice. Upon distribution of the notice, the movant shall file a Certificate of Service.

After reviewing these statutes and rules, one quickly surmises that a seller must provide an interested party with advance notice of the specifics about the sale, i.e., the who, the what, and the where, and how to oppose the sale if the interest holder should want. Now, all the seller must do is identify the entities that qualify as interest holders or need to receive this requisite notice.

2) Breadth of definition for "Interest" as used in §363(f) and R 6004

In most of the situations involving a sale, the seller will want to sell the item "free of and clear of liens and other interest." The seller's motivation for this type of sale is obvious. An unencumbered item will result in a higher sale price. To enable a seller to shed all encumbrances, the seller must not only follow USCS Bankruptcy R 2002, which requires the seller to provide notice to the trustee and all creditors but must also follow the notice requirements of USCS

Bankruptcy R 6004. R. 6004 adds those parties that have liens or other interest in the [proposed sale] property to the list of those needing to receive notice.

By defining the terms “creditor” and “liens”, the Bankruptcy Code makes the process of identifying these parties easy. *See* 11 U.S.C. § 101(10) and (37). However, the Code fails to define “interest” or those entities that may possess an interest in the item being sold.

> The Bankruptcy Code does not specifically define the term "interest" as used in Section 363(f). However, "the trend seems to be in favor of a broader definition that encompasses other obligations that may flow from ownership of the property." 3 Collier on Bankruptcy ¶ 363.06 (2022). "[T]he Code itself does not suggest that 'interest' should be understood in a special or narrow sense; on the contrary, the use of the term 'any' counsels in favor of a broad interpretation." *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 545 (7th Cir. 2003) (*citing United States v. Gonzales*, 520 U.S. 1, 5, 117 S. Ct. 1032, 137 L. Ed. 2d 132, (1997)).

In re Norrenberns Foods, Inc., 642 B.R. 825, 829 (Bankr. S.D. Ill. 2022)

By applying this broad interpretation approach, “courts have permitted a ‘broader definition that encompasses other obligations that may flow from ownership of the property.’" *Elliott v. GM LLC (In re Motors Liquidation Co.)*, 829 F.3d 135, 155 (2d Cir. 2016) (*citing* 3 *Collier on Bankruptcy* ¶ 363.06[1]). Instead of formulating a definite test or definition, courts will generally weigh each case and the presented factual situation on a case-by-case basis. *Id*. (referencing *In re PBBPC, Inc.*, 484 B.R. 860, 867 (B.A.P. 1st Cir. 2013)(internal citations omitted).

Most circuits take a liberal interpretation of the word “interest” and find that a party’s claim qualifies as an “interest” in the item being sold if “a relationship [exists] between the right to demand…payments from the debtors and the use to which the debtors had put their assets” being sold. *See In re TWA*, 322 F.3d 283, 289 (3rd Cir. 2003). In *Trans. World Airlines*, the debtor had sold all its assets within the bankruptcy to American Airlines free and clear of any interest in the property. *Id.* at 285. Before the sale's consummation, groups of the debtor's former employees holding unused travel vouchers and EEOC claims objected to the sale, requesting that their interest survive and pass through the sale to allow them to assert successor in interest claims against American Airlines.[1] Those employees holding travel vouchers received these vouchers as part of a settlement they received from pre-petition claims against the debtor.[2]The court overruled the EEOC and employees' objections and approved the asset sale order.[3] After the bankruptcy court's order, the EEOC pursued a series of appeals that eventually ended in the Third Circuit Court of Appeals.

The Third Circuit Court of Appeals upheld the original bankruptcy court's order, overruled the EEOC and the former employees' objections, and severed any connection of their claims from the sold assets, and the right to assert a successor in interest claim against American Airlines.[4] In so ordering, the court opined; "had [the debtor] not invested in the airline assets, which required the employment of the EEOC claimants, those successor liability claims would not have arisen."[5] By finding this connection between the EEOC and the former employees' claims and the assets, the court found this connection was severed when the assets were sold free and clear in accordance with 11 U.S.C § 363(f), and these parties were barred from asserting successor liability claims after the sale and against American Airlines.[6]

---

[1] *Id.*
[2] *Id.*
[3] *Id.* at 286-287.
[4] *Id.* at 290-293.
[5] *Id.* at 290.
[6] *Id.* at 293.

Other circuits and other bankruptcy courts also use this attenuated connection reasoning to determine that an "interest" exists between entities' claims and the items sold in accordance with 11 U.S.C. §363(f). *See In re Motor Liquidation Co.*, 829 F.3d 135 (2nd Cir. 2016)(where the Second Circuit Court of Appeals opined that parties who hold product defect claims against the debtor held an "interest" in the assets sold by the debtor in a 11 U.S.C. § 363(f) sale). *See also United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co.)*, 99 F.3d 573, 576 (4th Cir. 1996). *See also In re Verity Health Sys. of Cal.*, 606 B.R. 843, 845 (Bankr. C.D. Cal. 2019)(where the bankruptcy court found that liabilities owed to the California Department of Health Care Services were statutory liabilities which were "interest" in Medi-Cal Provider Agreements and said liabilities could be severed from those agreements when those agreements were sold in accordance with 11 U.S.C. §363(f)). *See also In re White Motor Credit Corp.*, 75 Bankr. 944 (Bankr. S.D. Ohio 1987) (holding that 363(f) precluded tort claims against an asset purchaser). *In re All American of Ashburn, Inc.*, 56 Bankr. 186 (Bankr. N.D. Ga. 1986) (holding that 363(f) precluded successor liability in a product liability claim); *In re New England Fish Co.*, 19 Bankr. 323 (Bankr. W.D. Wash. 1982) (holding that a free and clear sale under the Bankruptcy Code precludes Title VII claims against the successor).

However, the Seventh Circuit falls outside of those circuits that formally adopt this attenuated approach when ruling that a sale in accordance with 11 U.S.C. 363(f) shields the sale purchaser from successor liability. Rather, the courts within the Seventh Circuit appear to be split in their approach to claims like successor liability. *See DirectBuy, Inc. v. Buy Direct, LLC*, No. 2:15-CV-

344-JPK, 2022 U.S. Dist. LEXIS 40550 (N.D. Ind. Mar. 8, 2022) (where the district court supports its decision from the holdings in *Zerrand-Bernal Group v. Cox*, 23 F.3d 159 (7th 1994) and *Chi. Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc.*, 59 F.3d 48, 49 (7th Cir. 1995) to find that the 11 U.S.C. §363(f) fails to apply a blanket prohibition to an unsecured creditor's ability to bring a successor liability claim against the purchaser).[7] *See Ninth Ave. Remedial Grp. v. Allis-Chalmers Corp.*, 195 B.R. 716, 720 (N.D. Ind. 1996)(where the court found that holders of CERLA claims arising before the conclusion of the bankruptcy proceedings were barred from bringing successor liability, and those holders of claims occurring after were not). Whereas *see In re Norrenberns Foods, Inc.*, 642 B.R. 825, 829 (Bankr. S.D. Ill. 2022) and *In re Vista Mktg. Grp. Ltd.*, No. 12-B-83168, 2014 Bankr. LEXIS 1441, at *1 (Bankr. N.D. Ill. Mar. 28, 2014)(where the courts followed the interpretation established in *In re TWA*, 322 F.3d 283).

Despite this potential split in interpretations amongst the districts within the Seventh Circuit, one would be wise to take a liberal and broad approach to or definition of "interest" and attempt to notice as many parties as possible at the time of motioning for sale of an item free and clear of any liens and interest in accordance with 11 U.S.C ¶363(f). Parties are rarely punished for sending out too much information or providing notice to too many parties or entities.

[7] It should be noted that Magistrate Judge Kolar did restrict and qualify his decision. Specifically, he stated that his opinion was strictly based on the current record before him, and wroted, "[t]he Court cautions that it has not reached any firm conclusions on the issues discussed herein" [that is a 11 U.S.C. §363(f) precluding or prohibiting successor liability of the purchaser]. *DirectBuy, Inc. v. Buy Direct,* 2022 U.S. Dist. LEXIS 40550 at 48.

3) **Failure to Provide Notice**

Now that you know the statutes and rules, and have an idea of the pool of entities that must receive advance notice of any sale of an item outside of the ordinary course of business, what happens if you fail to provide notice to an entity that was entitled to receive it? Like in many other circumstances, an unnoticed party will be unaffected by the action, meaning that the sale will not affect the unnoticed entity's interest in that sold item. *See Archer-Daniels-Midland Co. v. Country Visions Coop.*, 628 B.R. 315, 322 (E.D. Wis. Feb. 19, 2021). Thus, in most cases, a purchaser will not receive the item free and clear even if the debtor attempted to sell the item in accordance with 11 U.S.C. § 363(f), and the purchase will need to contend with the unnoticed interest post-sale.

One may ask whether any situations or scenarios may overcome a defect of a party receiving notice. This section looks at two possible scenarios and answers that question for both.

Finally, this section will also identify what happens to a claim against or an interest in the item being sold when a noticed creditor fails to raise it before the item is sold.

a. To Parties Holding an Interest

i. Effect of Party's Actual Knowledge Despite No Procedural Notice

Hypothetically, actual knowledge can stand in the place of procedural notice. *See Doolittle v. Cty. of Santa Cruz (In re Metzger),* 346 B.R. 806 (Bankr. N.D. Cal. 2006). However, given the amount of information and its specificity requirements, a real-life scenario where a claim or interest holder possess the requisite information to achieve this task of replacing actual notice seems less probable.

In *In re Metzger*, and as to actual knowledge, the court opined:

> The level of knowledge must be examined in each case to determine it rises to the level required to comport with due process. *In re Halux*, 665 F.2d 213, 216 (8th Cir. 1981) (evidence of actual knowledge must be more substantial than discussion in general terms of possible auction at some undetermined future date); *Loloee*, at 662 [*In re Loloee*, 241 B.R. 655, 662 (9th Cir. B.A.P. 1999)](holders of liens thatmay be adversely affected are entitled to unambiguous notice and an adequate opportunity to reflect and respond); *Center Wholesale*, at 1448 [In re Center Wholesale, Inc., 759 F.2d 1440,1448 (9th Cir. 1985)] (notice must fulfill due process requirements of timeliness and specificity and must be examined in light of the Code's statutory requirements, safeguards, and remedies).

Id. at 817. The court also determined in a Chapter 11 bankruptcy case that this actual knowledge must be about the sale and items involved, and not just the bankruptcy itself. *Id.* at 817-818. The court supported this conclusion and rejected any inquiry notice requirements of the unnoticed party that had knowledge of the underlying Chapter 11 bankruptcy because:

> In a chapter 11 case, the creditor who is not given notice, even if he has actual knowledge of reorganization proceedings, does not have a duty to investigate and inject himself into the proceedings.

Id. at 818. Bankruptcy courts in the Seventh Circuit follow the same logic and reasoning when it comes to actual knowledge replacing procedural notice. *See In re Olsen*, 563 B.R. 899 (Bankr. E.D. Wis. 2017)(where the court found that ambiguous information in a telephone call about a potential sale at a confirmation hearing one week away did not provide the unnoticed party with the requisite information, time, or opportunity to protect its interest). *See also Compak Cos., LLC* *v. Johnson*, 415 B.R. 334, 335 (N.D. Ill. 2009)(where the party had no notice of the sale but had notice of the related bankruptcy proceeding).

Therefore, if the debtor or sale item purchaser hope to overcome a notice deficiency by arguing that an unnoticed party had actual knowledge of the sale, then the asserting party must show that the unnoticed party had actual knowledge of the sale, the details of that sale, enough time to assert the unnoticed party's interest, and the knowledge on how to assert that interest, i.e., how to object to the sale.

ii. Notice Mailed to Listed Address despite it being the Improper Address

Unless a creditor, or a party holding an interest in the item being sold, specifies a different mailing address, notices must be mailed to the address shown on the list of creditors or schedule of liabilities, whichever is filed later. *See* Fed. R. Bankr. P. 2002(g). Thus, if the debtor sends the notice to the listed address and the address is wrong, then the debtor fulfills its procedural requirement. However, a party that never receives notice of the sale, even if a debtor sent such notice to the address listed, can still challenge the sale on the grounds that the order is void in accordance with Fed. R. Civ. P. 60(b)(4). This topic will be discussed in more detail later.

b. From Parties Holding an Interest

A party holding an interest in the item being sold free and clear that has notice of a requested sale holds an obligation to assert that interest before the item is sold or suffer the loss of that interest. *See Ragosa v. Canzano (In re Colarusso)*, 295 B.R. 166 (B.A.P. 1st Cir. 2003). In *In re*

Colarusso, the party holding an interest argued that it held an adverse possession claim on a portion of the real estate being sold.[8] The party further argued that the disputed area was not part of the bankruptcy estate and could not be sold because of her adverse possession claim or interest.[9] The party asserting the adverse possession interest participated in the bankruptcy, received notice of the sale, placed a bid at the sale, and never raised an objection asserting its argument before the sale.[10] The court found, given all of these factors, that the party now asserting the adverse possession consented to the sale being free and clear by its actions and inactions, including its possible adverse possession claim or interest.[11]

4) Mootness

a. Statutory Mootness — 11 USC § 363(m)

Section 363(b) of the Bankruptcy Code permits a debtor-in-possession, "after notice and a hearing," to "sell . . . property of the estate." 11 U.S.C. § 363(b)(1). In a section 363(b) asset sale, the debtor-in-possession may sell the estate property "free and clear of any interest in such property of an entity." Id. § 363(f).

Should the bankruptcy court approve the sale, the Bankruptcy Code provides a degree of finality to the estate and the purchaser. Section 363(m) provides that:

[8] *Id.* at 169-170.
[9] *Id.*
[10] *Id.*
[11] *Id.* at 175.

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

11 U.S.C. § 363(m). The effect of this provision is to render statutorily moot any appellate challenge to a sale that is both to a good faith purchaser, and not stayed. *Mission Prod. Holdings, Inc. v. Old Cold LLC (In re Old Cold LLC)*, 879 F.3d 376, 383 (1st Cir. 2018); *see also In re Andy Frain Services, Inc.*, 798 F.2d 1113, 1127 (7th Cir. 1986).

The first circuit has explained that Section 363(m) applies even if the bankruptcy court's approval of the sale was not proper, so long as the bankruptcy court was acting under section 363(b). *Id.* at 388. Section 363(m) sets forth only two requirements: that there is a good faith purchaser, and that the sale is unstayed. The Seventh Circuit has also elaborated on the importance of honoring Section 363 (m). In its ruling in *Frain Services,* the court denied the appeal of a party that challenged the validity of a 363(m) sale—but did not obtain a stay of the sale—and explained that:

> If a party could willfully ignore the law, as Wilson has done, and then upset a sale to a good faith purchaser by attacking specific terms of the sale agreement, section 363(m) would be meaningless. Given the important role section 363(m) plays in assuring a good faith purchaser at a bankruptcy sale good title, we find that the sale, including all of its terms, cannot be challenged on appeal when the appellant fails to obtain a stay.

798 F.2d at 1127. The role that 363(m) plays is to provide finality and protection to good faith purchasers at 363(b) sales. The Code strongly favors finality because the protection of good faith purchasers maximizes the value of the assets for sale, which benefits both debtors and

creditors. *Hower v. Molding Sys. Eng'g Corp.*, 445 F.3d 935, 937-938 (7th Cir. 2006) (citing *In re CGI Indus., Inc*., 27 F.3d 296, 299 (7th Cir. 1994)).[12]

b. Obtaining a Stay – Evidentiary Requirements

Bankruptcy Rule 8007. Stay Pending Appeal; Bonds; Suspension of Proceedings

(a) Initial motion in the bankruptcy court.

(1) *In general.* Ordinarily, a party must move first in the bankruptcy court for the following relief:

(A) a stay of a judgment, order, or decree of the bankruptcy court pending appeal;

(B) the approval of a bond or other security provided to obtain a stay of judgment;

(C) an order suspending, modifying, restoring, or granting an injunction while an appeal is pending; or

(D) the suspension or continuation of proceedings in a case or other relief permitted by subdivision (e).

(2) *Time to file.* The motion may be made either before or after the notice of appeal is filed.

(b) Motion in the district court, the BAP, or the court of appeals on direct appeal.

(1) *Request for relief.* A motion for the relief specified in subdivision (a)(1)—or to vacate or modify a bankruptcy court's order granting such relief—may be made in the court where the appeal is pending.

(2) *Showing or statement required.* The motion must:

(A) show that moving first in the bankruptcy court would be impracticable; or

(B) if a motion was made in the bankruptcy court, either state that the court has not yet ruled on the motion, or state that the court has ruled and set out any reasons given for the ruling.

(3) *Additional content.* The motion must also include:

(A) the reasons for granting the relief requested and the facts relied upon;

(B) affidavits or other sworn statements supporting facts subject to dispute; and

(C) relevant parts of the record.

(4) Serving Notice. The movant must give reasonable notice of the motion to all parties.

(c) Filing a bond or other security. The district court, BAP, or court of appeals may condition relief on filing a bond or other security with the bankruptcy court.

[12] *C.f. Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599,602 (7th Cir. 2019) (holding that section 363(m) did not moot an appeal involving a dispute over the proceeds of a sale of assets in bankruptcy. "We now hold that § 363(m) does not make any dispute moot or prevent a bankruptcy court from deciding what shall be done with the proceeds of a sale or lease.").

(d) Bond or other security for a trustee or the United States. The court may require a trustee to file a bond or other security when the trustee appeals. A bond or other security is not required when an appeal is taken by the United States, its officer, or its agency or by direction of any department of the federal government.
(e) Continuation of proceedings in the bankruptcy court. Despite Rule 7062 and subject to the authority of the district court, BAP, or court of appeals, the bankruptcy court may:

> **(1)** suspend or order the continuation of other proceedings in the case; or
> **(2)** issue any other appropriate orders during the pendency of an appeal to protect the rights of all parties in interest.

A court may, in its discretion, stay a 363(b) sale pending an appeal. In considering whether to stay a 363(b) sale, a court will apply the same discretionary factors as applied in other motions for stay pursuant to Fed. R. Civ. P. 62. A party seeking the stay must demonstrate that (1) it is likely to succeed on the merits, (2) it will suffer irreparable injury unless the stay is granted, (3) no substantive harm will come to other interested parties, and (4) the stay will do no harm to the public interest. *In re Ross*, 223 B.R. 702, 703 (B.A.P. 8th Cir. 1998). The movant must prove each of these elements by a preponderance of the evidence. *See In re Wire rope Corp. of Am., Inc.*, 302 B.R. 646, 648 (W.D. Mo. 2003).

Pursuant to Fed. R. Bankr. P. 8007, courts generally require the appellant to post a bond or other security to cover any loss to the purchaser caused by the delay of an appeal, should the appeal prove unsuccessful. Such a procedure is, of course, essential in bankruptcy cases, for without such protection for good faith purchasers, few, if any, persons would participate in federal bankruptcy sales. *Andy Frain*, 798 F.2d at 1125.

c. Good Faith Purchaser Defined

First, and true to its name, a good faith purchaser must act “in good faith” with respect to the integrity of its conduct in the course of the sale proceedings. *In re Rock Industries Machinery Corp.*, 572 F.2d 1195 (7th Cir. 1978). This means that the party must purchase without fraud, misconduct, or collusion, and must not take “‘grossly unfair’ advantage of other bidders.” *Mission Prod. Holdings*, 879 F.3d at 383 (*quoting In re Andy Frain Servs., Inc.*, 798 F.2d 1113, 1125 (7th Cir. 1986)).

Along with the requirement to comport with a general definition of “good faith,” the First Circuit has established two additional prongs to consider when determining if a purchaser acted in good faith. The First Circuit’s second prong of the good faith purchaser definition requires the buyer to have purchased the property "for value." *Id.* (citing *Greylock Glen Corp. v. Comty. Sav. Bank*, 656 F.2d 1, 4 (1st Cir. 1981)). If a purchaser buys in good faith at a fairly-conducted auction, paying the auction price is sufficient evidence of having paid value. *Licensing by Paolo, Inc. v. Sinatra* (*In re Gucci*), 126 F.3d 380, 390 (2d Cir. 1997).

The First Circuit’s third and final requirement is that a good faith purchaser must not have knowledge of adverse claims. *Greylock Glen Corp*., 656 F.2d at 4. Recent caselaw from the Seventh Circuit indicates that it will also consider a buyer’s knowledge of adverse claims when determining if the buyer acted in bad faith. “Someone who has both actual and constructive knowledge of a competing interest, yet permits the sale to proceed without seeking the judge's assurance that the competing interest-holder may be excluded from the proceedings, is not acting in good faith." *Archer-Daniels-Midland Co. v. Country Visions Coop.*, 29 F.4th 956, 959 (7th Cir. April 4, 2022).

In *Archer-Daniels*, the buyer's constructive knowledge was established by the adverse claimant's right of first refusal's presence in the real estate records. *Id.* Actual knowledge was established by the buyer's possession of a title search report showing the adverse claim, plus the fact that the buyer learned of the adverse claimant's inquiries regarding the sale. *Id.*

A likely appellate challenge to the sale itself is not the type of "adverse claim" that, if known, deprives the purchaser of good faith status. *Mission Product*, 879 F.3d at 386-87 (citing 11 U.S.C § 363(m) (stating that the statutory protection applies "whether or not [the purchaser] knew of the pendency of the appeal") (brackets in original)).

Nor does knowledge of an objection to the sale procedures constitute knowledge of an adverse claim. As the Fifth Circuit held in *In re TMT Procurement Corp*, there "is a difference . . . between simply having knowledge that there are objections to the transaction and having knowledge of an adverse claim." *TMT Procurement Corp. v. Vantage Drilling Co.* (*In re TMT Procurement Corp*.), 764 F.3d 512, 522 (5th Cir. 2014) (per curiam); *see also Shupak v. Dutch Inn of Orlando, Ltd.* (*In re Dutch Inn of Orlando, Ltd.*), 614 F.2d 504, 506 (5th Cir. 1980) (per curiam) ("[M]ere knowledge of the claims . . . that are the basis of this appeal does not deprive [the purchaser] of the protection accorded to a good faith purchaser.").

Acknowledging that the Bankruptcy Code neither defines “good faith” nor states how it is to be established, the Seventh Circuit has placed the burden on the party alleging bad faith or seeking reconsideration of a good faith finding. *Hower v. Molding Sys. Eng'g Corp*., 445 F.3d 935, 939 (7th Cir. 2006) (citing *In re Andy Frain Servs., Inc*, 798 F.2d at 1125); *see also Katten v. Bailey*, 1995 U.S. Dist. LEXIS 14431, at *17, No. 95-C-2720 (N.D. Ill. Oct. 2, 1995) (applying *Andy Frain* and concluding that "upon appearing before the Bankruptcy Court, the plaintiff-appellants were required to establish by a preponderance of the evidence that Edward Fox was not a good faith purchaser").

A finding that a purchaser was a good faith purchaser is an appealable ruling. “Good faith” is a factual finding and reviewed for clear error. *Hower*, 445 F.3d at 938 (citing *In re Smith*, 286 F.3d 461, 464 (7th Cir. 2002)).

d. Rule 9024/Fed. R. Civ. P. Rule 60(b) Effect.

As set forth above, the purpose of Section 363(m) is to provide finality to the sales conducted pursuant to Section 363(b). If a purchaser acted in good faith, and a stay of the sale was not obtained, then any challenge to the sale should be statutorily moot.

However, even if a 363(b) sale is not stayed and the time for appeal has passed, the sale may be subject to challenge in accordance with the provisions of Fed. R. Civ. P. 60(b). *In re Edwards*, 962 F.2d 641, 643 (7th Cir. 1992) (citing *In re Met-L-Wood Corp.*, 861 F.2d 1012, 1016 (7th Cir. 1988)). Fed. R. Civ. P. 60 is applied to bankruptcy provisions via Bankruptcy Rule 9024. The time limits of 60(c) apply; and a motion for relief under Sections 60(b)(1) – (3) must be made within one year after the entry of judgment. However, there is no time limit for a motion pursuant to 60(b)(4), based on the argument that the judgment is void. *Id.* at 644. A claim that a party was deprived of due process, notice, and an opportunity to be heard may be raised in a 60(b)(4) motion for relief. *In re Olsen*, 563 B.R. 899, 904 (Bankr. E.D. Wis. February 17, 2017) (citing *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 271 (2010), *aff'd*, 628 B.R. 315 (E.D. Wis. February 19, 2021, *aff'd*, 29 F.4th 956959 (7th Cir. April 4, 2022).

A collateral attack on a 363(b) sale via 60(b)(4) is, of course, at odds with 363(m) and the Code's design to provide finality to the sale. However, the Bankruptcy Code cannot do away with one's Constitutional right to notice and due process. The Seventh Circuit has stated that it will address a 60(b)(4) challenge to a 363(b) sale by considering the competing interests, rather than with a formula. *In re Edwards*, 962 F.2d at 644.

In *Edwards*, the court determined that the interest in vesting a bona fide purchaser with good title outweighed the interest of the creditor who challenged the 363(b) sale (which had taken place over eighteen months before the creditor brought its 60(b)(4) challenge). *Id.* at 645.

> The strong policy of finality of bankruptcy sales embodied in section 363(m) provides, in turn, strong support for the principle that a bona fide purchaser at a bankruptcy sale gets good title, *In re Met-L-Wood Corp.*, 861 F.2d at 1018; *In re Mann*, 907 F.2d 923, 926 (9th Cir. 1990), even if the section does not of its own force preclude collateral attack on such sales. (And it does not, at least if our reading of *In re Sax* is correct.) Rule 60(b) must be interpreted in fight of this policy. The policy would mean rather little if years after the sale a secured creditor could undo it by showing that through some slip-up he hadn't got notice of it.

Id. However, the Wisconsin Eastern Bankruptcy Court ruled in *In re Olsen*, that although the purchaser in that case was not a good faith purchaser, even if it was, the balancing of interests would support granting the interested party's 60(b)(4) motion because that party had a right of first refusal that it could have exercised if it had received proper notice. 563 B.R. at 909. (Note that (1) the *Olsen* court would not have been invalidating the entire sale, only allowing the interested party to exert its right of first refusal, and (2) the higher courts affirming the Olsen ruling tended to focus on the ruling that the purchaser was not a good faith purchaser and subsequent discussion regarding the alternative ruling granting the 60(b)(4) motion was only tangential.)

e. Equitable Mootness ("The Nameless Doctrine")

The concept of equitable mootness "bars" the prosecution of an appeal or action when a comprehensive change of circumstances has occurred such that it would be inequitable and/or imprudent for the reviewing court to address the merits of the appeal.[13] *In re Continental Airlines*, 91 F.3d 553, 560 (3d Cir. 1996). Appellees and courts may employ the doctrine of equitable mootness when a 363(b) sale or a Chapter 11 reorganization plan is subject to appeal or challenge via 60(b)(4).

The term "equitable mootness," on its face, would indicate that when there is no equitable relief possible in a bankruptcy matter, courts may declare the issue equitably moot. However, many

[13] The doctrine of equitable mootness is sometimes criticized as an abrogation of federal courts' constitutional obligation to hear appeals within their jurisdiction. *See In re One2One Commc'ns, LLC*, 805 F.3d 428 (3d Cir. 2015) (Krause, J., concurring).

courts, including the Seventh Circuit, have recognized that often “equitable mootness” is cited when equitable relief is still *possible* (i.e. the court has authority under Article III of the Constitution and could fashion some form of relief) but would be imprudent.

For this reason, "equitable mootness" has been characterized as a misnomer: "There is nothing equitable about the equitable mootness doctrine. . . . The matter is moot out of necessity, not application of equitable principles. In a very real sense the doctrine is more accurately denominated as ‘prudential mootness.’” *In re Box Brother Holding Corp*., 194 B.R. 32, 45 (Bankr. D. Del. 1996). In fact, the term “equitable mootness” has been banished from the Seventh Circuit lexicon. *In re UNR Indus.*, 20 F.3d 766, 769 (7th Cir. 1994). However, the underlying arguments are still valid within the Circuit.

> Several provisions of the Bankruptcy Code of 1978 provide that courts should keep their hands off consummated transactions. For example, 11 U.S.C. § 363(m) says that the reversal of an order authorizing the sale or lease of property of an estate "does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal". Unless the sale is stayed pending appeal, the transaction survives even if it should not have been authorized in the first place. *See In re Sax*, 796 F.2d 994 (7th Cir. 1986); *cf. In re Edwards*, 962 F.2d 641 (7th Cir. 1992) (concluding that § 363(m) does not, however, forbid all forms of collateral attack). Another section of the Code, 11 U.S.C. § 1127(b), dramatically curtails the power of a bankruptcy court to modify a plan of reorganization after its confirmation and "substantial consummation". Section 1127(b), unlike § 363(m), does not place any limit on the power of the court of appeals, but the reasons underlying §§ 363(m) and 1127(b)--preserving interests bought and paid for in reliance on judicial decisions, and avoiding the pains that attend any effort to unscramble an egg--are so plain and so compelling that courts fill the interstices of the Code with the same approach. Sometimes the doctrine goes under the banner "equitable mootness," but the name is misleading. There is a big difference between inability to alter the outcome (real mootness) and unwillingness to alter the outcome ("equitable mootness"). Using one word for two different concepts breeds confusion. Accordingly, we banish "equitable mootness" from the (local) lexicon.

> We ask not whether this case is moot, "equitably" or otherwise, but whether it is prudent to upset the plan of reorganization at this late date.

Id. (emphasis added). While the Seventh Circuit frowns upon the term "equitable mootness," it recognizes the necessity to weigh interests at stake when asked to undo a consummated transaction in a bankruptcy proceeding.

Most courts utilize the same five factors when considering, in light of the relief requested, whether it is prudent to address the merits of an interested party's claim:

(1) whether the reorganization plan has been substantially consummated,
(2) whether a stay has been obtained,
(3) whether the relief requested would affect the rights of the parties not before the court,
(4) whether the relief requested would affect the success of the plan, and
(5) the public policy of affording finality to bankruptcy judgments.

In re Continental Airlines, 91 F.3d at 560; *Milfam II LP v. Am. Commer. Lines, LLC* (*In re Am. Commer. Lines, LLC*), case no. 03-90305-BHL-11 U.S. Dist. LEXIS 65494, *9, (S.D. Ind. March 30, 2006).[14]

While the doctrine of equitable mootness is most commonly used to block the appeal of an approved reorganization plan under Chapter 11, the Second Circuit and Bankruptcy Appellate Panel for the First Circuit have applied the principal to a range of appeals involving all manner of bankruptcy court orders. *GLM DFW, Inc. v. Windstream Holdings, Inc.* (*In re Windstream*

[14] "In applying this doctrine that is now nameless within the Seventh Circuit, the court must consider whether the reorganization plan has been substantially consummated; whether a stay has been obtained; whether the relief requested would affect parties not before the court; whether the relief requested would affect success of the plan; and the public policy of affording finality to bankruptcy judgments."

Holdings, Inc.), 838 Fed. Appx. 634, 637 (2d Cir. 2021); *La Trinidad Elderly LP SE v. Loiza Ponce Holdings LLC*, 627 B.R. 779, 795 (1st Cir. B.A.P. 2021).

In *TransUnion Risk & Alternative Data Sols., Inc. v. Best One, Inc.* (*In re TLFO, LLC*), 572 B.R. 391, 434 (Bankr. S.D. Fla. 2016), the Bankruptcy Court for the Southern District of Florida applied the doctrine of equitable mootness when declining a motion to reconsider a 363(b) sale.

"The public policy of affording finality to bankruptcy judgments is better described as the lens through which the other equitable mootness factors should be viewed." *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d at 190. The same considerations for general public policy affording finality of reorganization plans are equally applicable to affording finality to 363(b) sales.

> [W]e should ask whether we want to encourage or discourage reliance of investors and others on the finality of bankruptcy confirmation orders. The strong public policy in favor of maximizing debtor's estates and facilitating successful reorganization, reflected in the code itself, clearly weighs in favor of encouraging such reliance. Indeed, the importance of allowing approved reorganizations to go forward in reliance on bankruptcy court confirmation orders may be the central animating force behind the equitable mootness doctrine. . . . the allowance of such appellate review would likely undermine public confidence in the finality of bankruptcy confirmation orders and make successful completion of large reorganization like this more difficult.

Continental Airlines, 91 F.3d at 565 (citations omitted) (ellipses added). The same sentiment was expressed by the Seventh Circuit in *UNR Industries*, recognizing that protecting the interests of those who acquire assets through bankruptcy proceedings increases the price that the estate can realize for the property and benefits all creditors in the aggregate. 20 F.3d at 770.

> And it is the reliance interests engendered by the plan, coupled with the difficulty of reversing the critical transactions, that counsels against attempts to unwind things on appeal. Every incremental risk of revision on appeal puts a cloud over the plan of reorganization, and derivatively over the assets of the reorganized firm. People pay less for assets that may be snatched back or otherwise affected by subsequent events. . . . By protecting the interests of persons who acquire assets in reliance on a plan of reorganization, a court increases the price the estate can realize ex ante, and thus produces benefits for creditors in the aggregate. Many common law doctrines, such as the rule that a holder in due course takes free of certain defects in its predecessor's rights, reflect the importance of this effect. We do likewise in preserving plans of reorganization unless a powerful reason demands alteration.

Id. (ellipses added). While it may be best not to use the term "equitable mootness,"[15] the underlying doctrine and its reasoning may be useful to employ if a party is seeking to undo a substantially consummated transaction within a bankruptcy proceeding.

5) **Precautions**
   a. Prior Court Approval of Notice
   b. Title Searches- Both by Buyer and Seller
   c. Constructive Notice

CONCLUSION

The Bankruptcy Code is written to provide finality to judgments within a bankruptcy proceeding, but ultimately the actions of the parties involved can determine whether a transaction is truly final, and the sale item gone with the bang of the auctioneer's gavel, or vulnerable to lingering challenges. All sides of a 363(b) transaction will benefit from common-sense due diligence, an expansive interpretation of the term "interest" under 363(f), liberally provided notice, and candor towards the tribunal. A purchaser will benefit from the protections awarded to a good faith

[15] At least in the Seventh Circuit. *See In re UNR Indus.*, 20 F.3d at 769.

purchaser under 363(m) and the bankruptcy debtor will benefit because the transaction will be afforded significant protection from future challenge or appeal, leading to a more efficient resolution to the bankruptcy proceedings.

If you find yourself on the other side of the table and need to appeal an order approving a 363(b) sale, make every reasonable effort to obtain a stay.

ETHICAL CONSIDERATIONS:

A long-standing client, that did not seek your representation on this hypothetical case until now, initially purchased an asset through an 11 USC § 363(b)(1) sale that was challenged/appealed. The appellant did not seek a stay of the order pending the appeal, and the appellant won. Your client asked you to assert the good faith purchaser assertion/ argument provided in 11 USC § 363(m), allowing him/her/it to be unaffected by the appeal. You file the motion.

Afterward, through additional fact investigation/discovery, you learn your client's actions and activity(ies) not only potentially compromise the client's assertion that the client is a good faith purchaser[16], but contradict representations made in your motion and may also expose the client to potential liability under 363(n). Your client remains adamant about continuing the course. What do you do, why, and what possible ethical exposure do you incur?

Consider:

<u>Rule 1.2. Scope of Representation and Allocation of Authority Between Client and Lawyer</u>

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, as to a plea to be entered, whether to waive jury trial and whether the client will testify.

[16] Recall, for example that "Someone who has both actual and constructive knowledge of a competing interest, yet permits the sale to proceed without seeking the judge's assurance that the competing interest-holder may be excluded from the proceedings, is not acting in good faith." *Archer-Daniels*, 29 F.4th at 959.

(b) A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities.

(c) A lawyer may limit the scope and objectives of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

Rule 1.16. Declining or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the Rules of Professional Conduct or other law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or

(3) the lawyer is discharged.

(b) Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(3) the client has used the lawyer's services to perpetrate a crime or fraud;

(4) a client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

(7) other good cause for withdrawal exists.

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

*Note Comment No. 2 to IRPC 1.16: “A lawyer ordinarily must decline or withdraw from representation if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct or other law. The lawyer is not obliged to decline or withdraw simply because the client suggests such a course of conduct; a client may make such a suggestion in the hope that a lawyer will not be constrained by a professional obligation.”

Rule 3.3. Candor Toward the Tribunal

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer which will enable the tribunal to make an informed decision, whether or not the facts are adverse.

Rule 4.1. Truthfulness in Statements to Others

In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Rule 8.4. Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or

(g) engage in conduct, in a professional capacity, manifesting, by words or conduct, bias or prejudice based upon race, gender, religion, national origin, disability, sexual orientation, age, socioeconomic status, or similar factors. Legitimate advocacy respecting the foregoing factors does not violate this subsection. A trial judge's finding that preemptory challenges were exercised on a discriminatory basis does not alone establish a violation of this Rule.

PLANS (Elizabeth Little)

A. BINDING EFFECT OF A PLAN

Once the bankruptcy court finds that a proposed plan of reorganization meets the statutory requirements under 11 U.S.C. 1129, the court confirms the plan. At the point, pursuant to 11 U.S.C. 1141(a), the provisions of a confirmed plan bind the debtor, any entity issuing securities or acquiring property under the plan, and any creditor of, or equity security holder or general partner in, the debtor.

This means that, with a few exceptions, any debts or claims that arose prior to plan confirmation are discharged and creditors are prohibited from taking any action to collect those debts. Pursuant to 11 U.S.C. § 524(a)(2), a discharge operates as: "an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived." The discharge is subject to the terms of the plan, and the confirmed plan is binding regardless of whether a creditor's claim was impaired or whether such creditor accepted the plan.

However, confirmation of a plan of reorganization does not discharge a corporate debtor from claims that arose after confirmation of a plan or claims of a creditor who failed to receive adequate notice. Additionally, debts are not discharged pursuant to plans which in reality are liquidating plans.

B. PLAN RELEASES

In addition to a discharge of debts against the debtor, plans of reorganization also may include consensual and nonconsensual releases of non-debtors from claims held by creditors. These non-debtor parties may include principals, guarantors, affiliates, officers, directors, or shareholders. To seek non-consensual releases in a plan, Bankruptcy Rule 2002(c)(3) requires the debtor to provide notice that the plan proposes an injunction, describe the nature of the injunction, and identify the entities subject to the injunction. If the debtor fails to provide adequate notice of the third-party release, then courts will be unable to determine whether a majority of creditors, when supporting the plan, knowingly consent to the release of their potential claims.

C. EFFECT OF INSUFFICIENT NOTICE ON DISCHARGE OF A DEBTOR

Claims may not be discharged if a debtor fails to provide notice to the creditor of the bankruptcy case and (a) the creditor's claim is not scheduled or (b) the claim is scheduled as disputed, contingent, or unliquidated. A confirmed plan that purports to discharge third-party liability or enjoin suits against third parties may be unenforceable against entities who did not receive notice of the bankruptcy or an opportunity to object to confirmation. *See In re Unioil*, 948 F.2d 678, 684 (10th Cir. 1991) (finding creditor's claims not discharged in bankruptcy where the creditor had knowledge of the bankruptcy, but failed to receive any formal notice for filing proofs of claim, filing objections to the reorganization plan, or the confirmation hearing). Whether the debtor has provided adequate notice depends on the specific facts of a case, and the debtor has the burden to establish sufficient notice to the creditors.

In *Berger v. Trans World Airlines, Inc. (In re Trans World Airlines, Inc.)*, 96 F.3d 687 (3d Cir. 1996), the court found the creditors' defamation claim that arose postpetition but prior to a confirmation hearing were not discharged in bankruptcy where the debtor knew of the creditors but failed to provide them formal notice of the confirmation hearing. "A creditor will be deemed to be 'known' to the debtor if the debtor has either actual knowledge of its existence or if its identity 'can be identified through reasonably diligent efforts.'" *Id.* at 690. The court reasoned that had the debtor conducted a diligent search of its records, the creditors' claims should have been revealed even though the creditors filed their defamation action as a counterclaim to the debtor's fraud suit rather than proceeding in bankruptcy court. Accordingly, such creditors were "known" creditors with respect to their postpetition defamation claim. Despite the debtor's knowledge of these defamation claims, the debtor failed to provide notice of the confirmation hearing to the creditors, and thus the court found the defamation claims were not discharged.

1. Due Process Concerns

Under the Due Process Claim of the Constitution, a creditor's rights in a bankruptcy case are protected property interests that cannot be impaired without notice and an opportunity to be heard. Even if a known creditor has knowledge of the bankruptcy case, they may not be bound by the provisions of a confirmed plan if a debtor fails to provide the creditor actual notice of the bankruptcy filing, the bar date, or the plan confirmation hearing. The Supreme Court has held:

> As specifically applied to bankruptcy reorganization proceedings, . . . a creditor, who has general knowledge of a debtor's reorganization proceeding, has no duty to inquire about further court action. The creditor has a "right to assume" that he will receive all of the notices required by statute before his claim is forever barred.

New York v. New York, New Haven & Hartford R.R. Co., 344 U.S. 293, 297, 73 S. Ct. 299, 301, 97 L. Ed. 333 (1953).

In *Arlington Heights Congregate Housing Partnership*, 189 B.R. 187 (Bankr. S.D. Ind. 1995), the court allowed an untimely claim by a creditor filed four months after the bar date and plan confirmation. The creditor was a known creditor of the debtor with a priority tax claim, but the debtor failed to schedule the creditor.

Throughout the bankruptcy case, the creditor informally discovered that the debtor had filed bankruptcy, but the debtor never provided actual or formal notice to the creditor of the bankruptcy case, bar date, or the confirmation hearing. Accordingly, the court found that due process considerations required the allowance of the untimely claim.

2. Notice Of Publication To Unknown Creditors And Tort Claimants

On the other hand, court have found that notice by publication may be sufficient to bind a creditor when the creditor is not known or reasonably discoverable. A creditor's identity is not reasonably discoverable if the debtor cannot identify the creditor using reasonable diligence. The debtor is not required to perform expansive and endless searches, but rather, the debtor must focus on its books and records to provide notice to found creditors. An unknown creditor may include a creditor whose interests are conjectural or in the future, such as a creditor with unmanifested injuries that has not yet been brought to the debtor's attention.

In these circumstances, notice by publication may be employed to satisfy the due process standard. In determining whether notice by publication is sufficient, a court may look to (a) the amount of time between publishing and a bar date, (b) the frequency of publication of a bar date notice or confirmation hearing, and (c) the choice of newspaper. There is no bright-line rule to determine whether notice by publication will discharge all prepetition debts of unknown creditors.

In *Sweeney v. Alcon Laboratories*, No. 20-2066, 2021 WL 1546031 (3d Cir. Apr. 20, 2021), the court found the debtor's notice by publication was sufficient to satisfy due process standards and discharge certain tort claimants' claim. The creditor's claim arose from a chemical injection he received at the age of 15 in 1975 to treat a football injury. The creditor did not experience any ill effects from this injection until 2009 and was diagnosed with a disease in 2015 when a neurosurgeon confirmed that the creditor's exposure to the chemical in 1975 likely caused the progression of his disease.

Meanwhile, the debtor filed a voluntary petition for bankruptcy in 2012, and published notice of the deadline for filing proofs of claim in the New York Times and a regional publication in the debtor's home base. Later, the debtor published notice of the confirmation hearing in USA Today, The Wall Street Journal, and the same regional publication. In 2013, the bankruptcy court confirmed the debtor's plan of reorganization and discharged and terminated all claims against the debtor, known and unknown, and enjoined the commencement and prosecution of any claims or causes of action so discharged.

In 2016, the creditor then commenced a personal injury lawsuit against the reorganized debtor, and the debtor filed a motion to dismiss pursuant to sections 524 and 1141(d)(1) of the Bankruptcy Code. The creditor argued that due process was not satisfied by the bar date and confirmation hearing notices because the content of the notice omitted critical information. The creditor argued that previous lawsuits based on the debtor's chemical (that were resolved a decade before the bankruptcy filing) demonstrate the debtor's knowledge of its liability. The district court rejected this argument and granted the motion to dismiss, and the Third Circuit affirmed, noting the notice was constitutionally sufficient because there were no allegations that the debtor's books and records disclosed any outstanding claims arising from those previous lawsuits. The court noted, "A debtor need not conduct a 'vast, open-ended investigation,' nor must it 'search out each conceivable or possible creditor and urge that person or entity to make a claim against it.'" *Id.* at *4.

D. NOTICE TO GOVERNMENTAL ENTITIES

The debtor also is required to provide governmental entities with sufficient notice of the bankruptcy case, bar date, and plan confirmation hearing to provide an opportunity for such entities to protect their rights. Generally, the bar date for governmental entities is at least 180 days from the petition date. Apart from creditors, the debtor must also provide notice to the Securities and Exchange Commission and the IRS at its address listed in the register maintained under Bankruptcy Rule 5003(e) for the district in which the case is pending. If a debtor discloses a debt for something other than taxes, the debtor must also provide notice to the US Attorney for the district in which the case is pending and to the department, agency, or instrumentality of the US in which the debtor became indebted. Similar to the effect of failing to provide notice to general creditors, the failure to provide notice to the US Attorney and the affected governmental entity may result in the bar date not applying to the affected entity.

E. ETHICAL CONSIDERATION

1. Scenario

You represent a creditor with an administrative expense claim. The chapter 11 plan provides that creditors with administrative expense claims that fail to file a request for payment of such claims by the administrative deadline set forth in the plan would be forever barred from asserting such claims against the debtor. You receive most of the information from your client about the administrative expense claim, but there are still a few significant outstanding issues you need to discuss with the client. Despite repeated attempts to contact the client, the client will not respond to you. It's the deadline and the claim still has not been finalized. What do you do?

2. Considerations

Rule 1.3. Diligence. A lawyer shall act with reasonable diligence and promptness in representing a client.

- Comment 1: A lawyer should pursue a matter on behalf of a client despite opposition, obstruction or personal inconvenience to the lawyer, and may take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor.
- Comment 4: Unless the relationship is terminated as provided in Rule 1.16, a lawyer should carry through to conclusion all matters undertaken for a client.

Rule 1.4. Communication

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;

(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;

(3) keep the client reasonably informed about the status of the matter;

(4) promptly comply with reasonable requests for information; and

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law or assistance limited under Rule 1.2(c).

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

- Comment 3: [3] Paragraph (a)(2) requires the lawyer to reasonably consult with the client about the means to be used to accomplish the client's objectives. In some situations -- depending on both the importance of the action under consideration and the feasibility of consulting with the client -- this duty will require consultation prior to taking action. In other circumstances, such as during a trial when an immediate decision must be made, the exigency of the situation may require the lawyer to act without prior consultation. In such cases the lawyer must nonetheless act reasonably to inform the client of actions the lawyer has taken on the client's behalf.

Rule 1.13. Organization as Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

Section Five

The Third Rail of Bankruptcy – Injunctions, Releases and Ethics Related to Non-Debtors

Martha Reddy Lehman-Moderator
Amundsen Davis
Indianapolis, Indiana

Wendy D. Brewer
Fultz Maddox Dickens PLC
Indianapolis, Indiana

Andrew C. Ozete
Farmer Scott Ozete Robinson & Schmitt LLP
Evansville, Indiana

Meredith R. Theisen
Rubin & Levin, P.C.
Indianapolis, Indiana

Section Five

Martha Reddy Lehman

Martha is the counsel the financial industry seeks to provide favorable resolutions from the routine to the most complex matters. Martha's considerable career experience allows her to use a vast knowledge of the industry to propose solutions from best-practice to groundbreaking. Having built long standing relationships with her opposing counsel, she is able to thoroughly assesses her clients' prospects before setting foot in the courtroom.

Martha's clients are most often secured lenders, unsecured creditors, creditors' committees, trustees, and debtors. She assists with the purchase of assets from insolvent entities, both inside and outside of bankruptcy, and counsels clients regarding mechanic's and other forms of liens, as well as commercial litigation matters in connection with her practice. Her counsel includes natural extensions of the creditors' rights and bankruptcy area of law including insolvency, corporate financial statements, real estate, compliance, environmental, agriculture, breaches of contract, and family-owned business issues. She has authored "friend of the court" briefs in both the Supreme Court of the United States and the Indiana Supreme Court on bankruptcy and litigation issues.

Martha is board certified by the American Board of Certification in Business Bankruptcy and is a fellow and life fellow of the Indianapolis Bar Foundation. She serves as President of the Archdiocese of Indianapolis Finance Counsel and is also a member of the House of Delegates for the Indiana State Bar Association as well the HEAL Committee for the Indianapolis Bar Association.

Contact information:
mlehman@amundsendavislaw.com
317-464-4142

Wendy D. Brewer
FULTZ MADDOX DICKENS PLC

Wendy Brewer is Counsel with the firm of Fultz Maddox Dickens PLC, practicing in the areas of business bankruptcy and restructuring, commercial foreclosures, civil litigation, loan documentation, and providing general counsel advice for small businesses. She has been certified as a Business Bankruptcy Specialist by the American Board of Certification since 2007 and currently serves on the Board of Directors for the ABC. Wendy is a past president or chairperson for each of the Creditors Rights and Bankruptcy Law Section of the Indiana State Bar Association, the Commercial and Bankruptcy Law Section for the Indianapolis Bar Association, and the Indiana Association for Corporate Renewal (now Indiana Turnaround Management Association). She has also regularly been recognized as an Indiana Super Lawyer since 2008 and has been recognized in multiple categories by Best Lawyers since 2010.

Wendy is active in the community and has served on multiple not-for-profit boards including Partners in Housing Development Corporation, Happy Hollow Children's Camp, FHS Tiger Volleyball, Inc., and the Fishers Fast Break Club, Inc. Wendy also served for several years on the Mayor's Celebration of Diversity Awards Luncheon Committee.

Ms. Brewer is a 1995 graduate of the College of Law at Florida State University, and is admitted to practice law in Indiana, Florida, and Georgia.

Andrew C. Ozete
aozete@fsolegal.com
812.602.3582

My practice is centered on advising businesses, banking and creditors' rights, including bankruptcy, State Court, and negotiated workout solutions. I represent businesses, financial institutions, trade creditors, and debtors in transactions, leases, litigation, business workouts, loan restructurings, and Chapter 11 cases. I help guide my clients through the uncertain waters of the bankruptcy process and help them maximize their returns.

I advise institutional clients and small business owners in a wide range of matters, and serve in general counsel capacity for various clients. Additionally, I am a frequent speaker on business, bankruptcy and creditors' rights issues, at which I provide information, training and education to local business groups as well as local and state-wide attorney legal education organizations.

I am board certified in business bankruptcy law by the American Board of Certification. I was selected as an Indiana Super Lawyer each year from 2012 through 2020. I also received the Distinguished Barrister Leadership in Law award from the Indiana Lawyer in 2019. In 2021, I was recognized for Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law, Business Organizations including LLC's and Partnerships, and Bankruptcy Litigation by Best Lawyers in America.

Practice Areas

- Business Services
- Creditors' Rights and Bankruptcy
- Banking and Financial Institutions
- Employment
- Manufacturing

Education

1992 - Indiana University - Bachelor of Arts, telecommunication

1996 - Indiana University School of Law - Doctor of Jurisprudence

FARMER SCOTT OZETE ROBINSON & SCHMITT LLP
ATTORNEYS

Bar Admissions

1996 - State of Indiana
1998 - State of Illinois

Professional Associations

Past President - Evansville Bar Association
Past President - Public Education Foundation of Evansville
Past President - Bankruptcy & Creditors' Rights Section Council of the Indiana State Bar Association
Past President - Vanderburgh Law Library Foundation
Past Chair - Evansville Bar Association, Commercial Law Section
Member - American Bankruptcy Institute
Member - Indiana State Bar Association
Member - Illinois State Bar Association
Member - Evansville Bar Association

Service to Community

Andy's service has included being the President of the Public Education Foundation of Evansville, Inc., Chairman of the Native Trails District of the Boy Scouts of America, a Member of the Board of Trustees of the Evansville Vanderburgh Public Library, the Board Development Committee Chair of the Public Education Foundation of Evansville, Inc., a volunteer youth soccer coach, and acting as the President of the Church Council, Chairman of the Contemporary Worship Committee, President of the Christian Education Board, an adult Sunday School teacher and Vacation Bible School coordinator of his Church.

Honors

2009 - Board certified in business bankruptcy law by the American Board of Certification
2009 - Indiana Rising Star, Super Lawyers
2012 - 2022 - Indiana Super Lawyer
2019 - Leadership in Law, Distinguished Barrister Award, Indiana Lawyer
2021, 2022 - Best Lawyers in America®

Meredith R. Theisen
Partner, Rubin & Levin, P.C., Indianapolis

Meredith R. Theisen concentrates her practices in the areas of bankruptcy, bankruptcy litigation, debtors and creditors' rights, business representation, secured transactions, real estate sales, state court receiverships, commercial litigation, and bankruptcy trustee and state court receiver representation.

Her bankruptcy practice includes representing individuals, businesses, debtors, and creditors in Chapters 7, 11, 12 and 13 bankruptcy cases, out of court debt restructuring, receivership actions, and litigation matters. She has served as counsel to individuals and business reorganizing in Chapter 11 cases or liquidating in complex Chapter 7 cases. She also has extensive experience representing bankruptcy trustees in both Chapter 7 and 11 cases. Throughout her practice, Meredith has developed an expertise in asset protecting, business liquidation and wind down, property acquisition through a bankruptcy 363 sale, lease assignment through a bankruptcy 365 assumption and assignment process, defending preference/fraudulent conveyance actions and non-dischargeability actions.

Meredith R. Theisen
Rubin & Levin, P.C.
135 North Pennsylvania Street, Ste 1400
Indianapolis, IN 46204
ph: (317) 860-2877
e-mail: mtheisen@rubin-levin.net

The Third Rail of Bankruptcy– Injunctions, Releases and Ethics Related to Non-Debtors

2022 Steven H. Ancel Annual Bankruptcy Institute

By: Martha R. Lehman, Wendy D. Brewer, Andrew C. Ozete, and Meredith R. Theisen

The Texas Two-Step

What is the Texas Two-Step?

- **Step 1** – Utilizing Ch. 10 of the Texas Business Organizations Code, file a Plan of Merger and split the entity into 2 or more brand new entities.
  - Apportion some limited assets and the majority of liabilities to newly formed BadCo.
  - Apportion the operating assets, employees, and ongoing business lines, to newly formed GoodCo.
- **Step 2** – File a bankruptcy for BadCo. (and typically seek an injunction against claims being filed against the non-debtor affiliates).
- It is not quite that simple, but those are the basic dance moves.

What is the Texas Two-Step?

- Chapter 10 of the Texas Business Organizations Code outlines the process for Mergers of Texas domestic entities.
- The "Merger" may also be a "Divisive Merger" where a single entity is divided into multiple entities and the assets and liabilities are allocated.
- Section 10.008(a)(3) and (4) of the Code provide that:
  - (a) When a merger takes effect:
    - (3) all liabilities and obligations of each organization that is a party to the merger are allocated to one or more of the surviving or new organizations in the manner provided by the plan of merger.
    - (4) each surviving or new domestic organization to which a liability or obligation is allocated under the plan of merger is the primary obligor for the liability or obligation, and, except as otherwise provided by the plan of merger or by law or contract, no other party to the merger, other than a surviving domestic entity or non-code organization liable or otherwise obligated at the time of the merger, and no other new domestic entity or non-code organization created under the plan of merger is liable for the debt or other obligation.

2017 Georgia Pacific – *In re Bestwall LLC*

- The Georgia Pacific Case a/k/a *In re Bestwall LLC*, Case No. 17-31795 Western District of North Carolina (Asbestos Litigation).
  - Georgia Pacific Holdings reincorporated in Texas, underwent a divisional merger under Section 10.008, allocated its assets and liabilities:
    - Bestwall LLC – received the personal injury asbestos liability claims; and
    - Georgia Pacific (New GP) – received the operating business assets, employees, etc.
  - New GP entered into a funding agreement with Bestwall whereby Bestwall agreed to indemnify New GP from any asbestos personal liability claims, and New GP agreed to provide certain funding for a liquidation trust against which the personal injury claims could be asserted.
  - Bestwall reincorporated in North Carolina and filed a Ch. 11.

2020 Certain Teed Corporation – *In re: DBMP LLC*

- The CertainTeed Case a/k/a *In re DBMP LLC,* Case No. 20-30080, Western District of North Carolina (Asbestos Litigation)
  - CertainTeed underwent a divisional merger under Section 10.008, and allocated its assets and liabilities:
    - DBMP LLC – received the personal injury asbestos liability claims and insurance; and
    - CertainTeed LLC (New CertainTeed) – received the operating business assets, employees, etc.
  - New CertainTeed entered into a funding agreement with DBMP whereby DBMP agreed to indemnify New CertainTeed from any asbestos personal liability claims, and New CertainTeed agreed to provide certain funding for a liquidation trust against which the personal injury claims could be asserted.
  - DBMP LLC reincorporated in North Carolina and filed a Ch. 11.

2020 Trane Technologies and Trane U.S. – *In re: Aldrich Pump LLC*

- The Trane Case a/k/a *In re Aldrich Pump LLC,* Case No. 20-30608, Western District of North Carolina (Asbestos Litigation)
  - Trane underwent a divisional merger under Section 10.008, and allocated its assets and liabilities:
    - Aldrich Pump LLC – received the personal injury asbestos liability claims and insurance; and
    - Trane Technologies Company (New Trane Technologies) – received the operating business assets, employees, etc.
  - New Trane entered into a funding agreement with Aldrich Pump whereby Aldrich agreed to indemnify New Trane from any asbestos personal liability claims, and New Trane agreed to provide certain funding for a liquidation trust against which the personal injury claims could be asserted.
  - Aldrich Pump LLC reincorporated in North Carolina and filed a Ch. 11.

2021 Johnson & Johnson – *In re LTL Management LLC*

- The J&J Case a/k/a *In re LTL Management LLC*, Case No. 21-30589, District of New Jersey (Talc Powder Litigation) – removed to NJ from North Carolina.
  - The Declaration filed in support of First Day Motions describes a much more complicated version of the Texas Two-Step, but ultimately:
    - LTL was formed and became solely responsible for Old J&J's liabilities arising out of talc-related claims.
    - LTL also received certain assets (some royalty rights through a subsidiary, some cash, and some other rights related to the Talc Litigation).
    - New J&J also entered into a funding agreement with LTL whereby New J&J agreed to fund a North Carolina Trust (a Qualified Settlement Fund) in the amount of $2 billion for the payment of current and future talc-related claims.

Hold your horses! Why ain't this a Fraudulent Transfer?

- Section 10.008(a)(2) provides:
  - (2) all rights, title, and interests to all real estate and other property owned by each organization that is a party to the merger is allocated to and vested, subject to any existing liens or other encumbrances on the property, in one or more of the surviving or new organizations as provided in the plan of merger without:
    - (A) reversion or impairment;
    - (B) any further act or deed; or
    - (C) any transfer or assignment having occurred.
- So – there are no deeds, no bills of sale, no assignments, etc. The assets are simply "allocated" pursuant to the Plan of Merger.

Yeah, but just because a chicken has wings don't mean it can fly!

- The personal injury claimants committees in many of these cases have alleged fraudulent transfer claims – despite the language in Section 10.008(a)(2).
- Bankruptcy Judge Whitley (W.D. of North Carolina) in the *Aldrich Pump* and *DBMP* denied motions to dismiss those claims and stated:
  - "if a corporation uses a divisional merger to dump its liabilities into a newly created 'bad' company which lacks the ability to pay creditors while its 'good' twin corporation walks away with the enterprise's assets, a fraudulent transfer action lies."
- Bankruptcy Judge Kaplan (District of New Jersey) in *LTL Management* has stated the following:
  - "to the extent Debtor's actions drift [in the direction of a scheme to hinder, delay, and defraud talc powder creditors], this Court is prepared to take swift action and will honor its commitment of ensuring that claimants receive fair and timely compensation under a comprehensive and transparent distribution scheme."
- Does the existence of the funding agreements make a difference?

Hmmm – this sounds crooked as a dog's hind leg

- The personal injury claimants committees in each of *In re Bestwall LLC* and *In re: LTL Management LLC*, sought to dismiss the Chapter 11 filings as "bad faith" filings.
- The Bankruptcy Court in each case denied the Motion to Dismiss.
- The 3rd Circuit accepted a direct appeal of the *LTL Management* decision – and the appeal remains pending.
- The personal injury claimants in several of the cases have also filed a variety of Breach of Fiduciary Claims against various directors and officers involved in accomplishing the divisive mergers.

Where do the cases stand now?

- *In re: Bestwall LLC* – In 2020 a billion dollar settlement trust was approved to be funded, but no Plan has yet been confirmed while the parties litigate claims of fraud by tort claimants and their attorneys.
- *In re: DBMP LLC* – The tort claimants filed a fraudulent transfer adversary proceeding against New CertainTeed and in July 2022, the bankruptcy court denied a motion to dismiss the claim. Litigation is continuing.
- *In re: Aldrich Pump LLC* - The tort claimants filed a fraudulent transfer adversary proceeding. Litigation is continuing.
- *In re: LTL Management LLC* – A direct appeal to the 3rd Circuit was filed regarding the bankruptcy court decision denying the motion to dismiss for bad faith and extending a preliminary injunction against the non-debtor J&J affiliates. Oral argument occurred in September 2022 and the matter remains pending.
- *Plastronics Socket Partners Ltd. v. Hwang*, 2022 WL 108948 (Fed Cir. 2022) finding a licensee could not avoid contractual royalty obligations because the Texas statute does not "abridge [the] rights of any creditor under existing laws."

Use of the Automatic Stay and Preliminary Injunctions to Halt Litigation Against Non-Debtors

Application of the Automatic Stay to Non-Debtors

- Generally, the automatic stay under § 362(a)(1) only protects the debtor and does not bar suits against non-debtors, even when wholly owned by the debtor, or the debtor's insurers, guarantors, and sureties. *See In re White*, 415 B.R. 696, 698 (Bankr. N.D. Ill. 2009).
  - However, the 4^{th} Circuit has identified two exceptions to this general rule:
    1) Where there is such identity between the debtor and third-party defendant that a judgment against the third-party defendant will in effect be a judgment against the debtor; and
    2) Where the pending litigation, though not brought against the debtor, would cause the debtor irreparable harm.

See A.H. Robins Co., Inc. v. Picinin (In re A.H. Robins Co., Inc.), 788 F.2d 994, 999 (4th Cir. 1986), *A.H. Robins Co., Inc. v. Aetna (In re A.H. Robins Co., Inc.)*, 828 F.2d 1023-24 (4th Cir. 1987).

Application of the Automatic Stay to Non-Debtors

- The application of these exceptions is rare and reserved for "unusual circumstances," which may include the following:
  - When debtor and non-debtor are jointly and severally liable co-defendants, the continued litigation against the non-debtor could effectively bind the debtor, and therefore, require the debtor to defend itself despite the automatic stay in order to avoid being bound by adverse judgments.
  - Indemnification concerns if the debtor is required to indemnify the non-debtor, which could put the debtor's estate directly at risk.

Application of the Automatic Stay to Non-Debtors

- ***Edelson, PC v. Girardi*, 2021 U.S. Dist. LEXIS 134283 (N.D. Ill. July 19, 2021)**
  - Held that § 362(a)(1) does not, on its face, automatically stay proceedings involving non-debtors.
  - Declining to extend the exceptions set out by the 4th Circuit because the 7th Circuit has not yet had the opportunity to consider the correct process for invoking an exception to the general rule regarding the applicability of § 362(a)(1).
    - Noting that the handful of times the 7th Circuit has considered the exceptions to the general rule, it has found that the non-debtor did not qualify for the exceptions.
- ***In re Aearo Techs. LLC*, 642 B.R. 891 (Bankr. S.D. Ind. 2022)**
  - Acknowledged the extension of § 362(a)(1) by the court in *In re LTL Mgmt. LLC*, 638 B.R. 291 (Bankr. N.J. 2022), but, as noted in *LTL Mgmt.*, also recognized that many courts have used some iteration of the phrases "extension of the stay" and "injunctive relief" interchangeably when discussing whether to permit actions against non-debtor third parties to proceed.
  - Declined to extend the exceptions set out by the 4th Circuit in *A.H. Robins Co.* on the basis that the 7th Circuit has not formally adopted these exceptions, nor has the 7th Circuit actually extended the stay to a non-debtor under these exceptions.

Application of the Automatic Stay to Non-Debtors

- The broader scope of § 362(a)(3) may also apply to stay actions against non-debtors and involves a two-step inquiry:
  1) Whether property of the estate is at issue; and
  2) Whether the action in question constitutes an action to obtain possession of, or exercise control over, the property in question.
- This most often comes up in the context of shared insurance policies. Debtors often argue that the risk of continued litigation depletes proceeds of shared insurance policies, which as a general rule are property of the bankruptcy estate, but not always.

Application of the Automatic Stay to Non-Debtors

- ***Nat'l Tax Credit Partners v. Havlik*, 20 F.3d 705 (7th Cir. 1994)**
  - § 362(a)(3) reaches farther, encompassing every effort to exercise control over property of the estate—including but direct and indirect efforts.
  - The analysis of what constitutes indirect efforts to exercise control over property of the estate comes down to whether a third party's effort has a pecuniary effect on the estate.

- ***In re Aearo Techs. LLC*, 642 B.R. 891 (Bankr. S.D. Ind. 2022)**
  - The Court for purposes of the § 362(a)(3) analysis assumed the shared insurance policies between the Debtors and 3M Debtors were property of the estate.
  - However, for the second prong, found that there was currently no evidence of direct efforts to exercise control over property of the estate.
    - There was no evidence that the claimants were proceeding directly against the insurance policies.
    - 3M had taken no action against the insurance policies other than putting the insurers on notice.
  - The Court also found that there were no indirect efforts to exercise control over property of the estate because, ultimately, 3M will fully fund any liability incurred by the Debtors pursuant to the Funding Agreement.

§ 105(a) Preliminary Injunctions

- If there are not sufficient "unusual circumstances" present or acts to obtain possession of or exercise control over property of the estate, then debtors often turn to the Court's own inherent authority to stay proceedings against non-debtors under § 105(a).
- A § 105(a) preliminary injunction should only be issued in extraordinary circumstances where it is "necessary or appropriate" to carry out the provisions of the Bankruptcy Code.
- § 105(a) preliminary injunctions are governed by the standards generally applicable to the issuance of injunctive relief in non-bankruptcy contexts and must be brought by an adversary proceeding.
- There are two separate inquiries that need to be undertaken before a Court can issue a § 105(a) preliminary injunction—(1) Does the Court have jurisdiction?; and (2) Is the injunction appropriate?

Jurisdiction to Issue a Preliminary Injunction

- In the context of a § 105(a) injunction, the Court is typically focused on "related to" jurisdiction, which are proceedings "related to" the Bankruptcy Code that have a potential effect on other creditors. *See Bush v. U.S.*, 939 F.3d 839, 844-46 (7th Cir. 2019).
- The analysis of "related to" jurisdiction looks at the relation of the dispute to the estate, and not of the party to the estate. *Elscint, Inc. v. First Wis. Fin. Corp. (In re Xonics)*, 813 F.2d 127 (7th Cir. 1987).
- The 1st, 3rd, 5th, 6th, 8th, 9th, 10th, and 11th Circuits have taken a broad approach in interpreting § 1334(b)'s "related to" jurisdiction in that it requires only that the outcome of the proceeding ***could conceivably have any effect*** upon the bankruptcy estate.

But NOT the 7th Circuit . . .

***In re Aearo Techs. LLC*), 642 B.R. 891 (Bankr. S.D. Ind. 2022)**

- However, the 7th Circuit has adopted a more constrained approach to "related to" jurisdiction in that "[a] case is 'related' to a bankruptcy when the dispute 'affects the amount of property for distribution [i.e., the debtor's estate] or the allocation of property among creditors.'" *Mem'l. Estates*, 950 F.2d 1364, 1368 (7th Cir. 1992) (quoting *Elscint, Inc. v. First Wis. Fin. Corp. (In re Xonics)*, 813 F.2d 127, 131 (7th Cir. 1987)).
- The Court noted that initially it would appear that the claimants' actions, as they related to 3M, fell within the 7th Circuit's limited view of "related to" jurisdiction because of the Debtors' obligations to indemnify 3M for any liability, but ultimately held that it did not have "related to" jurisdiction to issue the § 105(a) injunction due to the circular nature of the Funding Agreement.
  - The Funding Agreement provided for an *uncapped, non-recourse* commitment from 3M to fund *all* of the Debtors' liabilities, including any indemnity obligations owed to 3M.
- As a result, the Court could not conclude that continuation of the litigation against 3M would have any effect on the amount of property for distribution or the allocation of property among creditors.
- Court noted that even if it were to find that it had jurisdiction it would still have reached the same conclusion because § 105(a) injunctions should only be issued in extraordinary circumstances where it is "necessary or appropriate" to carry out the provisions of the Code.
  - Focused on the actual economic effect of not issuing the injunction, the Court found no basis to invoke its § 105(a) powers.

Appropriateness of § 105(a) Preliminary Injunctions

- To enjoin an action against a non-debtor party, the court must find that failure to enjoin the action would affect the estate and would adversely or detrimentally influence and pressure the debtor through that non-debtor.
- To obtain a preliminary injunction under § 105(a), a debtor must show, by a preponderance of the evidence, the necessity for injunctive relief by showing the following:
  1) Irreparable harm to the bankruptcy estate absent the issuance of the injunction;
  2) A strong likelihood of success on the merits;
  3) No harm or minimal harm to the other party or parties; and
  4) The issuance of such an extraordinary remedy of an injunction is in the public interest.

Requirements for a Preliminary Injunction

1. **Irreparable Harm**
   - Typically established by establishing economic harm to the estate.
2. **Likelihood of Success on the Merits**
   - In the bankruptcy context, reasonable likelihood of success on the merits is equivalent to the debtor's ability to successfully reorganize. *In re Otero Mills, Inc.*, 21 B.R. 777, 779 (Bankr. D.N.M. 1982).
   - At the beginning stages of the case, the success of the debtor's reorganization is speculative, and the debtor typically needs to only demonstrate the prospect or possibility that it will succeed. *Conestoga Wood Specialties Corp. v. Sec'y of U.S. Dept't of Health & Human Servs.*, 724 F.3d 377 (3d Cir. 2013).

Requirements for a Preliminary Injunction

3. **No Harm or Minimal Harm to Others**

    - Courts look to the balance of the relative harm between the debtor and the non-debtor parties.

    - Courts weigh such factors as the length of time of the stay, the constitutional or contractual issues, and the financial impact to the creditor body as a whole. *See, e.g.*, *In re Philadelphia Newspapers, LLC*, 407 B.R. 606, 617 (E.D. Pa. 2009); *In re LTL Mgmt., LLC*, Adv. Pro. No. 21-03032 (MBK), 2022 WL 586161, *19 (Bankr. D. N.J. Feb. 25, 2022).

4. **Public Interest**

    - Courts also balance the public interest in a successful bankruptcy reorganization of the debtor versus other competing societal interests being asserted by the creditor.

    - Injunctions are implemented when it is necessary or appropriate to preserve the going concern of the debtor or to maximize the property available to satisfy the claims of all creditors of the estate.

In re USA Gymnastics, Adv. No. 19-50075 [Dkt. 71] (Bankr. S.D. Ind. Apr. 22, 2019)

- Issued a § 105(a) injunction finding that the continued prosecution and defense lawsuits endangered the Debtor's restructuring effort by threatening depletion and dilution of the assets available for distribution to the Debtor's creditors and by impeding the Debtor's ability to reach a full and fair settlement with its creditors and confirm a plan of reorganization.

- Specifically, the Court noted the following:
  - If not for the injunction, the Debtor would most likely be required to participate in the litigation in order to protect its interest, thereby negating the benefits of the automatic stay.
  - The Debtor has certain obligations to indemnify non-debtors from any loss incurred as a result of the pending lawsuits.
  - Significant concerns regarding depletion of the Debtor's shared insurance policies with certain non-debtors.

In re Bestwall LLC, 606 B.R. 243 (Bankr. W.D.N.C. 2019)

- Finding that the Debtor satisfied all 4 requirements for a § 105(a) injunction:
  - **Likelihood of Success:** The Funding Agreement allowed for the Debtor to request payment of funds necessary to pay the costs of the chapter 11 and to fund a § 524(g) trust to the extent the Debtor's asserts were insufficient, and thereby, at that particular point in the case, the Court had no reason to conclude the Debtor wouldn't be able to fund a plan of reorganization.
  - **Irreparable Harm:** The Court held that it would defeat the purpose of the chapter 11 case if the claims effectively continued to be prosecuted in the tort system notwithstanding the pendency of the Debtor's bankruptcy.
    - Specifically noting the Debtor's indemnification obligation, the binding effect of findings and judgments against the non-debtors, the burden to the Debtor in being forced to defend the litigation to avoid evidentiary prejudice and the division of key personnel between defending the lawsuits against the non-debtor and the Debtor's restructuring efforts.
  - **Balance of Harms:** The Court noted that mere delay is insufficient to prevent the issuance of an injunction and that the harm from any delay far outweighed the harm to the Debtor if the injunction was not issued because it would defeat the entire purpose and goal of the bankruptcy proceeding.
  - **Public Interest:** The Court noted that courts have consistently recognized the public interest in successful reorganization of a debtor, especially in the mass tort context.

In re LTL Mgmt., LLC, 638 B.R. 291 (Bankr. D.N.H. 2022)

- Finding that the Debtor satisfied all 4 requirements for a § 105(a) injunction:
  - **Likelihood of Success:** The Court relying on the Debtor's explained strategy for reorganization, including the Funding Agreement, and the lack of any evidence suggesting that the Debtor did ***not*** have a reasonable likelihood of reorganization, held that the Debtor satisfied the low standard of likelihood of success.
  - **Irreparable Harm:** The Court found that the continued litigation would have an adverse impact on the estate, would hinder the Debtor's reorganization efforts, and would serve as a constant drain on resources and time.
    - Specifically noting the Debtor's contractual indemnification obligations and the potential harm the continued litigation could cause to the funding of the Debtor's trust.
  - **Balance of Harms:** The Court found that the claimants would actually benefit from the injunction and the efficient handling of their claims through the bankruptcy process.
    - Noting that the bankruptcy method of dealing with claims also protects the interests of future claimants, reduces evidentiary and causation burdens on claimants, prevents a race for proceeds, and promotes equality in distribution.
  - **Public Interest:** Similarly, the Court noted the public interest in the efficient bankruptcy claim resolution process, especially in the mass tort context.


Third-Party Releases

Background

A third party other than the debtor may require a release in a confirmation order from the bankruptcy court in order to secure their participation in the plan

Typically, this occurs because a third party is providing significant funding for a plan's distributions

For example, an insurance company might say that it would fund a significant contribution in a bankruptcy case, but that it wants to then be released of all liability in relation to claims from its insured and claimants against the insured by funding distributions in the case

Purdue Pharma L.P.

- Basically, litigation throughout the country has sought to hold Purdue Pharma L.P.
- The claims of the potential plaintiffs vastly exceed the value of Purdue as an entity
- The Sackler family, in order to try to chop off this liability, offered to fund in excess of $4.3 billion to an opioid victim settlement fund as part of the chapter 11 process
- The bankruptcy court decided that recovering over $4.3 billion from the Slackers was a big enough benefit to the estate to allow the Slackers to get their release in the plan confirmation

Purdue Pharma L.P.

- In December of 2021, though, Colleen McMahon of the U.S. District Court for the Southern District of New York ruled in the case that nonconsensual releases of creditors' direct claims against nondebtor entities are not permitted under the Bankruptcy Code.
- In her ruling, she held not only that there is no statutory authority under § § 105(a), 524(e), 1123(a)(5) and 1129(a)(1), but also that ***post-Stern***, the Bankruptcy Court lacked constitutional authority to enter the confirmation order with third-party releases.
- The case is currently under appeal to the 2nd Circuit. **The question is: How do you get the deal done?**

How to Get your Plan with Third Party Release Confirmed?

Step 1: You MUST forum shop

- The Fourth, Sixth, Seventh, Ninth and Eleventh Circuits have, to some degree or another, approved third party releases, at least in some circumstances.
- The Fifth and Tenth Circuits ban nonconsensual third party releases on the basis that they are prohibited by § 524(e).
- The Circuits rejecting third party releases read “does not” as “shall not” and conclude the confirmation order may not provide third party releases.
- The Circuits approving third party releases generally in reviewing this language have determined that since it says “does not” and does not say “cannot,” it merely means that the discharge generally does not affect the liability of another entity.
- These Courts then look to the emanating penumbras of the power of the judge under 11 U.S.C. § 105(a) to administer a bankruptcy case to find the authority for the release.

How to Get your Plan with Third Party Release Confirmed?

<u>Step 2</u>: Act Fast

- The next thing you need to do is to get your case filed and confirmed quickly.
- This is because in light of the perceived injustice and backlash over the Purdue Pharma third party release, the Non-Debtor Release Prohibition Act of 2021 (the "NRPA") has been introduced in Congress last year.

<u>Step 3</u>: Prepare the Evidence

- Be prepared to provide the necessary evidence to the Court to support the release.
- You need to be prepared to show that as a predicate, the funding of the case will not happen without the third party release.

How to Get your Plan with Third Party Release Confirmed?

<u>The Dow Factors</u>:

1) Whether the debtor and third party share an identify of interest, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor;
2) Whether the non-debtor has contributed substantial assets to the reorganization;
3) Whether the injunction [or third-party release] is essential to reorganization—namely whether the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;
4) Whether the impacted lass or classes has overwhelmingly voted to accept the plan;
5) Whether the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
6) Whether the plan provides an opportunity for those claimants who choose not to settle and recover in full; and
7) Whether the bankruptcy court made a record of specific factual findings that supports its conclusions.

See In re Dow Corning Corp., 280 F.3d 648 (6th Cir. 2002)

Forum Shopping as an Independent Evil

- This is a matter that is important to Indiana and its citizens to be sure that bankruptcy cases often deeply affecting them are not ultimately heard in remote jurisdictions.
- By supporting venue reform, large cases involving Indiana businesses would be more likely to be heard in Indiana.
- This would protect better the interests of all constituents and further increase the opportunities for Indiana counsel and judges to participate in the restructuring process.
- The issue is significant enough that attorneys general from 43 states have all signed off on a letter to Congress specifically supporting venue reform legislation.

Ethics of Third-Party Injunctions and Releases

Indiana Rules of Professional Conduct

- Lawyer's interactions with parties who are not represented governed by Rule 4.3 of Indiana Rules of Professional Conduct

- The rule states as follows:

Rule 4.3. Dealing with Unrepresented Persons

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such person are or have a reasonable possibility of being in conflict with the interests of the client.

Indiana Rules of Professional Conduct

- Lawyer's interactions with parties who are not represented governed by Rule 4.3 of Indiana Rules of Professional Conduct

- The rule states as follows:

Rule 4.3. Dealing with Unrepresented Persons

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such person are or have a reasonable possibility of being in conflict with the interests of the client.

Commentary to the Rule

Comment

- [1] An unrepresented person, particularly one not experienced in dealing with legal matters, might assume that a lawyer is disinterested in loyalties or is a disinterested authority on the law even when the lawyer represents a client. In order to avoid a misunderstanding, a lawyer will typically need to identify the lawyer's client and, where necessary, explain that the client has interests opposed to those of the unrepresented person. For misunderstandings that sometimes arise when a lawyer for an organization deals with an unrepresented constituent, see Rule 1.13(d).

Commentary to the Rule

Comment

- [1] An unrepresented person, particularly one not experienced in dealing with legal matters, might assume that a lawyer is disinterested in loyalties or is a disinterested authority on the law even when the lawyer represents a client. In order to avoid a misunderstanding, a lawyer will typically need to identify the lawyer's client and, where necessary, explain that the client has interests opposed to those of the unrepresented person. For misunderstandings that sometimes arise when a lawyer for an organization deals with an unrepresented constituent, see Rule 1.13(d).

Commentary (cont'd)

- [2] The Rule distinguishes between situations involving unrepresented persons whose interests may be adverse to those of the lawyer's client and those in which the person's interests are not in conflict with the client's. In the former situation, the possibility that the lawyer will compromise the unrepresented person's interests is so great that the Rule prohibits the giving of any advice, apart from the advice to obtain counsel. Whether a lawyer is giving impermissible advice may depend on the experience and sophistication of the unrepresented person, as well as the setting in which the behavior and comments occur. This Rule does not prohibit a lawyer from negotiating the terms of a transaction or settling a dispute with an unrepresented person. So long as the lawyer has explained that the lawyer represents an adverse party and is not representing the person, the lawyer may inform the person of the terms on which the lawyer's client will enter into an agreement or settle a matter, prepare documents that require the person's signature and explain the lawyer's own view of the meaning of the document or the lawyer's view of the underlying legal obligations.

Commentary (cont'd)

- [2] The Rule distinguishes between situations involving unrepresented persons whose interests may be adverse to those of the lawyer's client and those in which the person's interests are not in conflict with the client's. In the former situation, the possibility that the lawyer will compromise the unrepresented person's interests is so great that the Rule prohibits the giving of any advice, apart from the advice to obtain counsel. Whether a lawyer is giving impermissible advice may depend on the experience and sophistication of the unrepresented person, as well as the setting in which the behavior and comments occur. This Rule does not prohibit a lawyer from negotiating the terms of a transaction or settling a dispute with an unrepresented person. So long as the lawyer has explained that the lawyer represents an adverse party and is not representing the person, the lawyer may inform the person of the terms on which the lawyer's client will enter into an agreement or settle a matter, prepare documents that require the person's signature and explain the lawyer's own view of the meaning of the document or the lawyer's view of the underlying legal obligations.

Application to Bankruptcy

- Do not automatically assume an identity of purpose between your client and the unrepresented person
- That can be challenging if you represent a creditor and the person calling is another creditor
- You still need to give the Rule 4.3 disclosure.
- AND if you take on another client…
- Be mindful of your obligation to file a Rule 2019 Disclosure

Application to Bankruptcy (cont'd)

- Many creditors with claims in a large Chapter 11 case may not be represented by counsel.
  - Does this impose additional duties upon counsel for the debtor or counsel for a statutory committee?
  - Counsel for the debtor represents an entity with interests that are theoretically opposed to those of creditors. That would suggest a cautionary approach for debtor's counsel when answering questions or communicating with unrepresented creditors. The text of the rule makes it clear that a debtor's counsel should be advising an unrepresented party to obtain counsel.

Application to Bankruptcy (cont'd)

- What about counsel for a statutory committee?
  - In theory, the committee's interests should be aligned with those of unsecured creditors.
  - The commentary in section 2 might suggest that attorneys for an unsecured creditors committee could interact with unsecured creditors without providing any warnings because the committee's interests and those of unsecured creditors are not likely to be opposed to one another.
  - But what happens if that creditor tells you about a preferential transfer that it received?

Injunctive Relief

- What happens when the debtor is seeking injunctive relief on behalf of a non-debtor?
  - *In re USA Gymnastics*, Adv. Pro. No. 19-50075 [Dkt. 71] (Bankr. S.D. Ind. Apr. 22, 2019)
  - Debtor sought injunctive relief to prevent dissipation of insurance proceeds
    - Official Committee supported relief in order to preserve assets available for distribution through a plan
    - Injunctive relief granted

Injunctive Relief (cont'd)

- *In re Aearo Techs. LLC*, 642 B.R. 891 (Bankr. S.D. Ind. 2022)
  - Debtor sought injunctive relief to protect a non-debtor parent company and argued that the stay automatically applied due to common insurance
    - Informal working group of claimants opposed relief
    - Injunctive relief denied
    - But not all creditors agreed on the strategy for opposing the requested relief

Plan Releases

- What happens when the plan is proposing third party release?
  - When drafting the plan, does counsel for the debtor have to explain that the releases have value?
  - Do the plan documents have to explain that the creditors may not need to give the releases in order to receive a distribution?

Plan Releases (cont'd)

- What duty does counsel have when answering questions about the proposed release?
  - If a creditor calls with questions, do you advise them to get counsel?
  - Do you refer them to the committee?
  - And does it depend on whether the committee is supporting or opposing the plan?

Plan Releases (cont'd)

- What information should the plan and disclosure statement contain in order to provide as much information as possible to claimants who do not have counsel?
  - Does the court's approval of the disclosure statement avoid any ethical issues?
  - After all, if the plan contains "adequate information" to allow a creditor to make a decision, is that enough?

Releases (cont'd)

- Does the ethical obligation change depending upon where the bankruptcy case is venued?
  - Certain circuits allow for third party releases while others restrict them.
  - If you are in Indiana handling a case in a circuit where authority limits a release, how far can you push the envelope?

Indiana Caselaw

- Recent cases from the Indiana Supreme Court suggest that the Court is taking a very broad view on when a party is represented.
- This can add to the dilemma for debtor's counsel or for committee counsel.

Indiana Supreme Court

- *Matter of Steele*, 181 N.E.3d 976 (Ind. 2022)
  - Lawyer was representing himself in a dispute with a friend.
  - Friend retained counsel but lawyer communicated with his friend because parties can communicate with one another during representation.
  - Supreme Court found a violation and noted that the rule cannot be used to bypass a party's attorney.

Indiana Supreme Court

- *Matter of Martin*, 166 N.E.3d 345 (Ind. 2021)
  - Lawyer represented man in connection litigation after the dissolution of his first marriage
  - Client's second wife was charged in a criminal case involving the client and a domestic dispute
  - Second wife hired counsel to represent her
  - First wife noticed a deposition for second wife but did not inform second wife's attorney of the deposition
  - Lawyer, who was aware of second wife's status, participated in the deposition of second wife without her attorney present
  - Second wife made incriminating statements during the deposition
  - Supreme Court found that the lawyer violated Rule 4.2 even though the deposition was not related to the action between his client and the second wife

Thank You!

Martha Lehman
Amundsen Davis, LLC
201 North Illinois Street, Ste 1400
Indianapolis, IN 46204
(317) 464-4142
mlehman@amundsendavislaw.com

Wendy D. Brewer
Fultz Maddox Dickens PLC
333 North Alabama Street, Ste 350
Indianapolis, IN 46204
(317) 567-9048
wbrewer@fmdlegal.com

Andrew C. Ozete
Farmer Scott Ozete Robinson & Schmitt LLP
21 SE Third Street, Ste 900
Evansville, IN 47708
(812) 602-3582
aozete@fsolegal.com

Meredith R. Theisen
Rubin & Levin, P.C.
135 N. Pennsylvania Street, Ste 1400
Indianapolis, IN 46204
(317) 860-2877
mtheisen@rubin-levin.net

Section Six

AVOIDANCE ACTIONS, ALTER EGOS, ACCOUNTABILITY, & CRYPTO ASSETS: A MIXED BAG OF COMMERCIAL BANKRUPTCY UPDATED

PRESENTERS:

SAMUEL D. HODSON
TAFT STETTINIUS & HOLLISTER LLP

JOHN HUMPHREY
TAFT STETTINIUS & HOLLISTER LLP

JASON T. MIZZELL
KROGER GARDIS & REGAS, LLP

JONATHAN D. SUNDHEIMER
BARNES & THORNBURG LLP

Section Six

Avoidance Actions, Alter Egos, Accountability, & Crypto Assets: A Mixed Bag of Commercial Bankruptcy Updated........Jonathan D. Sundheimer – Moderator

Samuel D. Hodson
John R. Humphrey
Jason T. Mizzell

Biographies

Samuel D. Hodson, Taft Stettinius & Hollister LLP

Sam Hodson is a partner in the Indianapolis office of Taft Stettinius & Hollister. He practices in the Business & Finance, Taxation, and the Insolvency & Restructuring practice groups. Sam has been recognized by peer review organizations including: Indiana Super Lawyer (since 2010 in bankruptcy and creditors' rights), Best Lawyers in America (since 2012 in banking and finance, insolvency and reorganization, bankruptcy and creditors' rights and tax controversy) and Martindale Hubble (AV rated since 2002). Best Lawyers recognized him as the Indianapolis market Lawyer of the Year: in 2023 and 2016 for Tax Litigation and Controversy, in 2017 for Bankruptcy Litigation and in 2018 for Banking and Finance Litigation. Martindale Hubble has recognized him as a "Premium Client Champion" since 2017. Sam is certified in business bankruptcy by the American Board of Certification and serves as a director on the ABC board. His education includes: Bachelor of Arts, Political Science, Indiana University; Master of Business Administration, Finance, Indiana University Kelly School of Business; and Doctor of Jurisprudence, Indiana University, McKinney School of Law. Sam serves on the boards of: The Midwest Clinic; Music for All; Big Brothers Big Sisters of Central Indiana; the American Board of Certification; the Turnaround Management Association, Indiana; and the IUPUI ABA Paralegal Program Degree Certification Advisory Committee.

Contact information:

shodson@taftlaw.com
(317) 713-3557

John Humphrey, Taft Stettinius & Hollister LLP

John represents secured lenders, trade creditors, landlords, buyers and sellers of distressed businesses and others seeking financial solutions in complex legal matters.

A member of the American Bankruptcy Institute and a frequent lecturer on bankruptcy and out-of-court restructuring matters, John consults with business and individual debtors to help resolve financial problems through negotiation, out-of-court resolutions and bankruptcy. He has represented numerous clients in significant bankruptcy litigation matters, including multi-million dollar preference and fraudulent transfer cases. He is a member of Taft's Distressed Company Task Force, which was created to assist borrower clients in every way during the COVID-19 pandemic, including how to navigate discussions with their lenders and in addressing concerns over suppliers and stakeholders.

John is a Certified Public Accountant and was in private practice in business consulting and taxation prior to becoming an attorney. He continues to apply this expertise in tax controversy cases.

Throughout his tenure, John has been recognized with industry accolades for his work, including as an honoree by Indiana *Super Lawyers* and *Best Lawyers in America®* for Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law

Contact information:

jhumphrey@taftlaw.com
(317) 713-3571

Jason T. Mizzell, Kroger Gardis & Regas, LLP

Jason focuses his practice in the areas of litigation, E-discovery, creditors' rights, secured transactions, and bankruptcy matters. He served as staff counsel for the Honorable James M. Carr, United States Bankruptcy Judge for the Southern District of Indiana from 2013-2017 before moving into private practice. His substantial background in electronic discovery has seen his practice shift from exclusively creditors' rights and bankruptcy issues to include litigation in a number of different practice areas including environmental law and sports and entertainment law.

He is active in leadership roles within the Indianapolis Bar Association and the Indiana State Bar Association and regularly gives educational presentations to other attorneys on bankruptcy matters.

Contact information:

jmizzell@kgrlaw.com
(317) 777-7434

Jonathan D. Sundheimer, Barnes & Thornburg LLP

Simply put, Jonathan counsels businesses and individuals that loan money or are owed money. On the front-end of lending relationships, Jonathan has experience representing banks, both large and small, with loan originations, extensions, modifications and amendments. He has advised banks regarding loan participations, subordination agreements and mezzanine financing.

On the back-end of lending relationships, Jonathan has experience enforcing commercial real estate loans, representing receivers and collecting judgments. He regularly represents special servicers and financial institutions throughout Indiana in negotiating loan modifications and loan enforcement. In bankruptcy, he has represented creditors in all aspects of Chapter 11 proceedings, including cash collateral disputes, 363 sales and plan confirmations.

In both bankruptcy and commercial litigation, Jonathan's work has led to published opinions in Indiana state and federal courts, the Indiana Court of Appeals and the U.S. Court of Appeals for the Seventh Circuit. Out of court, he has helped restructure loans secured by real property, rents and equipment.

Jonathan has frequently advised manufacturing clients on strategies for minimizing risk in the supply chain. His advice has helped both suppliers and original equipment manufacturers avoid assembly line shutdowns and ensure continuing operations. Whether negotiating contract terms or seeking the appointment of a receiver over a supplier's operations, Jonathan's work has reduced losses when sole source suppliers go dark.

Jonathan is a frequent speaker, and has presented to the National Association of Credit Managers, Indianapolis Bar Association's Leonard H. Opperman Chapter 11 Roundtable, ICLEF Annual Bankruptcy Institute, and the Building Owners and Managers Association.

Contact information:

jsundheimer@btlaw.com
(317) 231-7319

Chapter 5 Avoidance Actions
Two Problem Issues

Samuel Hodson
Taft Stettinius & Hollister

The Bankruptcy Code grants the trustee or debtor-in-possession the power to pursue claims under chapter 5, sections 541, 542, 544, 545, 547, 548 and 549. These claims are commonly referenced as "avoidance actions" or "clawback actions" because the relief they seek is to reverse transfers of property once held by the debtor and administer that property as part of the estate. Often, the most valuable assets in an estate are avoidance actions. Occasionally, cases are filed for the purpose of allowing recipients of arguably voidable claims to make peace with a sophisticated trustee before a judge familiar with these actions. If the putative defendants have strong defenses, this approach makes much more sense than fighting with several creditors (or a single motivated creditor) before a state court judge with limited experience. Sometimes filings are timed to either protect a transfer to a friendly creditor or expose a transfer (e.g. a coerced payment or judgment lien) to a hostile creditor.

Sale of Claims

Although chapter 5 actions are frequently the most valuable assets in an estate, they are occasionally not pursued by trustees because of insufficient cash to fund the litigation. Some courts have taken the strict view that, except for in limited circumstances (such as through a confirmed chapter 11 plan), avoidance claims cannot be assigned. Others have taken a more liberal view that under certain circumstances a trustee may assign avoidance claims if doing so will benefit the bankruptcy estate.

The 9th and 5th Circuits have approved the sale of claims under certain circumstances. A bankruptcy trustee may sell "avoidance powers to a self-interested party that will abandon those claims, so long as the overall value obtained for the transfer is appropriate." *Silverman v. Birdsell*, 2020 WL 236777, (9th Cir. Jan. 15, 2020). Affirming the lower courts, the 9th Circuit reaffirmed its prior holding that "a bankruptcy trustee may sell an estate's avoidance claims to a creditor when 'the creditor is pursuing interests common to all creditors' and 'allowing the creditor to exercise those powers will benefit the remaining creditors.'" *Id*., quoting *In re PRTC, Inc*., 177 F.3d 774, 782 (9th Cir. 1999) and *Briggs v. Kent*, 955 F.2d 623, 626 (9th Cir. 1992) ("If a creditor is pursuing interests common to all creditors…, he may exercise the trustee's avoiding powers."). In *Silverman*, the court-approved sale was "expected to result in abandonment of the claims by transferring them to the would-be defendant." *Id.*

A sale to a potential defendant may need to be scrutinized under both Rule 9019 and Section 363. When a bankruptcy court "authorizes the sale of the estate's litigation claims to the would be defendant of those claims, … [it] must analyze the sale under both §363(b)(1) and Fed. R. Bankr. P. Rule 9019." *Id.* When applying § 363, the court must "assure that optimal value is realized by the estate under the circumstances." *Id.* In comparing the cash bid for the claims to the objecting parties' motion, the bankruptcy court had questioned whether any person "would succeed in litigating the estate's claims," reflecting the conclusion that the cash bid was superior. *Id.* (The question of whether a claim that was unwinnable could even be ethically sold was not raised by the parties or addressed by the court.) The bankruptcy court had been familiar "with the extended litigation history between the parties" and had carefully considered "the relevant factors." *Id*. The bankruptcy court had also considered all the relevant criteria when applying Bankruptcy Rule 9019 for approval of a settlement. It considered "(a) the probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of litigation involved, and the expense, inconvenience and delay necessarily attending it; and (d) the paramount interest of the creditors and a proper deference to their reasonable views …." *Id*., quoting and citing *In re Mickey Thompson Entm't Grp*., Inc., 292 B.R. 415, 420 (BAP 9th Cir. 2003) and *In re A&C Props*., 784 F.2d 1377, 1382 (9th Cir. 1986).

The 5th Circuit Court of Appeals has also addressed both the sale and competitive bidding issues. In *In re Moore*, the chapter 7 trustee filed a motion for approval of a settlement of an adversary proceeding commenced against the debtor, his wife, and two affiliated companies that were allegedly alter egos of the debtor by a prepetition judgment creditor of the debtor, The Cadle Company ("Cadle"), *Cadle Co. v. Mims* (*In re Moore*), 608 F.3d 253 (5th Cir. 2010). Cadle had sued the defendants in state court in 2005, attempting to collect the judgment and asserting claims of reverse veil piercing, fraudulent conveyance, and constructive trust. After the debtor filed a chapter 7 case in Texas in 2006, Cadle removed the state court claims, which became part of the debtor's bankruptcy estate, to the bankruptcy court, where the litigation continued as an adversary proceeding with the trustee substituted as plaintiff. Cadle, however, continued to fund the litigation due to the absence of sufficient estate assets. Upon learning of the proposed settlement, Cadle filed an objection and offered to purchase the causes of action from the trustee for an amount slightly greater than the proposed settlement offer. After concluding that, as a matter of law, the claims could not be sold, the bankruptcy court approved the proposed settlement as being fair and reasonable and in the best interests of the estate pursuant to Bankruptcy Rule 9019. The district court affirmed on appeal.

Cadle appealed to the 5th Circuit. The court ruled that both the reverse veil-piercing and fraudulent-conveyance claims were property of the estate that could be sold, reversed the bankruptcy court's ruling, and remanded the case for further proceedings. In addition, the 5th Circuit ordered the bankruptcy court to consider the propriety of an auction and section 363 sale procedures in light of Cadle's offer to purchase the claims, as well as the propriety of the settlement of the claims under Bankruptcy Rule 9019.

The 5th Circuit began its analysis by considering whether the reverse veil-piercing and fraudulent-conveyance claims were property of the debtor's estate. Previous cases under Texas state law, the court explained, have established that both veil-piercing and reverse veil-piercing claims are property of a debtor's bankruptcy estate under section 541 of the Bankruptcy Code, rather than assets of individual creditors. By contrast, the 5th Circuit explained that there is conflicting authority under its own precedent as to whether state-law fraudulent-transfer claims may be property of a debtor's estate under section 541.

The panel emphasized that deeming a claim belonging exclusively to a creditor prior to the commencement of a bankruptcy case property of the debtor's estate would conflict with the general rule that a cause of action is part of a debtor's estate only if the debtor could have prosecuted the action immediately prior to filing for bankruptcy. The court proceeded to analyze whether a fraudulent transfer claim may become property of a debtor's estate pursuant to section 544(b) and, if so, whether such a cause of action may be sold.

The court recognized the split of authority on whether a trustee may sell state-law fraudulent-transfer actions after the commencement of a bankruptcy case. On the one hand, the 9th Circuit held in *In re P.R.T.C., Inc*. that these actions may be sold or transferred, *Ducker Spradling & Metzger v. Baum Trust* (In re P.R.T.C., Inc.), 177 F.3d 774 (9th Cir. 1999). On the other, the Third Circuit ruled in *In re Cybergenics Corp* 330 F.3d 548 (3d. Cir. 2003) that the power to avoid a debtor's prepetition transfers and obligations to maximize the value of the bankruptcy estate for the benefit of creditors pursuant to section 544 of the Bankruptcy Code "neither shift[s] ownership of the fraudulent transfer action to the debtor in possession, nor [constitutes] a debtor's assets" and therefore cannot be sold or transferred.

The 5th Circuit adopted the 9th Circuit's approach. The court reasoned that fraudulent transfer claims are property of the estate under section 541(a)(1) or, in the alternative, become property of the estate pursuant to section 544(b) and may be sold pursuant to section 363(b) of the Bankruptcy Code (which authorizes the trustee DIP to sell estate assets outside the ordinary course of business, after notice and a hearing). According to the panel, the ability to sell fraudulent-transfer claims is generally consistent with: (a) the ability of a trustee pursuant to section 1123(b)(3)(B) to transfer the right to exercise avoidance powers under a chapter 11 plan; (b) the right of a single creditor to prosecute an avoidance action on behalf of the estate after court approval under the principle of "derivative standing"; and (c) the reimbursement of creditors for successfully pursuing, at their own risk and expense, a transfer avoidance action for the benefit of the estate pursuant to section 503(b)(3)(B).

Whether a proposed settlement of estate claims should be analyzed as a sale under section 363(b) is likewise subject to a split of authority. In 1998, for example, the 1st Circuit concluded (without analysis) in *In re Healthco Int'l* Inc. 136 F.3d 45 (First Circuit 1998) that a settlement should not be subjected to scrutiny as a sale. The 3rd and 9th Circuits bankruptcy appellate panels ruled to the contrary in *In re Martin* 91 F.3d 389 (Third Circuit 1996) and *In re Mickey Thompson Entm't Group, Inc*., respectively. In *In Moore*, the 5th Circuit panel determined that subjecting a proposed settlement to scrutiny under section 363(b) and Bankruptcy Rule 6004 (delineating procedural requirements for a proposed use, sale, or lease of estate property) as well as Bankruptcy Rule 9019 is the preferred approach. Although the decision to implement formal sale procedures when considering a settlement of claims should remain in the discretion of the bankruptcy court, under the specific facts of *Moore*, the offer from the debtor's major creditor to purchase claims for a higher amount than the proposed settlement "obligated the bankruptcy court to consider whether an auction and § 363 sale were appropriate." The bankruptcy court's failure to do so meant that "the true value of the claims [remained] undetermined" and was an abuse of discretion. The court limited the scope of its ruling to "causes of action that [the trustee] has inherited from creditors under § 544(b)—causes of action that exist independent of the bankruptcy proceeding." It expressly declined to address "the broader question [of] whether a trustee may sell all chapter 5 avoidance powers, such as the power to avoid preferences under § 547 or to avoid fraudulent transfers under § 548."

A Delaware bankruptcy court has also approved the sale of avoidance actions when presented some compelling facts. In *Claridge Associates, LLC, et al. v. Anthony Schepis* (*In re Pursuit Capital Management, LLC*), Adv. P. No. 16-50083 (LSS) (Bankr. D. Del. Nov. 2, 2018), Judge Silverstein held that a chapter 7 trustee was authorized to sell the right to pursue fraudulent conveyance claims to third parties, pursuant to section 363 of the Bankruptcy Code. In doing so, the Court extended the Third Circuit's holding in Official Committee Of Unsecured Creditors of *Cybergenics Corp. v. Chinery*, 330 F.3d 548 (3d. Cir. 2003) (*en banc*) to chapter 7 cases.

The equities in *Pursuit Capital* strongly supported sale of the claims. Pursuit Capital Management, LLC was the general partner of two investment partnerships. Two individuals were the sole owners and controlling principals of the debtor and several offshore funds and investment management companies. By 2009, one of the funds ceased making new investments and started to wind down. Litigation followed against the debtor, the principals and affiliates by various investors who had lost money. The debtor filed for chapter 7 relief. A year later, the chapter 7 trustee filed a motion to sell all the debtor's assets, pursuant to section 363(b) and (f) of the Bankruptcy Code, to some of the investors who had asserted prepetition claims. The assets consisted wholly of claims against third parties, including fraudulent conveyance claims against the principals and affiliates.

The Court authorized the trustee to sell all rights, title and interests to any claims belonging to the Debtor, the trustee and the bankruptcy estate to the investors, *in return for a recovery to the bankruptcy estate from the resulting litigation.* In the litigation brought by the investors, the defendants filed a motion to dismiss the complaint, arguing, in part, that the investors could not buy the claims and lacked standing to bring bankruptcy and state law avoidance actions against the defendants under sections 548(a)(1) and 544(b) of the Bankruptcy Code. The defendants cited the 3rd Circuit's Cybergenics decisions. See *Official Comm. Of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 226 F.3d 237 (3d. Cir. 2000) ("*Cybergencis I*"); *Official Comm. Of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548 (3d. Cir. 2003) (*en banc*) ("*Cybergenics II*"). The investors countered that *Cybergenics I* did not address the ability of a trustee to sell fraudulent conveyance claims and *Cybergenics II* authorized a bankruptcy court to use its equitable powers to permit the sale of avoidance claims to non-trustees.

In Cybergenics I, one of the main issues was whether a creditors' committee in a chapter 11 case could bring a derivative action on the estate's behalf to recover fraudulent conveyances, even if such claims might have been sold, as part of the debtor's assets, in an earlier 363 sale. On appeal, the Third Circuit held that the committee could pursue such claims, as the prior sale did not include state law fraudulent conveyance claims, which did not belong to the debtor. In Cybergenics II, the main issue was whether section 544 only allows a trustee to pursue state law fraudulent transfer claims. The district court held that it did and thus dismissed the complaint, based on the Supreme Court's holding in *Hartford Underwriters' Ins. Co. v. Union Planters Bank*, 530 U.S. 1 (2000).

On the second appeal, the Third Circuit distinguished the *Hartford* case on the basis that it was focused on a "non-trustee's right unilaterally to circumvent the Code's remedial scheme," while *Cybergenics II* was focused on "a bankruptcy court's equitable power to craft a remedy when the Code's envisioned scheme breaks down." The Third Circuit found that the Bankruptcy Code, pursuant to sections 1109(b) and 1103(c)(5), envisions a creditors' committee playing a central role in a chapter 11 case evidencing Congressional intent to allow derivative standing to committees. The 3rd Circuit also found that section 503(b)(3)(B) implicitly sanctions this practice, because it grants administrative priority claims for costs incurred in recovering transferred or concealed property of the debtor.

The 3rd Circuit further found refuge in the bankruptcy court's equitable powers. When a trustee refuses to bring an avoidance action, the bankruptcy court can invoke its equitable powers to affect the result the Bankruptcy Code was designed to obtain. In *Cybergenics II*, the remedy crafted with these equitable powers was to permit the creditors' committee to sue derivatively on behalf of the estate, provided the bankruptcy court acted as the gatekeeper for the prosecution of estate claims.

The Court found that the holding in *Cybergenics II* should be extended to chapter 7 cases. It reasoned that: (a) Section 503(b)(3)(B) (the statute on which *Cybergenic II* relies) applies equally to chapter 7 cases; and (b) the justification for use of equitable powers, especially in the context of avoidance actions, applies equally in chapter 7 cases. The Court also found support from *In re Trailer Sources, Inc*., 555 F.3d 231 (6th Cir. 2009), where the 6th Circuit specifically extended the equitable powers sanctioned in *Cybergenics II* to chapter 7 cases, reasoning that these cases are particularly vulnerable to a breakdown in the Code's scheme because trustees often lacks funds to pursue meritorious claims. Judge Silverstein also expressed concerns about the behavior of management and its impact on the fair administration of the case:

> In instances, such as this one, where a debtor's prepetition corporate management is alleged to have engaged in fraudulent transfers immediately prior to the bankruptcy filing, stripping the debtor of any funds that a chapter 7 trustee could use to make distributions to those creditors and/or investigate management's actions, the intended system has broken down, and it is appropriate for the bankruptcy court to use its equitable powers and craft a flexible remedy.

The 7th Circuit has not opined about the propriety of outright sales of avoidance actions, but it has allowed them to be pledged as liens. The 7th Circuit allowed granting a DIP lender a lien on avoidance actions in *In re Qualitech Steel Corp.*, 276 F.3d 245 at 246. In that case, under-secured creditors received a replacement lien encumbering avoidance actions over the objection of several other creditors. On the petition date, the secured lenders had liens on all the debtor's assets, securing about $265 million in claims. Management estimated the value of the debtor's assets to be $225 million. *Id*. The lenders were under-secured and the debtor was losing $10 million a month. A group of secured lenders agreed to fund the debtor with a $30 million super priority DIP financing, which “required demoting the [preexisting] secured lender’s position and substituting new security under [Code] §364(d)(1). The only other assets in sight were the proceeds of preference recovery actions …. [T]he bankruptcy court approved … financing of $30 million, with super security and an award of replacement security to the [primed] senior lenders, to the extent that this was necessary to maintain their financial positon. No one appealed or sought a stay.” Id. at 247.

Qualitech’s assets were sold five months after the financing for approximately $180 million. *Id.* The first $30 million went to the DIP lenders, “leaving $150 million for the old secured creditors,” who relied on the provision in the financing order giving them “extra security — first dibs in the preference recovery kitty, which would make up some but far from all the loss.” *Id*. The creditors’ committee argued that pre-bankruptcy lenders should not receive security interests in the proceeds of avoidance actions and that the secured lenders had improved their positon as a result of the DIP financing. *Id*. at 248. “But the bankruptcy judge concluded that good money had been thrown after bad, the secured lenders’ position had been eroded by at least the value of the anticipated preference recoveries, and that they therefore were entitled to a substitute security interest in that collateral.” *Id*. at 247.

The district court and the court of appeals affirmed. The 7th Circuit held that it was “too late to tell” the primed lenders “that they, rather than the unsecured creditors, must swallow” any loss resulting from the DIP financing. *Id.* at 248. The Court found that, “the secured creditors suffered a loss as a result of the DIP financing,” which “entitled [them] to” the preference recoveries under Code § 364(d)(1). Id. at 247. The court’s reasoning is significant:

> … [At the beginning of the case] in March 1999 the secured creditors had interests worth $225 million, yet … in August 1999 these interests were worth, at most, $197 million after paying off the DIP lenders…. [T]he secured lenders lost more than the value of the avoidance actions on any calculation.
>
> *Id.* at 248.

The 7th Circuit has also looked favorably on derivative standing. It has held that derivative standing is appropriate when three elements are met: (i) the trustee unjustifiably refuses a demand to pursue the action, (ii) the creditor establishes a colorable claim or cause of action, and (iii) the creditor seeks and obtains leave from the bankruptcy court to prosecute the action for and in the name of the trustee. In *Official Comm. of Unsecured Creditors v. NewKey Group, LLC* (*In re SGK Ventures, LLC*) 521 B.R. 842 (Bankr. N.D. Ill. 2014), the United States Bankruptcy Court for the Northern District of Illinois applied this standard to a derivative standing dispute that arose when the debtor's Official Committee of Unsecured Creditors sought derivative standing to pursue various causes of action on the estate's behalf against a group of defendants that included insiders and shareholders of the debtor. The 7th Circuit's standard in *Fogel* requires an additional finding that there exists a "colorable" claim. *Fogel v. Zell*, 221 F.3d 955 (7th Cir. 2000). The test would not permit the sale of frivolous claims.

The 7th Circuit's allowing liens to be placed against proceeds of avoidance actions and allowing derivative actions suggest that it may be willing to allow sale under conditions similar to those justifying derivative actions. Courts that have allowed trustees to assign avoidance claims have often analyzed the circumstances in the same framework as derivative requests. Several recent decisions suggest that, for at least some courts, the appropriate framework depends not on the type of avoidance claim being sold or the identity of the purchaser, but rather *who will ultimately benefit from any recoveries on the avoidance claim*. Using this analysis, the sale to a creditor pursuing the claim solely for its own benefit will likely be denied, while a trustee's proposed sale to a creditor that will pursue recovery for the benefit of the estate will be analyzed under a derivative standing framework that is more likely to be approved.

The 4th factor set forth in *Fogel* seems obvious but may have great importance in situations where a creditor is less motivated by recovering cash than doing harm to the principals of the debtor who would be the target of avoidance actions. For instance, it may cost a transferee hundreds of thousands of dollars to defend an avoidance action even if the chances of success are very low. Being a defendant may also exclude it from obtaining credit, qualifying for best rates or participating in business opportunities in which pending litigation may be a disqualifying factor. Allowing the sale of frivolous claims would also support the creation of collection mills extorting nuisance payments from anyone that received anything from a debtor within the avoidance period. The 7th Circuit set forth a simple test for frivolous in *Maxwell v. KPMG LLP*, 520 F.3d 713, 719 (7th Cir. 2008) (an argument is "frivolous" if the probability of the suit's succeeding is very low). The court rejected the argument that a large possible recovery balances the lack of evidence or supporting law. For example, spending $5,000 to pursue a $1 million claim with a 5% chance of success may make economic sense especially if defendants analyzing the claim in the same manner would likely pay something short of $50,000 to avoid the risk and litigation expense. The *Maxwell* court did not allow this business analysis to justify pursuing claims with low chances of success.

The possibility of a sale either voluntarily by a trustee or after being forced into an auction after a § 9019 motion is subjected to § 363 scrutiny adds creates some risks to trustees and settling defendants, especially when actions are not particularly strong. The chance to settle cheaply may turn into an extended fight with a motivated creditor. The offer may be also used to demonstrate that the claim is not frivolous. A trustee faced with bad facts, may need to consider whether bringing a modest settlement to the court will result in an auction and creditors questioning the trustee's contribution to whatever pot is created. Finally, the court and the trustee need to address the ethics of involving themselves in the monetization of frivolous claims when completing a § 363 analysis.

Tax Code Extended Avoidance Period under § 544(b)

Section 544(b) of the Bankruptcy Code allows a trustee to "avoid any transfer of interest of the debtor in property or any obligation incurred by the debtor this voidable *under applicable law* by a creditor holding an unsecured claims this is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title". The creditor whose rights create this benefit is often referenced as the "Golden Creditor or "Triggering Creditor". *Emphasis added.* It has been common for trustees to use more generous look back periods in state voidable transfer statutes to pursue assets. Section 548 of the Bankruptcy Code provides for only a 2 year look back period. Most state voidable transfer laws provide for 4 years, some allow for 6 years. If any creditor could avoid a transfer outside of bankruptcy to the extent of its claim, the trustee may pursue avoidance of the entire transfer for the benefit of all creditors. section 544(b) put all creditors in the position of the Golden Creditor. Courts interpreting section 544(b) have held that the Tax Code constitutes "applicable law".

Congress granted the IRS 10 years after assessment to collect delinquent taxes. 26 U.S.C 6501§ (a)(1). Avoiding transfers is one of its tools, but its time constraints begin with assessment, not the offending transfer, and look forward rather than backward. Insolvency professionals are accustomed to examining voidable transfers and general use the term "lookback" to describe the time limitations. The term is often erroneously used by practitioners and even courts to describe the section 6502 collection period. Some courts have assumed that the 10 years ends on the petition date and trustees are permitted to avoid transfers made 10 years before a bankruptcy is filed. *See: In re Polichuk,* 2010 WL 4878789, (Bankr. E.D. Pa. 2010)(*"*The IRS has at least a ten-year lookback period…")*; Finkel v. Polichuk,* 506 B.R.405 (Bankr. E.D. Pa. 2014); *In re Vaughn Co.,* 498 B.R. 297 (Bankr. D.N.M. 2013). Every court which has *directly addressed the issue* has held the section 6502 does not operate as a "lookback" but is a forward-looking collection period. See *Gordon v. Wester* (*in re Webster*), 629 B.R. 654, 676 (Bankr. N.D. Ga.2021). "Considering the focus on assessment in case law and the statutory text, the Court cannot find that Section 6502 operates to avoid transfers up to ten years prior to the petition irrespective of the status to the tax liability or assessment." *Gordon v. Harrison* (*In re Alpha Protective Servs. Inc.*) 531 B.R. 889, (Bankr. M.D. Ga. 2015). "Section 6502(a)(1) provides a 'limitation period', rather than a 'reach back period'…"). This interpretation is consistent with the plain text of the statute:

> Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun…(1) within 10 years after the assessment of the tax…

This IRS collection tool is substantially more complex than garden variety avoidance actions. Absent an assessment, it is not available. If the assessment was not made timely, the remedy also disappears. If the assessment was made close to the petition date, the relief may be less than that provided by state voidable transfer laws, and the statute provides no relief for transfers made before the assessment. The fact that a debtor lists an obligation to the IRS on its schedules, does not necessarily mean that the trustee has a decade of transactions to mine for recovery.

The Tax Code generally allows the IRS three years after a tax return has been filed to assess taxes. "[T]he amount of any tax imposed by this title shall be assessed within three years after the return was filed (whether or not such return was filed on or after the date prescribed)." 26 U.S.C. § 6501(a). This section applies only to the taxpayer. 26 U.S.C. § 6501(c) governs assessments against transferees and appears to allow assessment against transferees without initiating a fraudulent transfer lawsuit. "The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected *in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred*." *Emphasis added.* Section 6901(c)(1) of the Tax Code, in conjunction with 26 U.S.C. § 6501(a), generally provides that the IRS has four years to assess liability against an initial transferee following the filing of a tax return (three years to assess against the taxpayer, and one additional year to assess against the transferee). Timely assessment is a condition to collection in or outside of litigation. See 26 U.S.C. § 6502(a). "Where the assessment of any tax ... has been made ... such tax may be collected by levy or by a proceeding in court."; "[N]o proceeding in court without assessment for the collection of (tax for which a return was filed) shall be begun after the expiration of [the three-year assessment] period."); *In re Kaiser*, 525 B.R. at 710. "The process by which the IRS may
collect taxes against the transferee of property of the taxpayer is first assessment of tax liability, then collection, both of which are subject to well-specified limitations." *United States v. Holmes*, 727 F.3d 1230, 1233 (10th Cir. 2013).

Calculating the length of the IRS limitations period is straightforward. If outside of bankruptcy the IRS assesses a tax in March 2020 for tax year 2019. The IRS then has 10 years following the assessment (until March 2030) to collect the tax, including initiating a suit against transferees of the taxpayer's property to recover transfers to apply to the 2019 tax debt. If the IRS uses the full three-year assessment period contained in § 6501(a) of the Tax Code and does not assess the 2019 tax until December 2022, the deadline would be extended until December 2032, *13 years* after the applicable tax year. If the returns were filed late, or not filed at all, the period will be longer and even open-ended. For example, if a taxpayer never files a tax return, there is no statute of limitations for assessment. The implications of an indefinite period for assessment are unclear.

However, because assessment is tied to collection, the potential for an open-ended collections period has caused some courts to question the application of these rules.

If the IRS has not completed a tax assessment, complications arise for the IRS outside of bankruptcy that trail into a bankruptcy and will hamper a trustee. Outside of bankruptcy, no tax assessment means that the IRS may be precluded from asserting fraudulent transfer claims against transferees relating to the unassessed tax. In bankruptcy, even if there is no tax assessment, the IRS may still hold a "claim" against the debtor as defined in § 101 of the Bankruptcy Code, which, in theory, would still allow the trustee to use the IRS as the triggering creditor to pursue fraudulent transfers under § 544(b). Because the IRS could itself be precluded outside of bankruptcy from pursuing a taxpayer's transferees for fraudulent transfers due to the lack of an assessment, the same logic should apply to a trustee and also preclude the trustee's pursuit of transferees. By the same token, outside of bankruptcy if there is no tax assessment, the 10-year collection limitations period may not apply. In bankruptcy, that would, *in theory*, translate into the trustee being precluded from using the 10-year limitations period altogether. Defending against the extended fraudulent transfer claim may be as simple as reviewing the IRS filed proof of claim. If the date of assessment is after the date of the date of the transfer, more than 3 years after the return was filed or more than 10 years prior to the transfer, the trustee should not be able to use the extended period.

The use of the Tax Code as "applicable law" under § 544(b) continues to evolve and is often misunderstood and misapplied. One certainty is that the trustee does not have a blanket 10 year look back period whenever the IRS is a creditor. When defending claims which would be time-barred but for the IRS 10 year collection period, practitioners should: (1) become familiar with the conditions under which the IRS could collect outside of bankruptcy; and (2) closely examine the IRS claim and even the tax transcripts to ensure that the extended period is even available to the trustee.

Alter-Ego in Bankruptcy Cases

John Humphrey
Taft Stettinius & Hollister LLP

Question: If I represent a creditor of a debtor with limited liability (e.g. a corporation or limited liability company) in a bankruptcy case, can I sue the debtor's parent company or shareholder based on a theory of alter-ego or piercing the corporate veil while the debtor is in a bankruptcy case?

Some circuits allow a creditor to bring an alter ego claim against a shareholder of a bankruptcy debtor. See, for example, *RCS Engineered Products Company, Inc. v. Spartan Tube & Steel, Inc.*, 102 F.3d 223 (6th Cir. 1996). Further, such a suit is not precluded by the automatic stay. *Id*. The basis for this finding is that the debtor/subsidiary is not allowed under its particular state law to pierce its own veil.

The 7th Circuit follows a different rule, seemingly focusing on the trustee's rights to bring claims pursuant to § 544(b). If the alter ego claim is general to all creditors and not to an individual creditor, then only the trustee may pursue such a claim for the benefit of all creditors. *Koch Refining v. Farmers Union Central Exchange, Inc.*, 831 F.2d 1339 (7th Cir. 1987).

However, if a claim is individual to a creditor, then the debtor-in-possession or the trustee may not enjoin a creditor from pursuing that claim pursuant to *In re Teknek*, 563 F.3d 639 (7th Cir. 2009). A copy of the *Teknek* case is enclosed. The trick is to determine when a claim is individual to a creditor and when it is not. In *Teknek*, the creditor obtained a $3.77 million judgment against Teknek and a sister organization called Teknek Electronics ("Electronics") for patent infringement. While the litigation was pending, the principal shareholders of both Teknek and Electronics fraudulently conveyed all of the property of Teknek and Electronics to a new company called Teknek Holdings ("Holdings"). The judgment creditor obtained alter ego judgments against Holdings and the shareholders in the California court. Teknek then filed a Chapter 7 case in Illinois.

The Teknek trustee attempted to enjoin the judgment creditor from pursuing Holdings and the shareholders in favor of the trustee doing so. However, the 7th Circuit found that, since the judgment creditor had a judgment against Electronics and the trustee only had claims against Teknek (and no claims against Electronics), that the judgment creditor could not be enjoined from pursuing a judgment against the shareholders and Holdings (which had received assets from both Teknek and Electronics). A second issue was that the judgment holder was the only major creditor of the debtor Teknek, which was cited as important though not the sole reason for the decision.

The *Tekek* panel also found that the 7th Circuit's decision in *Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998) did not change the outcome. *Fisher* found that creditors could be enjoined from collecting from non-debtors, even if the creditors have independent claims against non-bankruptcy co-defendants who have acted in bad faith, so long as the estate also has claims against the particular non-bankruptcy co-defendants. The purpose of *Fisher* would seem to be to allow the estate to recover from a given defendant first, thus benefiting all creditors. However, in *Teknek*, the judgment creditor was allowed to pursue Holdings and the shareholders despite *Fisher* as a result of it having an independent claim against Electronics, despite there only being a single pot of assets albeit some of the assets had originally come from Electronics, against which the Teknek bankruptcy estate had no claim.

Teknek does not answer the question about how to allocate the assets of the shareholders and Holdings between the judgment creditor and the Teknek bankruptcy estate. The Teknek trustee would have also have had fraudulent transfer claims, but if the judgment creditor somehow obtains all of the assets of Holdings and the shareholders based on collections of its existing judgments prior to the trustee's being able to collect, there may be nothing remaining for the estate, even if the judgment creditor liquidates assets that were once Teknek's. In many cases, fraudulent transfer forms part of the basis for an alter ego claim, which supports the concept that the trustee should be given the sole power to collect these claims as the trustee is given that exclusive power by the Bankruptcy Code. This does not appear to have helped the trustee in Teknek, however.

Creditors' attorneys should consider opportunities to pursue alter ego claims in bankruptcy cases, which appear to be possible in certain circumstances such as those extant in *Teknek*.

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Harris N.A. v. Gander Partners LLC, N.D.Ill., January 26, 2011

563 F.3d 639
United States Court of Appeals,
Seventh Circuit.

In re TEKNEK, LLC, Debtor,
Phillip D. Levey, Trustee, Plaintiff–Appellant,
v.
Systems Division, Inc., Defendant–Appellee.

No. 08–1137.
|
Argued Sept. 23, 2008.
|
Decided April 29, 2009.

Synopsis
Background: Chapter 7 trustee, in adversary proceeding, sought to enjoin judgment creditor's collection efforts against corporate debtor's shareholders and related holding company, as debtor's alter egos, so that trustee could pursue same judgment for bankruptcy estate's benefit. The Bankruptcy Court entered preliminary injunction preventing judgment creditor from collecting judgment outside bankruptcy. Judgment creditor appealed. The United States District Court for the Northern District of Illinois, Rebecca R. Pallmeyer, J., 2007 WL 4557813, vacated preliminary injunction. Trustee appealed.

Holdings: The Court of Appeals, Cudahy, Circuit Judge, held that:

[1] judgment creditor's alter ego claims were not estate property or related to debtor's bankruptcy case, precluding preliminary injunction against judgment creditor's collection efforts;

[2] bankruptcy court lacked jurisdiction to approve trustee's settlement of his claims against alter egos during pendency of appeal; and

[3] sanctions against trustee and judgment creditor were warranted.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Preliminary Injunction.

West Headnotes (12)

[1] **Bankruptcy** Representation of debtor, estate, or creditors

Purpose and duty of bankruptcy trustee is to gather bankruptcy estate's assets for pro rata distribution to estate's creditors.

5 Cases that cite this headnote

[2] **Bankruptcy** In general; standing
Bankruptcy Representation of debtor, estate, or creditors

In aid of bankruptcy trustee's duty to gather bankruptcy estate's assets for pro rata distribution to estate's creditors, trustee has the sole right and responsibility to bring claims on behalf of estate and on behalf of creditors as a class, or so-called "general" claims, but individual creditors retain the right to bring "personal" claims that do not implicate trustee's purpose.

18 Cases that cite this headnote

[3] **Bankruptcy** In general; standing
Bankruptcy Representation of debtor, estate, or creditors

Bankruptcy trustee has the sole responsibility to represent the bankruptcy estate by bringing actions on its behalf.

4 Cases that cite this headnote

[4] **Bankruptcy**In general; standing
BankruptcyRights of Action; Contract Rights Generally

Included within bankruptcy estate of corporate debtor is any action that debtor may have to recover damages for fiduciary misconduct, mismanagement, or neglect of duty, and bankruptcy trustee succeeds to the right to bring such actions. 11 U.S.C.A. § 541.

4 Cases that cite this headnote

[5] **Bankruptcy**In general; standing
BankruptcyRepresentation of debtor, estate, or creditors

Bankruptcy trustee, who has creditor status under Bankruptcy Code, is the only party that can sue to represent the interests of creditors as a class. 11 U.S.C.A. § 544.

7 Cases that cite this headnote

[6] **Bankruptcy**In general; standing

Bankruptcy trustee has no standing to bring "personal" claims of creditors, which are defined as those in which claimant has been harmed and no other claimant or creditor has an interest in the cause.

15 Cases that cite this headnote

[7] **Bankruptcy**In general; standing

Single creditor may not maintain an action on his own behalf against a debtor-corporation's fiduciaries if that creditor shares in an injury common to all creditors and has personally been injured only in an indirect manner.

8 Cases that cite this headnote

[8] **Bankruptcy**Preliminary injunctions and restraining orders
BankruptcyRights of Action; Contract Rights Generally

Judgment creditor's alter ego claims against Chapter 7 debtor's sole shareholders and related holding company were not property of debtor's bankruptcy estate or related to debtor's bankruptcy case, and therefore bankruptcy court could not enter preliminary injunction barring judgment creditor's collection efforts against alter egos so as to allow trustee to pursue same judgment for bankruptcy estate's benefit, given existence of additional judgment debtor that was directly liable on judgment to judgment creditor, and on behalf of which alter egos also were liable on judgment to judgment creditor, and given that judgment creditor was debtor's only major creditor, such that allowing it to settle its claim against alter egos outside bankruptcy case would not derail case.

11 Cases that cite this headnote

[9] **Bankruptcy**Effect of Transfer

When a case is on appeal, all lower courts lose jurisdiction over it and related matters.

6 Cases that cite this headnote

[10] **Bankruptcy**Effect of Transfer

Bankruptcy court lacked jurisdiction to approve Chapter 7 trustee's settlement of all of his claims against corporate debtor's alter egos, given pendency before Court of Appeals of trustee's related appeal from order vacating preliminary injunction that trustee had sought so that he could pursue judgment creditor's claim against debtor's alter egos on behalf of bankruptcy estate, and therefore purported approval was null and void.

8 Cases that cite this headnote

[11] Bankruptcy—Moot questions

Bankruptcy court's purported approval of Chapter 7 trustee's settlement of all of his claims against corporate debtor's alter egos did not render moot trustee's related appeal from order vacating preliminary injunction which trustee had sought so that he could pursue judgment creditor's claim against debtor's alter egos on behalf of bankruptcy estate, given that settlement did not purport to settle issues directly before Court of Appeals and settlement was not validly approved by bankruptcy court, and therefore Court of Appeals retained jurisdiction over appeal.

7 Cases that cite this headnote

[12] Bankruptcy—Frivolity or bad faith; sanctions

Court of Appeals would impose sanction of $5,000 against Chapter 7 trustee for entering into settlement of his claims against corporate debtor's alter egos in derogation of Court of Appeals's jurisdiction over his related appeal from order vacating preliminary injunction against judgment creditor, and would impose sanction in same amount against judgment creditor for its abortive attempts to extricate itself from bankruptcy proceedings in apparent disregard of Court of Appeals' exclusive jurisdiction over matters.

4 Cases that cite this headnote

Attorneys and Law Firms

***641** John A. Lipinsky, Coman & Anderson, Lisle, IL, for Debtor.

Steven B. Towbin (argued), Shaw, Gussis, Fishman, Glantz, Wolfson & Towbin, Chicago, IL, for Trustee–Appellant.

Edward F. O'Connor (argued), O'Connor, Christensen & McLaughlin, Irvine, CA, for Defendant–Appellee.

Before BAUER, CUDAHY and WILLIAMS, Circuit Judges.

Opinion

CUDAHY, Circuit Judge.

Systems Division, Inc. (SDI) obtained a judgment for patent infringement against Teknek LLC (Teknek) and Teknek Electronics (Electronics) in a district court in California. While the patent suit was pending, Teknek and Electronics' sole shareholders, Jonathan Kennett and Sheila Hamilton, created Teknek Holdings (Holdings) and proceeded to funnel both companies' assets into Holdings, leaving Teknek and Electronics insolvent. From here, matters get complicated. After SDI won its patent suit, it successfully moved the federal district court in California to add Kennett, Hamilton and Holdings to the judgment as defendants on an alter ego theory. Meanwhile, Teknek (but not Electronics) filed for bankruptcy in the Northern District of Illinois, and the bankruptcy trustee brought an adversary proceeding against Hamilton, Kennett and other successor entities of Teknek (but not Electronics or Holdings) alleging, among other ***642** things, that Hamilton and Kennett were Teknek's alter egos and seeking to recover the SDI judgment on behalf of the estate. The question presented by this appeal is whether SDI's collection action against Kennett, Hamilton and Holdings (the alter egos) may be enjoined so that the trustee can pursue its claim for the same judgment against Kennett and Hamilton. The bankruptcy court held that SDI's claims against the alter egos were "property of the estate" under § 541 of the Bankruptcy Code, 11 U.S.C. § 541, and therefore that the trustee had an exclusive right to bring those claims. The bankruptcy court accordingly enjoined SDI from collecting its patent judgment outside of bankruptcy. On appeal, the district court found that SDI's alter ego claims were neither property of the estate nor related to the bankruptcy proceeding. It therefore ruled that SDI's claims were not subject to the automatic stay under § 362, nor to an injunction under § 105 of the Bankruptcy Code. We agree with the district court and therefore hold that it properly vacated the bankruptcy court's injunction.

I.

SDI makes "clean machines," which remove small particles from flat materials such as film, lamination and electronic circuitry. Teknek and Electronics were SDI's competitors. More precisely, Teknek was a U.S. distributor of clean machines made by Electronics, Teknek's Scottish affiliate. Teknek and Electronics were separate entities, both controlled by Hamilton and Kennett, Scottish citizens. Kennett owned 85 percent of the shares in both companies, and Hamilton owned the other 15 percent. In February 2000, SDI filed its patent infringement suit against Teknek and Electronics. A few months later, Kennett and Hamilton created Holdings. Between 2003 and 2004, Electronics transferred £ 5 million to Holdings, as well as manufacturing equipment and a building. Electronics received no consideration for these asset transfers. In contrast to Electronics' relatively large asset holdings, Teknek's assets were limited to some office furniture, computers, a car and Teknek's receivables. These assets ultimately were transferred to Holdings as well. Much was made at argument and by both the California federal district court and the federal district court in Chicago (which acquired jurisdiction through the bankruptcy filing) about whether Teknek's assets were transferred directly to Holdings or first to Electronics. Because this issue is not material to the outcome, we do not revisit it here.

Following a jury trial on its patent claims, SDI won a judgment of $3.77 million against Teknek and Electronics in August 2004. The defendants' liability on the judgment was joint and several. But by this point, Teknek and Electronics were judgment proof, so SDI moved the California federal court to add Kennett, Hamilton and Holdings as defendants based on an alter ego theory. The California court granted SDI's motion, finding that Kennett and Hamilton were alter egos of both Teknek and Electronics under California law, because they had transferred assets from Teknek and Electronics to Holdings with intent to defraud SDI. The California federal court's holding meant that the alter egos were directly liable for the patent judgment. The court also found that Holdings was a mere continuation of Electronics and therefore liable for Electronics' debt to SDI as a successor corporation. The alter ego finding was later affirmed by the Federal Circuit. Meanwhile Teknek filed its Chapter 7 petition in the bankruptcy court for the Northern District of Illinois. SDI appeared in the Illinois bankruptcy proceeding and filed a notice of its claim. Teknek's bankruptcy trustee filed an adversary proceeding in the bankruptcy case, asserting claims for, inter alia, ***643** fraudulent transfers and breach of fiduciary duty against Kennett and Hamilton. The trustee's complaint also seeks to hold Kennett and Hamilton personally liable for Teknek's obligation on the judgment to SDI based on an alter ego theory. This claim is identical to SDI's claim, except that Holdings is not a defendant in the trustee's complaint and the trustee seeks to reach the alter egos through Teknek only, rather than through Electronics or by virtue of the California federal court's order that the alter egos, too, are judgment debtors on the patent claims.

SDI and the alter egos came close to reaching a settlement outside the bankruptcy proceeding in the spring of 2007. In May of that year, Kennett and Hamilton filed a motion to stay the trustee's adversary proceeding in the bankruptcy court so that they could complete their settlement with SDI. The bankruptcy court denied the motion. Then in June, the bankruptcy judge entered the preliminary injunction that is the subject of this appeal.

The bankruptcy court's injunction order does not carefully distinguish between Teknek and Electronics. Although it acknowledges that SDI's patent suit was against both Teknek and Electronics, and that SDI sought to add Hamilton, Kennett and Holdings as defendants on an alter ego theory, the bankruptcy court states that the judgment in the patent suit is only against "the Debtor." The bankruptcy court's order omits any mention at all of Electronics' joint and several liability on the patent judgment. Also omitted is the California district court's alter ego ruling that Kennett, Hamilton and Holdings are equally on the hook for the liability of *Electronics* as they are for the liability of the *debtor.* The order indicates that the *debtor* is the only entity directly liable for the patent judgment. If this were the case, SDI would have been properly enjoined from pursuing its claim, as it would have been a claim against the debtor reserved for the bankruptcy trustee. But this is not the case. Nevertheless, neither Electronics nor the alter egos are mentioned as being directly liable. The bankruptcy court's injunction order concludes misleadingly that "the [California] District Court's determination that Hamilton, Kennett and Holdings could be properly added as defendants to the SDI Judgment and pursued for collection of the same was based on SDI's claims that (a) Hamilton and Kennett were the alter egos *of the Debtor;* (b) that Hamilton and Kennett caused the transfer *of the Debtor's* assets with the actual intent to defraud SDI; (c) that the assets were transferred for no consideration; and (d) that such transfers were intended to result *in the Debtor's* insolvency."

Because of the bankruptcy court's injunction, a settlement conference scheduled for July 2007 between SDI and the alter egos in California was canceled. In August, the trustee filed his own settlement motion in the Illinois bankruptcy court. In October the bankruptcy court entered an order finding that SDI's proceedings in California were adversely affecting the trustee's attempts to settle the case. Then the California federal court issued a sanctions order purporting to nullify the bankruptcy court's preliminary injunction and to enjoin the debtor, Electronics and the alter egos from transferring any assets. SDI appealed the bankruptcy court's preliminary injunction order to the district court for the Northern District of Illinois.

The district court in Chicago vacated the preliminary injunction, finding that the bankruptcy court lacked jurisdiction to enjoin SDI's settlement with the alter egos. The district court concluded that the automatic stay, 11 U.S.C. § 362, did not extend ***644** to SDI's claim. The court reasoned that SDI's claim was personal to it and independent of any claim a hypothetical general creditor could have brought against Teknek. Therefore the claim was not property of the estate, and not covered by the automatic stay. "SDI seeks to collect its patent infringement judgment directly from Electronics, Holdings, Kennett, and Hamilton.... Electronics, Holdings, Kennett, and Hamilton are directly liable to SDI for the patent infringement judgment, and neither Teknek nor any claimant or creditor has any interest in that judgment. Thus, SDI's claims are personal and do not belong to the estate." *In re Teknek, LLC,* No. 07 C 5229, 2007 WL 4557813, at *7 (N.D.Ill.Dec.21, 2007).

The district court in Chicago then acknowledged that, even if not property of the estate, SDI's claim may be within the bankruptcy court's "related-to" jurisdiction under 28 U.S.C. § 1334(b). The court concluded however that SDI's claim was not "related to" the bankruptcy case, because the "harm" SDI suffered was patent infringement—a harm no other creditor could claim—and because allowing SDI to collect from the non-debtors on the patent judgment would not prevent the trustee from also pursuing fraudulent transfer claims on behalf of the debtor's estate. 2007 WL 4557813, at *8, *10. Because the district court in Chicago agreed with the California federal court's finding that Teknek had transferred all of its assets directly to Holdings, instead of to Electronics, the court also concluded that there was no need for the bankruptcy court to untangle Teknek's assets from Electronics' assets, obviating that basis for related-to jurisdiction. The court also focused on the fact that SDI was Teknek's only major creditor: allowing SDI to settle its claim outside bankruptcy would not impair the recovery of a larger class of creditors, so the primary function of the trustee—to maximize recovery on behalf of creditors as a whole—was not implicated. *Id.* at *8.

Further, the district court found there was no indication the alter egos would not be able to satisfy both SDI's claim and any fraudulent transfer claims the trustee brought on behalf of the estate. *Id.* at *12. As a practical matter, then, the court found that allowing SDI to control the settlement would not derail the bankruptcy proceedings. We agree with most of these conclusions, though, as will appear, the fact that the underlying harm suffered by SDI was patent infringement does not, by itself, make it a claim no other creditor could assert. By such logic, all creditors' claims would be personal to the specific creditor: a supplier's claim for payment on supplies would be deemed personal because no other creditor could claim payment for the same supplies; an employee's claim for his back pay would be personal to the extent that no other employee could claim back pay for that employee's hours worked. If all such claims were "personal," no creditor would have to wait in line behind the bankruptcy trustee to assert her claims. With such segregation of claims, the bankruptcy system would collapse. What is significant about SDI's patent infringement claim is not that it is for patent infringement; instead significance lies in SDI's reduction of the claim to judgment against both the debtor *and an independent non-debtor*, Electronics. It is Electronics' joint and several liability that makes SDI's claim special. Because of Electronics' independent liability on the judgment, we also do not find it significant whether Teknek transferred assets first to Electronics and then to Holdings or directly to Holdings—either way, Electronics' independent liability remains. For the same reasons, we do not put much weight on the fact that SDI is the sole creditor in the bankruptcy case.

***645** The Illinois federal district court also found that "the equities counsel against the bankruptcy court's exercise of jurisdiction." *Id.* at *13. This seems to be a species of abstention rather than further support for the court's holding regarding the absence of related-to jurisdiction. In this respect, the district court relied on *Teachers Ins. & Annuity Ass'n of Am. v. Butler,* 803 F.2d 61, 65–66 (2d Cir.1986), for its conclusion that wrongdoers cannot take advantage of the bankruptcy jurisdiction to avoid paying a judgment against them. The court found that Kennett, Hamilton and Holdings had used "complicated machinations to avoid paying a judgment." *In re Teknek,* 2007 WL 4557813, at *13. "Bankruptcy procedures cannot be used to achieve this end, and the bankruptcy court thus lacked jurisdiction." *Id.* Yet *Teachers* did not explicitly address the bankruptcy court's related-to jurisdiction. Its decision was based on the bankruptcy court's "general equity powers under 11 U.S.C. § 105." 803 F.2d at 65. *Teachers* also preceded this court's decision in *Fisher v. Apostolou,* 155 F.3d 876 (7th Cir.1998), which plainly finds that bankruptcy jurisdiction may exist even where it enjoins a creditor from collecting from non-bankrupt co-defendants who have acted in bad faith. *See* *Fisher,* 155 F.3d at 880.

Following the Illinois district court's decision, the alter egos paid SDI in full satisfaction of the judgment against them. The trustee's appeal of the district court's order vacating the bankruptcy court's preliminary injunction is now before us.

II.

There is no dispute that if SDI were trying to collect its patent judgment from Teknek, the debtor, it would be barred by the terms of the § 362 automatic stay. But SDI also has a judgment on the same claim against Electronics. Electronics' liability is joint and several with that of the debtor and, importantly, Electronics is directly liable to SDI. A further wrinkle, however, is that Electronics, like Teknek, is insolvent. SDI addressed this problem by seeking to have Kennett, Hamilton and Holdings added to the patent judgment as additional judgment debtors. The California federal court obliged, holding that Kennett, Hamilton and Holdings were also jointly and severally—and directly—liable for the entire patent judgment, because they were the alter egos of both Teknek and Electronics. SDI's "claim" is therefore in the nature of a collection action—this "claim" has already been reduced to judgment against not merely the debtor, but also the four non-debtors, Electronics, Kennett, Hamilton and Holdings. SDI argues that it can reach the alter egos directly because of this judgment, and, in any event, that it can reach the alter egos via Electronics on a veil-piercing theory. At the same time, the trustee argues that it can reach the alter egos via Teknek and collect on SDI's judgment on behalf of the estate because that judgment is a debt the alter egos also owe to the debtor. This is because, in addition to looting Electronics, the alter egos also looted the debtor. The alter egos are therefore liable to the debtor for the SDI judgment because of their responsibility for the debtor's inability to repay it. In essence, then, both SDI and the trustee have a claim against the alter egos, but only one of them can receive satisfaction, because the patent judgment can only be recovered once.

[1] [2] To determine what entity may exercise this right of satisfaction against the alter egos, it is necessary to consider the kinds of claims that may be brought only by the trustee in bankruptcy. The purpose and duty of the trustee is to gather the estate's assets for pro rata distribution to the estate's creditors. *See* *Koch Ref. v. Farmers Union Cent. Exch., Inc.,* 831 F.2d 1339, 1352 (7th Cir.1987). In aid ***646** of that duty, and as discussed in detail below, the trustee has the sole right and responsibility to bring claims on behalf of the estate and on behalf of creditors as a class—so-called "general" claims. But the trustee's right to bring claims on behalf of creditors is not infinite. Individual creditors retain the right to bring "personal" claims that do not implicate the trustee's purpose. The distinction between "general" and "personal" claims ensures that the trustee will be able to fulfill the purpose of the bankruptcy laws without allowing the bankruptcy jurisdiction to swallow claims only tangentially related to the debtor. *See* *Fisher,* 155 F.3d at 880 ("The trustee, acting on behalf of the estate or the creditors as a whole, obviously may not roam around collecting whatever property suits her fancy. Her task instead is to recover and manage the 'property of the estate,' ...").

[3] [4] [5] [6] [7] As for the kinds of claims reserved for the trustee, first, the trustee has the sole responsibility to represent the estate by bringing actions on its behalf. *Fisher,* 155 F.3d at 879 (citing, *inter alia,* 11 U.S.C. § 323). In this respect, the bankruptcy estate is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541. The estate includes any action a debtor corporation may have "to recover damages for fiduciary misconduct, mismanagement or neglect of duty," and the trustee succeeds to the right to bring such actions. *Koch,* 831 F.2d at 1343–44. Second, the trustee has creditor status under 11 U.S.C. § 544 and is the only party that can sue to represent the interests of the creditors as a class. *Koch,* 831 F.2d at 1342–43; *see also* *Matter of Kaiser,* 791 F.2d 73, 76 (7th Cir.1986). However, the trustee has no standing to bring "personal" claims of creditors, which are defined as those in which the claimant has been harmed and " 'no other claimant or creditor has an interest in the cause.' " *Fisher,* 155 F.3d at 879 (quoting *Koch,* 831 F.2d at 1348).

> "[A]llegations that could be asserted by any creditor could be brought by the trustee as a representative of all creditors. If the liability is to all creditors of the corporation without regard to the personal dealings between such officers and such creditors, it is a general claim...
>
> "A trustee may maintain only a general claim. His right to bring a claim depends on whether the action vests in the trustee as an assignee for the benefit of creditors or, on the other hand, accrues to specific creditors."
>
> *Fisher,* 155 F.3d at 879–80 (quoting *Koch,* 831 F.2d at 1348–49); *Ashland Oil, Inc. v. Arnett,* 875 F.2d 1271, 1280 (7th Cir.1989) (holding that RICO claims were personal, and plaintiffs were therefore entitled to sue on their own, because their injuries were distinct from the injuries to creditors in general resulting from the diversion of corporate assets); *see also* *Steinberg v. Buczynski,* 40 F.3d 890, 891–92 (7th Cir.1994) (holding that the trustee could not bring a claim against sole shareholders of bankrupt corporation where shareholders had not looted or otherwise injured the corporation). "The equally valid mirror-image principle is that a single creditor may not maintain an action on his own behalf against a corporation's fiduciaries if that creditor shares in an injury common to all creditors and has personally been injured only in an indirect manner." *Koch,* 831 F.2d at 1349 (citing, *inter alia,* *Delgado Oil Co., Inc. v. Torres,* 785 F.2d 857, 861 (10th Cir.1986)); *see also* *In re MortgageAmerica Corp.,* 714 F.2d 1266, 1277 (5th Cir.1983) (holding that a fraudulent transfer claim against a corporate debtor's control person belongs to the corporate debtor, not to specific creditors); *Dana Molded* ***647** *Prods., Inc. v. Brodner,* 58 B.R. 576, 580–81 (N.D.Ill.1986) (holding that a judgment creditor lacked standing under RICO to bring a personal claim for bankruptcy fraud committed *against the corporation itself* in an attempt to hinder creditors generally).

To determine whether an action accrues individually to a claimant or generally to a corporation, then, we must look to the injury for which relief is sought. We must consider whether that injury is "peculiar and personal to the claimant or general and common to the corporation and creditors." *Koch,* 831 F.2d at 1349. In making this distinction it is helpful to compare the facts of the leading cases. In *Koch,* for instance, we found that a group of oil companies' claims against a debtor's fiduciaries were general claims. The oil companies had regularly exchanged petroleum products with the debtor, Energy Cooperative, Inc. (ECI). 831 F.2d at 1340. ECI, as debtor-in-possession, brought preference actions against the oil companies, and also sued its member-owners, who were regional agricultural cooperatives that had formed ECI to ensure a steady supply of petroleum products for their agricultural businesses. *Id.* ECI alleged that the member-owners had breached their fiduciary duties by preventing ECI from remedying breaches of contract and by causing ECI to take other actions contrary to its best interests. *Id.* ECI's suit sought to hold the member-owners liable for all of ECI's debts under a "veil-piercing" theory. ECI's Chapter 11 reorganization case was later converted to a Chapter 7 liquidation, and a trustee was appointed who continued pursuit of ECI's lawsuits in bankruptcy. The oil companies then brought their own suit seeking a declaration that the member-owners were ECI's alter egos and that ECI was solvent when it filed its bankruptcy petitions, such that the oil companies were entitled to recover from the member-owners whatever amounts the bankruptcy trustee recovered from the oil companies in its preference actions. 831 F.2d at 1341. The district court found that the oil companies had raised essentially the same allegations as those made by the trustee in bankruptcy. *Id.* We agreed. The oil companies' complaint alleged that they were injured only because of the member-owners' misuse of ECI and of ECI's corporate form, and that the oil companies were entitled to recover from the member-owners only due to the member-owners' manipulation of ECI to the plaintiffs' detriment. 831 F.2d at 1349.

> The injury alleged by the oil companies, it can be clearly seen, is to the corporation directly and to the oil companies indirectly. The trustee's complaint, as well, underscores that the debtor is a victim of the Member–Owners and has been harmed directly. The oil companies are only indirect or secondary victims; they have alleged nothing about their detrimental position that is peculiar and personal to them and not shared by ECI's creditors.

Id. Therefore, the oil companies' claim was general and could be pursued only by the trustee in bankruptcy.

In *Fisher,* by contrast, we found that a group of creditor-investors' fraud claims against a debtor's agents accrued to the creditor-investors personally. 155 F.3d at 877. In *Fisher,* the corporate debtor, Lake States, was a bogus commodities business that the individual debtor, Thomas Collins, and a group of accomplices had used as a "bucket shop," similar to a Ponzi scheme. After Collins' fraud was detected, he and Lake States were forced into bankruptcy. At the time of their bankruptcy filing, Lake States had only about $2 million in assets, not enough to satisfy its outstanding investor debt of about $64 million. In addition to the trustee's claims against the non-debtor accomplices to recover ***648** on behalf of the estate, a group of Lake States investors sought to bring securities, commodities and common law fraud claims outside the bankruptcy proceeding against the same non-debtor accomplices. To the extent that this group of creditor-investors sought to sue the accomplices merely to recover debts that arose out of the creditor-investors' transactions with Lake States, we held that they stood in the same position as the rest of the investors, "pursuing identical resources for redress of identical, if individual, harms." 155 F.3d at 881. Unlike in *Koch,* however, we found that the creditor-investors' fraud claims were not the same as those available to the trustee, even though, if the creditor-investors were allowed to pursue their claims, "there might be nothing left in the defendants' coffers from which the bankrupt's estate could recover." *Fisher,* 155 F.3d at 881 (discussing *Bankers Trust Co. v. Rhoades,* 859 F.2d 1096 (2d Cir.1988)). In this respect, we quoted approvingly the Second Circuit's holding in *Bankers Trust Co.:* " '[I]f [the creditor] Bankers was injured by [the non-debtor] defendants' acts, ... it has standing to bring a RICO claim, regardless of the fact that a bankrupt BAC might also have suffered an identical injury for which it has a similar right of recovery.' " *Fisher,* 155 F.3d at 881 (quoting *Bankers Trust Co.,* 859 F.2d at 1101). Accordingly, in *Fisher* we held that the investor-creditors had independent, personal claims for fraud against the debtors' accomplices, even though their claims arose from the accomplices' misuse of the funds they had invested in Lake States. In finding that the investor-creditors' fraud claims were personal to them, we reasoned that fraud inflicts a separate and distinct injury on its victims, one that is inflicted directly on those victims by its perpetrators, and that sometimes may be redressed by punitive damages. The creditor-investors' injuries from that fraud may not have been fully measured by the debts the accomplices owed to Lake States for the misuse of the investors' funds. Therefore we held that the creditor-investors should be allowed to bring their fraud suits—after the bankruptcy proceedings concluded—to recover any shortfall in their pro rata share as general creditors, as well as any individualized damages not compensated by their pro rata share. 155 F.3d at 883.

Nevertheless, in *Fisher* we upheld the bankruptcy court's jurisdiction to enjoin the creditor-investors' fraud claims because those claims were so closely related to the bankruptcy proceedings. We explained that in limited circumstances the trustee may temporarily block claims that are not property of the estate by petitioning the bankruptcy court to enjoin such claims, if they are sufficiently "related to" claims on behalf of the estate. 155 F.3d at 882 (citing 28 U.S.C. § 1334(b)). "The jurisdiction of the bankruptcy court to stay actions in other courts extends beyond claims by and against the debtor, to include 'suits to which the debtor need not be a party but which may affect the amount of property in the bankrupt estate,' or 'the allocation of property among creditors.' " 155 F.3d at 882 (quoting *Zerand–Bernal Group, Inc. v. Cox,* 23 F.3d 159, 161–62 (7th Cir.1994), and *In re Mem'l Estates, Inc.,* 950 F.2d 1364, 1368 (7th Cir.1992)). To protect this jurisdiction, the bankruptcy court may issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a); *Fisher,* 155 F.3d at 882. Thus, even though the investor-creditors' fraud claims were personal and distinct from claims that could be brought by other creditors, they were so related to the bankruptcy proceeding that, if not temporarily enjoined, they would have derailed those proceedings' efforts to recover for the class of creditors as a whole.

***649** [8] The case *sub judice,* however, is distinct from both *Koch* and *Fisher.* In both of those cases, the creditors' claims against the non-debtor fiduciaries depended on the non-debtor's misconduct *with respect to the corporate debtor*. In *Koch,* the oil companies sought to hold the member-owners liable based on their alleged breach of fiduciary duties to the debtor, ECI, 831 F.2d at 1340, and in *Fisher,* the creditor-investors' fraud claims were based on the accomplices' looting of the debtor corporation in which the plaintiffs had invested, 155 F.3d at 881. In this regard, general claims and claims that are "related to" the bankruptcy seemingly always involve transfers *from the debtor* to a non-debtor control person or entity. *See, e.g., In re MortgageAmerica Corp.,* 714 F.2d at 1275. To be sure, the case before us involves those facts as well—Teknek transferred all of its assets to the non-debtor Holdings, which is controlled by Kennett and Hamilton—but it also involves a separate non-debtor, Electronics, that is directly liable to SDI on the patent judgment without regard to the debtor's liability. SDI has already proven to a jury that Electronics inflicted an independent injury against it, and SDI has proven to the California district court that the alter egos inflicted an independent injury against Electronics—they looted Electronics and left it a shell—without regard to any injury Teknek inflicted on SDI, or any injury the alter egos inflicted on Teknek. SDI's claim against the alter egos does not depend on the alter egos' misconduct with respect to the debtor. SDI has equal recourse against the alter egos because of the injury suffered by Electronics. This distinction makes our case more like *In the Matter of Johns–Manville Corp.,* 26 B.R. 405 (Bankr.S.D.N.Y.1983), where the debtor and the non-debtors were sued as joint tortfeasors in asbestos product liability suits. The non-debtor co-defendants were not alter egos of the debtor, but rather were independent companies whom the plaintiffs alleged were jointly liable with the debtor for asbestos injuries. 26 B.R. at 407. Electronics is like the co-defendants in *Johns–Manville.* The presence of Electronics and its involvement in the underlying patent suit distinguishes this case from *Fisher,* where we held that "[w]hile the Apostolou Plaintiffs' claims are not 'property of' the Lake States estate, it is difficult to imagine how those claims could be more closely 'related to' it. They are claims to the same limited pool of money, in the possession of the same defendants, as a result of the same acts, performed by the same individuals, as part of the same conspiracy." 155 F.3d at 882. Here, though SDI's claims involve the same pool of money as the trustee's claims, and that money is in the possession of the same defendants (the alter egos), the claims are not based on the same acts. The alter egos looted both Teknek and Electronics. Those are separate acts, which caused separate injuries to two separate companies, only one of which is in bankruptcy.

The fact that the same alter egos controlled both Electronics and Teknek is not sufficient to bring SDI's claim against Electronics under the umbrella of the bankruptcy proceeding. With respect to the alter egos, this case is akin to "the more common case" referred to in *Fisher* where a creditor of a bankrupt files a claim against an insurer or guarantor of the bankrupt and is allowed to proceed because the suit is " 'only nominally against the debtor because the only relief sought is against his insurer,' guarantor, or other similarly situated party." *Fisher,* 155 F.3d at 882–83 (quoting *In re Hendrix,* 986 F.2d 195, 197 (7th Cir.1993)). The alter egos in the case before us are like an insurer or guarantor. As in *Hendrix,* now that SDI's claim has been reduced to judgment, its collection action is only nominally against Electronics and Teknek, because ***650** the only relief sought is against the non-debtor alter egos. *See Hendrix,* 986 F.2d at 197 ("[A]s to whether such an injunction extends to a suit only nominally against the debtor because the only relief sought is against his insurer, the cases are pretty nearly unanimous that it does not.") (collecting cases).

A final distinguishing characteristic of this case is the fact that SDI is the debtor's only major creditor. Allowing SDI to settle its claim outside of bankruptcy therefore will have no effect on a larger class of creditors, and in this sense it will not "derail the bankruptcy proceedings." *Fisher,* 155 F.3d at 883. We do not make too much of this distinction, however. If not for the presence of Electronics, an independent non-debtor that is directly liable to SDI for the patent judgment, we would have been required under *Fisher* to find that SDI's claim was so related to the bankruptcy case that it could be properly enjoined by the bankruptcy court. As a procedural matter, the lack of other creditors would have served better as the basis for a motion to dismiss the bankruptcy proceeding than as the basis for the jurisdictional argument SDI makes here. *See In re Am. Telecom Corp.,* 304 B.R. 867, 873 (Bankr.N.D.Ill.2004) (dismissing Chapter 7 case where debtor's two shareholders had filed bankruptcy petition only to avoid paying a judgment to the debtor's sole creditor, because such a petition "does not adequately implicate any of the policies that the U.S. Bankruptcy Code was enacted to serve"). SDI never filed such a motion. Still, the absence of other creditors is relevant. The trustee's "paramount duty" in Chapter 7 is to marshal the estate's assets for a pro rata distribution to all creditors. *See Koch,* 831 F.2d at 1352. To the extent that there is no larger creditor class, that duty will not be vindicated, and there is less of a principled basis for requiring a claim to be brought by the trustee rather than by the individual creditor.

III.

[9] [10] Before concluding, we address a matter in tension with our jurisdiction. While this appeal was pending

before us, the trustee filed a motion in the bankruptcy court to compromise all of his claims with Teknek's alter egos. On March 13, 2009, as our opinion was about to be issued, the bankruptcy court below issued a memorandum opinion purporting to grant the trustee's motion, *In re Teknek, LLC,* 402 B.R. 257, (Bkrtcy.N.D.Ill. 2009), notwithstanding this appeal, and in apparent violation of the ancient stricture that, when a case is on appeal, all lower courts lose jurisdiction over it and related matters. *In the Matter of Statistical Tabulating Corp., Inc.,* 60 F.3d 1286, 1289 (7th Cir.1995) (citing *Griggs v. Provident Consumer Disc. Co.,* 459 U.S. 56, 58, 103 S.Ct. 400, 74 L.Ed.2d 225 (1982)). The purpose of this rule is to avoid the confusion of placing the same matter before two courts at the same time and to preserve the integrity of the appeal process. *Whispering Pines Estates, Inc. v. Flash Island, Inc.,* 369 B.R. 752, 757 (Bkrtcy.App. 1 (N.H.) 2007). The situation before us is a perfect example of why this rule matters.

We came across the bankruptcy court's opinion approving settlement quite by chance; none of the parties brought it or the settlement to our attention. We immediately issued an order to the parties to address what effect this ruling might have on our appeal and to show cause why they should not be sanctioned for proceeding in apparent disregard of our jurisdiction. The alter egos did not respond to our order. They are not parties to this appeal, so perhaps that failure is excusable. SDI responded to our order with a tersely worded statement that it had no involvement ***651** in the settlement. Teknek responded with a slightly less terse filing, asserting that the settlement had no effect on our jurisdiction, because it involved the settlement of claims "separate and apart from the claims at issue in the present appeal." The trustee's response to our order to show cause provides the most context for the proceedings that have taken place in the bankruptcy court since the filing of this appeal. The trustee explains that, although he believes *his* settlement does not compromise our jurisdiction, he has previously been "vigilant in his defense of this Court's jurisdiction" in response to SDI's own attempts to impair our ability to decide this appeal. The trustee reports that he has opposed both summary judgment by SDI—seeking dismissal by the bankruptcy court of the trustee's action now on appeal—as well as SDI's attempt to withdraw its claim from the bankruptcy, all on grounds that our appeal deprived the bankruptcy court of jurisdiction. These related facts only now come to our attention, SDI not having mentioned them in response to our order to show cause. These facts provide grounds for sanctioning SDI, as well as giving the trustee credit for getting the jurisdiction question right early on, though he has clearly gotten it wrong since then.

We cannot fathom how the bankruptcy court could lack jurisdiction to dismiss SDI yet retain jurisdiction to approve the settlement between the trustee and the alter egos. Indeed, as the trustee himself pointed out to the bankruptcy court in his response to SDI's motion to withdraw its claim, "[u]ntil the Seventh Circuit has ruled on the Trustee's appeal, this Court should take no action that would alter the status quo or result in any legal prejudice to the Estate's claims." Yet that is exactly what the bankruptcy court did when it approved the trustee's settlement. The trustee cannot have it both ways.

[11] To be clear, while the trustee's settlement does not directly and specifically address the issues immediately before us, it purports to deal with matters that are integral to this appeal. The trustee brought the injunction action now on appeal only so that he could pursue SDI's claim against the alter egos on behalf of the bankruptcy estate. But the trustee's settlement purports to compromise all of the trustee's claims against the alter egos, leaving little if anything for the trustee to pursue on that score. The trustee now focuses on other relief he might have obtained from SDI had he won this appeal (relief that is largely ignored in his brief): damages for SDI's violation of the automatic stay and a turnover of the settlement proceeds SDI received from the alter egos. But the trustee mitigated his damages by settling with the alter egos outside our jurisdiction; any turnover of SDI's settlement proceeds would have been followed quickly by a return of those proceeds to SDI, the sole creditor in this case. Thus, although the matter on appeal is technically a separate adversary proceeding from the matter at issue in the trustee's settlement, the relationship is so close that it is obvious that the bankruptcy court lacked jurisdiction to approve the settlement. Therefore, the bankruptcy court's purported approval of the settlement is null and void. Moreover, because the trustee is required to get the bankruptcy court's approval before settling claims, the settlement itself is apparently of no effect. *See* Fed. R. Bankr.P. 9019; *see also, e.g., Yorke v. N.L.R.B.,* 709 F.2d 1138, 1147 (7th Cir.1983). Because the settlement does not purport to settle the issues directly before us, however, and because the settlement has not been validly approved by the bankruptcy court, the case before us is not moot and we retain jurisdiction to decide it. *See* ***652** *In re Markarian,* 228 B.R. 34, 48 (Bkrtcy.App.1 (Mass)1998) ("Since the Bankruptcy Court had no jurisdiction to approve the parties' compromise and enter dismissal, those orders are void; therefore, a case or controversy still existed when the Panel issued its October 28, 1998 Order.").

[12] One final issue remains, and that is proper sanctions.

We think a sanction of $5,000 against the trustee, payable to the court, for entering the rogue bankruptcy settlement at issue here is sufficient to deter similar actions in derogation of this court's jurisdiction in the future, while recognizing that the trustee acted correctly in opposing SDI's various motions below. We sanction SDI the same amount for its abortive attempts to extricate itself from the bankruptcy, again in apparent disregard of our exclusive jurisdiction over these matters. We leave to the bankruptcy court in due course the decision whether to sanction the alter egos, who are not before this court.

The district court's holding that SDI's claim is not property of the Teknek estate or related to the bankruptcy proceeding is AFFIRMED, and the district court's vacation of the preliminary injunction order is also AFFIRMED.

All Citations

563 F.3d 639, 61 Collier Bankr.Cas.2d 1757, 51 Bankr.Ct.Dec. 156, Bankr. L. Rep. P 81,477

Cryptocurrency Assets – The Crypto Winter and the Collapse of FTX

Jason T. Mizzell
Kroger Gardis & Regas, LLP

Over the last 6 months, there has been an unprecedented collapse in the value of cryptocurrencies that has led to a recent spate of high-profile crypto firms filing for Chapter 11 or Chapter 15. These filings may lead to new law defining the way crypto assets are treated in bankruptcy cases. Given the ever-increasing prominence of crypto assets on corporate balance sheets and in the hands of retail investors, even despite the current market, the outcome of these major cases may have long-lasting implications to bankruptcy practitioners.

Brief Primer: What is Cryptocurrency?

Cryptocurrency is a digital unit of value. Although there are many types of cryptocurrency, all serving various purposes, the defining characteristic of any kind of cryptocurrency is that they are decentralized: that is they are not issued by or controlled by any particular central government's currency. According to CoinBase, a popular Cryptocurrency exchange, the most popular forms of cryptocurrency are Bitcoin, Ethereum, Bitcoin Cash and Litecoin.

Bitcoin was the first and most popular form of cryptocurrency and its establishment pioneered the way for subsequent crypto projects. One Bitcoin is worth approximately $16,480.90 as of November 27, 2022 at 11:19 PM UTC.

Despite the large dollar value currently attributable to one Bitcoin, crypto assets have no inherent value: they are not tied to the value of gold or silver and are otherwise not backed by any central government. However, the value of any crypto asset is preserved in the blockchain, the supporting software that acts as a decentralized ledger for all assets in a particular crypto environment. Transactions in a particular cryptocurrency are all processed through the blockchain process.

To oversimplify: transactions conducted in a particular cryptocurrency are recorded and verified in the peer-to-peer blockchain network. Whenever any particular transaction is made, a "block" that represents that transaction is created and distributed to all participants in a particular network. The network participants (sometimes referred to as "miners") validate the transaction through computational power, the new "block" is added to the existing blockchain, and the update gets distributed across the entire blockchain network. Thereafter, the transaction is complete and registered within the network. Miners, acting to validate the transactions, receive a reward for their validation efforts, which is usually more cryptocurrency. This entire process protects the security of the blockchain network while also issuing new currency into the system.

Cryptocurrency is usually held in what is known as a "wallet." A wallet can take a number of different forms, either in the form of software on a device, a web-based wallet, or a cold-storage wallet like a USB device. Wallets generally contain a public key, which can be used to identify the wallet to others or to receive transactions, and a private key, which gives the user complete control and access over the crypto assets. The private key is the single most important piece of information for a crypto user because without a private key, the holder of the crypto asset cannot do anything with the assets.

The Crypto Winter

Although there is no single cause of the recent "Crypto Winter," the most cited catalyst was the collapse of the price of stablecoin TerraUSD (UST) and Luna, its companion token. A stablecoin is generally pegged to the value of fiat currency, in this case the US Dollar and is used to help bridge the gap between fiat currencies and crypto currencies. Its companion token Luna was intended to absorb volatility in currency markets while the stablecoin retains its pegged value through transactions that are beyond the scope of this brief overview. The cause of the collapse in value of the stablecoin has yet to be determined but TerraUSD was one of the largest stablecoins in existence at the time of its collapse, in May of 2022.

Beginning in June of 2022, crypto firms began suffering major problems, largely related to the liquidity of their holdings. Celsius Network was the first major crypto lender to freeze all transactions – Celsius subsequently filed for bankruptcy in July of 2022. Voyager Digital, a Canadian crypto broker, followed suit. Various other large crypto "banks" or exchanges have now also filed: the largest and most prominent of these is FTX which has been all over the news recently. As of November 28, 2022, BlockFi, another major crypto entity also succumbed.

FTX's bankruptcy filing has been sensational, causing John J. Ray III, FTX's new CEO and a major figure in the Enron case to opine:

> 5. Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here. From compromised systems integrity and faulty regulatory oversight abroad, to the concentration of control in the hands of a very small group of inexperienced, unsophisticated and potentially compromised individuals, this situation is unprecedented.

<u>Some Key Questions to be Answered</u>

FTX's case has barely begun and the full scope of the disaster that Mr. Ray describes is unknown at this time. But setting aside the sensational nature of FTX's bankruptcy, there are essential legal questions regarding the nature of crypto assets in bankruptcy that are about to be decided:

The most important question: what exactly is a virtual currency asset??? Is it money? A commodity? A security? Something else altogether? There is no clear answer yet.

- IRS Note 2014-21: provides guidance stating that although virtual currency can be used to pay for goods and services, it is not recognized as a currency by the IRS
- In 2015, the CFTC classified virtual currency as commodities
- In 2017, the SEC took the position that "tokens are securities and therefore subject to Federal securities laws.

Why does this matter?

If crypto assets are considered currency, the automatic stay contains exceptions with respect to swap agreements, particularly with currency swap agreements.

If crypto assets are considered commodities, the automatic stay also contains exceptions with respect to forward contracts. If crypto assets are commodities, it is simpler for the trustee to bring the assets back into the estate as opposed to having to determine the value of the asset on the relevant valuation date.

Are crypto assets property of the debtor's estate? Do investors have a right to recover their digital assets? What kind of oversight exists – or even should exist – with respect to Crypto Bank's usage of their customers' assets?

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
FTX TRADING LTD., *et al.*,[1]	Case No. 22-11068 (JTD)
Debtors.	(Joint Administration Pending)

DECLARATION OF JOHN J. RAY III IN SUPPORT OF
CHAPTER 11 PETITIONS AND FIRST DAY PLEADINGS

I, John J. Ray III, hereby declare under penalty of perjury as follows:

1. I am the Chief Executive Officer of the above-captioned debtors and debtors-in-possession (collectively, the "Debtors"), having accepted this position in the early morning hours of November 11, 2022. I am administering the interests and affairs of the Debtors from my offices in the United States.

2. My first official act in these roles was to authorize the chapter 11 filings of the Debtors and the commencement of the above-captioned chapter 11 cases (the "Chapter 11 Cases").

3. Since my appointment, I have worked around the clock with teams of professionals at Alvarez & Marsal, Sullivan & Cromwell, Nardello & Co., Chainalysis, Kroll and a confidential cybersecurity firm, to secure the assets of the Debtors wherever located, to identify reliable books and records, to assemble the information necessary to provide to this Court, and to respond to numerous inquiries from multiple regulators and government authorities including the

[1] The last four digits of FTX Trading Ltd.'s tax identification number are 3288. Due to the large number of debtor entities in these Chapter 11 Cases, a complete list of the Debtors and the last four digits of their federal tax identification numbers is not provided herein. A complete list of such information may be obtained on the website of the Debtors' proposed claims and noticing agent at https://cases.ra.kroll.com/FTX.

U.S. Commodity Futures Trading Commission ("CFTC"), the U.S. Attorney's Office for the Southern District of New York, the U.S. Securities and Exchange Commission ("SEC"), and the U.S. Congress, among others.

4. I have over 40 years of legal and restructuring experience. I have been the Chief Restructuring Officer or Chief Executive Officer in several of the largest corporate failures in history. I have supervised situations involving allegations of criminal activity and malfeasance (Enron). I have supervised situations involving novel financial structures (Enron and Residential Capital) and cross-border asset recovery and maximization (Nortel and Overseas Shipholding). Nearly every situation in which I have been involved has been characterized by defects of some sort in internal controls, regulatory compliance, human resources and systems integrity.

5. Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here. From compromised systems integrity and faulty regulatory oversight abroad, to the concentration of control in the hands of a very small group of inexperienced, unsophisticated and potentially compromised individuals, this situation is unprecedented.

6. These Chapter 11 Cases have five core objectives:

(a) **Implementation of Controls:** the implementation of accounting, audit, cash management, cybersecurity, human resources, risk management, data protection and other systems that did not exist, or did not exist to an appropriate degree, prior to my appointment;

(b) **Asset Protection & Recovery:** the location and security of property of the estate, a substantial portion of which may be missing or stolen;

(c) **Transparency and Investigation:** the pending, comprehensive, transparent and deliberate investigation into claims against Mr. Samuel Bankman-Fried, the other co-founders of the Debtors and third parties, in coordination with regulatory stakeholders in the United States and around the world;

(d) **Efficiency and Coordination:** cooperation and coordination with insolvency proceedings of subsidiary companies in other jurisdictions; and

(e) **Maximization of Value:** the maximization of value for all stakeholders through the eventual reorganization or sale of the Debtors' complex array of businesses, investments and digital and physical property.

These proceedings in the District of Delaware are the appropriate means to accomplish each of these objectives.

7. Except as otherwise indicated herein, all facts set forth in this declaration (the "Declaration") are based on my personal knowledge, my review of relevant materials in the Debtors' files or my opinion based on my experience, knowledge and information concerning the Debtors' operations and financial affairs. I am over the age of 18 and authorized to submit this Declaration on behalf of each of the Debtors.

8. For the reasons explained below, the Debtors expect to provide supplemental declarations as to the subject matter of this Declaration in connection with future motions as more information becomes available to the Debtors, stakeholders and the Court.

I. THE PREPETITION DEBTORS

A. Corporate Organization and Identification of Four Silos

9. For purposes of managing the Debtors' affairs, I have identified four groups of businesses, which I refer to as "Silos." These Silos include: (a) a group composed of Debtor West Realm Shires Inc. and its Debtor and non-Debtor subsidiaries (the "WRS Silo"), which includes the businesses known as "FTX US," "LedgerX," "FTX US Derivatives," "FTX US Capital Markets," and "Embed Clearing," among other businesses; (b) a group composed of Debtor Alameda Research LLC and its Debtor subsidiaries (the "Alameda Silo"); (c) a group composed of Debtor Clifton Bay Investments LLC, Debtor Clifton Bay Investments Ltd., Debtor

Island Bay Ventures Inc. and Debtor FTX Ventures Ltd. (the "Ventures Silo"); and (d) a group composed of Debtor FTX Trading Ltd. and its Debtor and non-Debtor subsidiaries (the "Dotcom Silo"), including the exchanges doing business as "FTX.com" and similar exchanges in non-U.S. jurisdictions. These Silos together are referred to by me as the "FTX Group."

10. Each of the Silos was controlled by Mr. Bankman-Fried.[2] Minority equity interests in the Silos were held by Zixiao "Gary" Wang and Nishad Singh, the co-founders of the business along with Mr. Bankman-Fried. The WRS Silo and Dotcom Silo also have third party equity investors, including investment funds, endowments, sovereign wealth funds and families. To my knowledge, no single investor other than the co-founders owns more than 2% of the equity of any Silo.[3]

11. The diagram attached as Exhibit A provides a visual summary of the Silos and the indicative assets in each Silo. Exhibit B contains a preliminary corporate structure chart. These materials were prepared at my direction based on information available at this time and are subject to revision as our investigation into the affairs of the FTX Group continues.

B. The WRS Silo

12. The WRS Silo includes FTX US, an exchange for spot trading in digital assets and tokens. FTX US was founded in January 2020. FTX US is available to U.S. users

[2] To my knowledge, Mr. Bankman-Fried owns (a) directly, approximately 53% of the equity in Debtor West Realm Shires Inc.; (b) indirectly, approximately 75% of the equity in Debtor FTX Trading Ltd.; (c) directly, approximately 90% of the equity in Debtor Alameda Research LLC; and (d) directly, approximately 67% of the equity in Clifton Bay Investments LLC.

[3] Based on the information provided to me, the only Debtors that have received third party equity investments are Debtor FTX Trading Ltd. (Dotcom Silo) and Debtor West Realm Shires Inc. (WRS Silo). To my knowledge, (a) approximately 25% of the equity in Debtor FTX Trading Ltd. is owned by a dispersed group of approximately 600 third party equity investors and (b) approximately 22.25% of the equity in Debtor West Realm Shires Inc. is owned by a dispersed group of approximately 570 third party equity investors. FTX Trading Ltd also acquired 51% of Blockfolio, Inc. in 2020, with the remaining 49% of Blockfolio, Inc. owned by the original shareholders.

and, according to statements by Mr. Bankman-Fried, had approximately one million users as of August 2022. FTX US's spot exchange is registered with the Department of the Treasury (via the Financial Crimes Enforcement Network) as a money services business and holds a series of state money transmission licenses in the United States.

13. The WRS Silo also owns 100% of the equity interests in the LedgerX business, which is operated by non-Debtor LedgerX LLC (d/b/a FTX US Derivatives) ("LedgerX"). LedgerX offers futures, options, and swaps contracts on digital assets and other commodities to both U.S. and non-U.S. persons. LedgerX operates with licenses from the CFTC. Based on the information that I have reviewed at this time, LedgerX is solvent.

14. The WRS Silo also owns 100% of the equity interests in non-Debtor FTX Capital Markets LLC, which is an SEC-registered broker-dealer. Based on the information that I have reviewed at this time, FTX Capital Markets LLC is solvent.

15. The WRS Silo also owns 100% of the equity interests in non-Debtor Embed Financial Technologies Inc., as well as its wholly-owned non-Debtor subsidiary Embed Clearing LLC, which operates as a securities clearing firm and is an SEC-registered broker-dealer. Based on the information that I have reviewed at this time, each of these non-Debtor entities is solvent.

16. The WRS Silo also owns 100% of the equity interests in FTX Value Trust Company, a South Dakota Trust Company, which provides custodial services. Based on the information that I have reviewed at this time, this non-Debtor company is solvent.

17. The WRS Silo also owns 100% of other Debtor and non-Debtor companies operating miscellaneous businesses, such as video game development and a market place for trading non-fungible tokens. Finally, the WRS Silo has made loans and investments,

including a loan of FTT tokens to BlockFi Inc. in a principal amount of FTT tokens valued at $250 million as of September 30, 2022.

18. I have been provided with an unaudited consolidated balance sheet for the WRS Silo as of September 30, 2022, which is the latest balance sheet available. The balance sheet shows $1.36 billion in total assets as of that date. However, because this balance sheet was produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in it, and the information therein may not be correct as of the date stated.

19. The chart below summarizes certain information regarding the WRS Silo's consolidated assets as reflected in the September 30, 2022 balance sheet:

WRS Silo Consolidated Assets as of September 30, 2022	
Current Assets	
Cash and Cash Equivalents	$144,207
Restricted Cash	$267,738
U.S. Dollar Denominated Stablecoins	$68,035
Customer Custodial Funds	$102,225
Accounts Receivable	$2,978
Accounts Receivable, Related Party	$71,563
Loans Receivable	$250,000
Prepaid Expenses and Other Current Assets	$21,448
Crypto Assets Held at Fair Value	$1,026
Total Current Assets	**$929,220**
Property and Equipment, Net	$2,017
Other Non-Current Assets	$429,428
Total Assets	**$1,360,665**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, assets shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(3) Restricted cash at the WRS Silo is primarily comprised of approximately $250 million in restricted funds at non-Debtor LedgerX.

(4) Customer custodial fund assets are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited were not recorded as assets on the balance sheet and are not presented.**

(5) Loans receivable of $250 million consists of a loan by Debtor West Realm Shires Inc. to BlockFi Inc. of $250 million in FTT tokens.

(6) Intangible assets (in the amount of $229 million) are not reflected above. These consist of values attributable to customer relationships and trade names.

(7) Goodwill balance (in the amount of $135 million) is not reflected above.

20. To my knowledge, the WRS Silo Debtors do not have any long-term or funded debt. The WRS Silo Debtors are expected to have significant liabilities arising from crypto assets deposited by customers through the FTX US platform. However, such liabilities are not reflected in the financial statements prepared while these companies were under the control of Mr. Bankman-Fried. The chart below summarizes certain information regarding the WRS Silo's consolidated liabilities as reflected in the September 30, 2022 balance sheet:

WRS Silo Consolidated Liabilities as of September 30, 2022	
Current Liabilities	
Accounts Payable and Accrued Expenses	$6,014
Accounts Payable, Related Party	$124,221
Custodial Funds Due to Customers	$102,225
Purchase Consideration Payable	–
Loan Payable	–
Lease Liability, Current	$1,672
Crypto Asset Borrowings at Fair Value	$1,737
Total Current Liabilities	**$235,869**
Lease Liability, Non-Current	$9,399
Deferred Taxes	$20,185
Contract Liability	$887
SAFE Note, Related Party, Non-Current	$50,000
Other Non-Current Liabilities	–
Total Liabilities	**$316,014**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, liabilities shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(3) Customer custodial fund liabilities are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited are not presented.**

21. All Debtors and non-Debtors in the WRS Silo are organized in the State of Delaware, other than non-Debtor FTX Vault Trust Company, which is a South Dakota Trust Company.

C. The Alameda Silo

22. The parent company and primary operating company in the Alameda Silo is Alameda Research LLC, which is organized in the State of Delaware. Before the Petition Date (as defined below), the Alameda Silo operated quantitative trading funds specializing in crypto assets. Strategies included arbitrage, market making, yield farming and trading volatility. The Alameda Silo also offered over-the-counter trading services, and made and managed other debt and equity investments. In short, the Alameda Silo was a "crypto hedge fund" with a diversified business trading and speculating in digital assets and related loans and securities for the account of its owners, Messrs. Bankman-Fried (90%) and Wang (10%).

23. Alameda Research LLC prepared consolidated financial statements on a quarterly basis. To my knowledge, none of these financial statements have been audited. The September 30, 2022 balance sheet for the Alameda Silo shows $13.46 billion in total assets as of its date. However, because this balance sheet was unaudited and produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in it and the information therein may not be correct as of the date stated.

24. The chart below summarizes certain information regarding the Alameda Silo's consolidated assets as reflected in the September 30, 2022 balance sheet:

Alameda Silo Consolidated Assets as of September 30, 2022	
Current Assets	
Cash and Cash Equivalents	$547,964
Restricted Cash	-
U.S. Dollar Denominated Stablecoins	-
Customer Custodial Funds	-
Investments	$3,976,632
Accounts Receivable	$10,845
Accounts Receivable, Related Party	$427,323
Loans Receivable	$41,607
Loans Receivable, Related Party	$4,102,365
Prepaid Expenses and Other Current Assets	$1,083
Crypto Assets Held at Fair Value	$4,084,886

Total Current Assets	**$13,192,706**
Property and Equipment, Net	$26,763
Other Non-Current Assets	$239,696
Total Assets	**$13,459,165**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

(3) Related Party Loans Receivable of $4.1 billion at Alameda Research (consolidated) consisted primarily of a loan by Euclid Way Ltd. to Paper Bird Inc. (a Debtor) of $2.3 billion and three loans by Alameda Research Ltd.: one to Mr. Bankman-Fried, of $1 billion; one to Mr. Singh, of $543 million; and one to Ryan Salame, of $55 million.

25. The chart below summarizes certain information regarding the Alameda Silo's consolidated liabilities as reflected in the September 30, 2022 balance sheet:

Alameda Silo Consolidated Liabilities as of September 30, 2022	
Current Liabilities	
Accounts Payable and Accrued Expenses	$916,305
Accounts Payable, Related Party	$75,900
Custodial Funds Due to Customers	$309,634
Purchase Consideration Payable	-
Loans Payable	-
Loans Payable, Related Party	$13,762
Lease Liability, Current	-
Crypto Asset Borrowings at Fair Value	$3,773,979
Total Current Liabilities	**$5,089,579**
Lease Liability, Non-Current	-
Deferred Taxes	-
Contract Liability	-
SAFE Note, Related Party, Non-Current	-
Other Non-Current Liabilities	-
Total Liabilities	**$5,089,579**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

26. As mentioned above, Alameda Research LLC is organized in the State of Delaware. The other Debtors in the Alameda Silo are organized in Delaware, Korea, Japan, the British Virgin Islands, Antigua, Hong Kong, Singapore, the Seychelles, the Cayman Islands, the Bahamas, Australia, Panama, Turkey and Nigeria.

D. The Ventures Silo

27. The Debtors in the Ventures Silo make and manage private investments. The investments are held in Debtors Clifton Bay Investments, LLC, Clifton Bay Investments Ltd., FTX Ventures Ltd., Island Bay Ventures Inc. and, potentially, affiliated companies.

28. To my knowledge, Debtors Clifton Bay Investments, LLC and FTX Ventures Ltd. prepared financial statements on a quarterly basis. The September 30, 2022 balance sheet for Debtor Clifton Bay Investments LLC shows assets with a total value of $1.52 billion as of its date, and the September 30, 2022 balance sheet for FTX Ventures Ltd. shows assets with a total value of $493 million as of its date. To my knowledge, none of these financial statements have been audited. Because these balance sheets were unaudited and produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in them, and the information therein may not be correct as of the date stated.

29. I have not been able to locate financial statements for Island Bay Ventures Inc.

30. The chart below summarizes certain information regarding the Ventures Silo's assets as reflected in the September 30, 2022 balance sheets, excluding any assets held by Island Bay Ventures Inc.

Ventures Silo Consolidated Assets as of September 30, 2022		
	Clifton Bay Investments LLC (consolidated)	**FTX Ventures Ltd**
Current Assets		
Cash and Cash Equivalents	$245	$261
Restricted Cash	-	-
U.S. Dollar Denominated Stablecoins	-	-
Customer Custodial Funds	-	-
Investments	$1,492,856	$397,861
Accounts Receivable	-	-
Accounts Receivable, Related Party	$10,200	-

Loans Receivable	$16,810	-
Loans Receivable, Related Party	-	-
Prepaid Expenses and Other Current Assets	-	-
Crypto Assets Held at Fair Value	-	$95,337
Total Current Assets	**$1,520,111**	**$493,459**
Property and Equipment, Net	-	-
Other Non-Current Assets	-	-
Total Assets	**$1,520,111**	**$493,459**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

31. The chart below summarizes certain information regarding the Ventures Silo's liabilities as reflected in the September 30, 2022 balance sheets excluding any liabilities of Island Bay Ventures Inc.:

Ventures Silo Consolidated Liabilities as of September 30, 2022		
	Clifton Bay Investments LLC (Consolidated)	**FTX Ventures Ltd**
Current Liabilities		
Accounts Payable and Accrued Expenses	$44	-
Accounts Payable, Related Party	$1,519,283	$129,518
Custodial Funds Due to Customers	-	-
Purchase Consideration Payable	-	-
Loans Payable	-	-
Loans Payable, Related Party	-	$362,915
Lease Liability, Current	-	-
Crypto Asset Borrowings at Fair Value	-	-
Total Current Liabilities	**$1,519,326**	**$492,432**
Lease Liability, Non-Current	-	-
Deferred Taxes	-	-
Contract Liability	-	-
SAFE Note, Related Party, Non-Current	-	-
Other Non-Current Liabilities	-	-
Total Liabilities	**$1,519,326**	**$492,432**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

(3) Related Party Accounts Payable at Clifton Bay Investments LLC consists of four related-party balances: one with Debtor Alameda Research Ltd, of $1,400 million; one with Debtor Alameda Research LLC, of $68.6 million; one with Alameda Ventures Ltd, of $38.5 million; and one with Debtor West Realm Shires Services Inc. of $2.25 million.

(4) Customer custodial fund liabilities are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited are not presented**.

32. All Debtors in the Ventures Silo are organized in the State of Delaware or the British Virgin Islands.

E. The Dotcom Silo

33. The Dotcom Silo includes FTX.com, the trade name for the business conducted by the parent company in the Dotcom Silo, FTX Trading Ltd., which is organized in Antigua. FTX.com is a digital asset trading platform and exchange. It was founded by Messrs. Bankman-Fried, Wang and Singh and commenced operations in May 2019. The Dotcom Silo also holds certain marketplace licenses and registrations in certain non-U.S. jurisdictions, including the European Union and Japan. The FTX.com platform is not available to U.S. users.

34. In addition to its core digital asset exchange, the Dotcom Silo offered an off-exchange portal that enabled users to connect and request quotes for spot digital assets and trade directly. The portal enabled users to lend their digital assets to other users for spot trading and matched users wanting to borrow with those willing to lend.

35. The FTX.com platform grew quickly since its launch to become one of the largest cryptocurrency exchanges in the world. Mr. Bankman-Fried claimed that, by the end of 2021, around $15 billion of assets were on the platform, which according to him handled approximately 10% of global volume for crypto trading at the time. Mr. Bankman-Fried also claimed that FTX.com, as of July 2022, had "millions" of registered users. These figures have not been verified by my team.

36. The Dotcom Silo's unaudited consolidated balance sheet as of September 30, 2022 is the latest balance sheet that was provided to me with respect to the Dotcom Silo. It shows total assets of $2.25 billion as of September 30, 2022. Because such balance sheet was

produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in it, and the information therein may not be correct as of the date stated.

37. The chart below summarizes certain information regarding the Dotcom Silo's consolidated assets as reflected in the September 30, 2022 balance sheet:

Dotcom Silo Consolidated Assets as of September 30, 2022	
Current Assets	
Cash and Cash Equivalents	$483,724
Restricted Cash	$10,188
U.S. Dollar Denominated Stablecoins	$1,140,795
Customer Custodial Funds	–
Accounts Receivable	$9,459
Accounts Receivable, Related Party	$188,155
Loans Receivable	$103,949
Prepaid Expenses and Other Current Assets	$42,661
Crypto Assets Held at Fair Value	$659
Total Current Assets	**$1,979,590**
Property and Equipment, Net	$256,996
Other Non-Current Assets	$22,148
Total Assets	**$2,258,734**

(1) Amounts shown in thousands of U.S. Dollars.

(2) The balance sheet for non-Debtor FTX Digital Markets Ltd. is consolidated to Debtor FTX Trading Ltd.'s balance sheet. The September 30, 2022 Balance Sheet of non-Debtor FTX Digital Markets Ltd. reflects an asset position of $149,336, as follows: Cash and Cash Equivalents ($82,564), Restricted Cash ($10,000), U.S. Dollar Denominated Stablecoins ($63), Related Party Receivables ($45,944), Prepaid Expenses and Other Current Assets ($4,922), Property and Equipment, Net ($5,565) and Other Non-Current Assets ($278) (amounts in thousands of U.S. Dollars).

(3) Non-debtor FTX Digital Markets Ltd. has a net intercompany accounts payable of $30 million due to entities controlled by Debtor FTX Trading Ltd.

(4) In the above table, assets shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(5) Customer custodial fund assets are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited are not presented.**

(6) Loans Receivable of $250 million at FTX US consists of a loan to BlockFi Inc. of $250 million in FTT tokens.

(7) Intangible assets (in the amount of $343 million) are not reflected above. These consist of values attributable to customer relationships and trade names.

(8) Goodwill balance (in the amount of $359 million) is not reflected above.

38. To my knowledge, the Dotcom Silo Debtors do not have any long-term or funded debt. The Dotcom Silo Debtors may have significant liabilities to customers through the

FTX.com platform. However, such liabilities are not reflected in the financial statements prepared by these companies while they were under the control of Mr. Bankman-Fried. The chart below summarizes certain information regarding the Dotcom Silo's consolidated liabilities as reflected in the September 30, 2022 balance sheet:

Dotcom Silo Consolidated Liabilities as of September 30, 2022	
Current Liabilities	
Accounts Payable and Accrued Expenses	$38,970
Accounts Payable, Related Party	$125,626
Custodial Funds Due to Customers	–
Purchase Consideration Payable	$26,970
Loan Payable	$124,298
Lease Liability, Current	$23
Crypto Asset Borrowings at Fair Value	$149,723
Total Current Liabilities	**$465,610**
Lease Liability, Non-Current	–
Deferred Taxes	–
Contract Liability	–
SAFE Note, Related Party, Non-Current	–
Other Non-Current Liabilities	$46
Total Liabilities	**$465,656**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, liabilities shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(3) The balance sheet for non-Debtor FTX Digital Markets Ltd. is consolidated to Debtor FTX Trading Ltd.'s balance sheet. The September 30, 2022 Balance Sheet of non-Debtor FTX Digital Markets Ltd. reflects total liabilities in the amount of $1,278, as follows: Accounts Payable and Accrued Expenses ($1,259), Accounts Payable, Related Party ($19) (amounts in thousands of U.S. Dollars).

(4) Customer custodial fund liabilities are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited were not recorded as assets on the balance sheet and are not presented.**

39. The Debtors in the Dotcom Silo are organized in jurisdictions around the world, with the parent company FTX Trading Ltd. organized in Antigua. The Debtors in the Dotcom Silo also own 100% of the equity interests in over a dozen non-Debtor companies.

II. EVENTS LEADING TO CHAPTER 11 FILING

40. The Debtors faced a severe liquidity crisis that necessitated the filing of these Chapter 11 Cases on an emergency basis on November 11, 2022, and in the case of Debtor

West Realm Shires Inc., on November 14, 2022 (collectively, the "Petition Date"). In the days leading up to the Petition Date, certain of the circumstances described in Part III below became known to a broader set of executives of the FTX Group beyond Mr. Bankman-Fried and members of his inner circle. Questions arose about Mr. Bankman-Fried's leadership and the handling of the Debtors' complex array of assets and businesses.

41. As the situation became increasingly dire, Sullivan & Cromwell and Alvarez & Marsal were engaged to provide restructuring advice and services to the Debtors.

42. On November 10, 2022, the Securities Commission of the Bahamas (the "SCB") took action to freeze assets of non-Debtor FTX Digital Markets Ltd., a service provider to FTX Trading Ltd. and the employer of certain current and former executives and staff in the Bahamas. Mr. Brian Simms, K.C. was appointed as provisional liquidator of FTX Digital Markets Ltd. on a sealed record. The provisional liquidator for this Bahamas subsidiary has filed a chapter 15 petition seeking recognition of the provisional liquidation proceeding in the Bankruptcy Court for the Southern District of New York.

43. In addition, in the first hours of November 11, 2022 EST, the directors of non-Debtors FTX Express Pty Ltd and FTX Australia Pty Ltd., both Australian entities, appointed Messrs. Scott Langdon, John Mouawad and Rahul Goyal of KordaMentha Restructuring as voluntary administrators.

44. At the same time, negotiations were being held between certain senior individuals of the FTX Group and Mr. Bankman-Fried concerning the resignation of Mr. Bankman-Fried and the commencement of these Chapter 11 Cases. Mr. Bankman-Fried consulted with numerous lawyers, including lawyers at Paul, Weiss, Rifkind, Wharton & Garrison LLP, other legal counsel and his father, Professor Joseph Bankman of Stanford Law

School. A document effecting a relinquishment of control was prepared and comments from Mr. Bankman-Fried's team incorporated. At approximately 4:30 a.m. EST on Friday, November 11, 2022, after further consultation with his legal counsel, Mr. Bankman-Fried ultimately agreed to resign, resulting in my appointment as the Debtors' CEO. I was delegated all corporate powers and authority under applicable law, including the power to appoint independent directors and commence these Chapter 11 Cases on an emergency basis.

45. Other than the proceedings in the Bahamas and Australia, to my knowledge, no other Debtor or non-Debtor subsidiary is subject to other insolvency proceedings at this time.

III. ACTION TAKEN SINCE MR. BANKMAN-FRIED'S DEPARTURE

A. New Governance Structure

46. Many of the companies in the FTX Group, especially those organized in Antigua and the Bahamas, did not have appropriate corporate governance. I understand that many entities, for example, never had board meetings.

47. The following new independent directors (the "Directors") have been appointed as directors of the primary companies in the FTX Group:

(a) **WRS Silo: Mitchell I. Sonkin:** Mitchell Sonkin is currently a Senior Advisor to MBIA Insurance Corporation in connection with the restructuring of the Firm's insured portfolio exposure of the Commonwealth of Puerto Rico's $72 billion of outstanding debt. He is also currently Chairman of the Board of the ResCap Liquidating Trust, successor to ResCap and GMAC Mortgage Corporations. Before joining MBIA, Mr. Sonkin was a senior partner at the international law firm, King & Spalding, where he was co-chair of King & Spalding's Financial Restructuring Group and a member of the firm's Policy Committee. He has over 40 years of experience in U.S. and international bond issuances, corporate reorganizations, bankruptcies and other debt restructurings and has served as a bankruptcy-court-appointed examiner. In particular, he has played a significant role in numerous municipal, utility, insurance, airline, healthcare debt and international debt restructurings including the Anglo/French Euro Tunnel debt reorganization.

(b) **<u>Alameda Silo: Matthew R. Rosenberg</u>:** Mr. Rosenberg is a Partner at Lincoln Park Advisors, a financial advisory firm that he founded in 2014. He has more than 25 years of restructuring, corporate finance, principal investing, operating and board experience. Prior to founding Lincoln Park Advisors, he was a partner at the restructuring and investment banking firm Chilmark Partners, a partner in two private equity funds, the Zell/Chilmark Fund and Chilmark Fund II, the Chief Restructuring Officer of The Wellbridge Company and a member of multiple corporate boards. His restructuring advisory experience includes such companies as OSG, Supermedia, Nortel, Trinity Coal, USG Corporation, JHT Holdings, Inc., Covanta Energy, Sirva, Lodgian, Inc., ContiGroup Companies, Inc., Fruit of the Loom, Ltd. and Recycled Paper Greetings.

(c) **<u>Ventures Silo: Rishi Jain</u>:** Mr. Jain is a Managing Director and Co-Head of the Western Region of Accordion, a financial and technology consulting firm focused on the private equity industry. He has more than 25 years of experience supporting management teams and leading finance and operations initiatives in both stressed and distressed environments. Prior to joining Accordion, Mr. Jain was part of Alvarez & Marsal's corporate restructuring and turnaround practice for over 10 years and served in a variety of senior financial operating roles. His most notable assignments have included helping lead the restructuring, liquidation and wind down of Washington Mutual and its predecessor entity, WMI Liquidating Trust. He also navigated the restructuring of Global Geophysical Services in its chapter 11 and eventually the liquidation and wind down in its second chapter 11 filing.

(d) **<u>Dotcom Silo: The Honorable Joseph J. Farnan (Lead Independent Director)</u>:** Mr. Farnan served as a United States District Judge for the District of Delaware from 1985 to 2010. He served as Chief Judge from 1997-2001. During his tenure, Mr. Farnan presided over numerous bench and jury trials involving complex commercial disputes. Prior to his appointment to the federal bench, Mr. Farnan was appointed to several positions in local, state and the federal government returning to private practice in 2010 with the formation of Farnan LLP, a law firm focused on complex commercial matters, including chapter 11 proceedings, securities litigation, antitrust litigation and patent litigation. Additionally, Mr. Farnan serves as an arbitrator, mediator, independent director and trustee of businesses contemplating or filing chapter 11 bankruptcy.

(e) **<u>Dotcom Silo: Matthew A. Doheny</u>:** Mr. Doheny is President of North Country Capital LLC, an advisory and investment firm focused on challenging advisory assignments and investing private investment portfolios in special situation opportunities. He has held this position since January 2011. Mr. Doheny has served on the board of directors or as Chief Restructuring Officer of numerous stressed and distressed companies, including Yellow Corp., MatlinPatterson, GMAC Rescap and Eastman

Kodak. He was also Managing Director and Head of Special Situations Investing at HSBC Securities Inc. from 2015 to 2017. Previously, Mr. Doheny served as Portfolio Manager in Special Situations at Fintech Advisory Inc. from 2008 to 2010 and as Managing Director of the Distressed Products Group at Deutsche Bank Securities Inc. from 2000 to 2008.

48. The appointment of the Directors will provide the FTX Group with appropriate corporate governance for the first time.

49. The Directors intend to hold joint board meetings of the Debtors on matters of common interest, including (a) the implementation of controls, (b) asset protection and recovery, (c) the investigation into claims against the founders and third parties, (d) cooperation with insolvency proceedings of subsidiary companies in other jurisdictions and (e) the maximization of value for all stakeholders through the eventual reorganization or sale of the Debtors' complex array of businesses, investments and property around the world. The Directors will implement appropriate procedures for the resolution of any conflicts of interest among the Silos and, if necessary, within the Silos as the case progresses, including the potential engagement of independent counsel to represent various Debtors in the resolution of intercompany claims against other Debtors. I expect there to be a multitude of intercompany claims that will benefit from fair resolution under the rules and conventions of U.S. chapter 11 practice in the District of Delaware for complex, multi-Debtor cases. For the time being, my belief is that all stakeholders are best served by a coordinated and centralized administration.

B. Cash Management

50. The FTX Group did not maintain centralized control of its cash. Cash management procedural failures included the absence of an accurate list of bank accounts and account signatories, as well as insufficient attention to the creditworthiness of banking partners

around the world. Under my direction, the Debtors are establishing a centralized cash management system with proper controls and reporting mechanisms.

51. During these Chapter 11 Cases, cash that the Debtors are able to locate and transfer to the United States without adverse consequences, including substantially all proceeds of the global reorganization effort, will be deposited into financial institutions in the United States that are approved depository institutions in accordance with the U.S. Trustee Guidelines. Each Silo will have a centralized cash pool, and the Debtors will implement appropriate arrangements for allocating costs across the various Silos and Debtors. The Debtors expect to file promptly a Cash Management Motion that will describe the new cash management system in more detail.

52. Because of historical cash management failures, the Debtors do not yet know the exact amount of cash that the FTX Group held as of the Petition Date. The Debtors are working with Alvarez & Marsal to verify all cash positions. To date, it has been possible to approximate the following balances as of the Petition Date based on available books and records:

Entity	Unrestricted Cash	Custodial Cash	Other Restricted Cash	Total Cash
Debtor Entities				
FTX EU Ltd	$1,250,848	$47,925,646	$175,832	$49,352,327
West Realm Shires Services Inc.	$32,233,606	$14,596,119	$1,270,700	$48,100,425
West Realm Shires Inc.	$35,411,619	-	-	$35,411,619
Paper Bird Inc	$7,906,893	-	-	$7,906,893
FTX Exchange FZE	$1,812,563	-	$4,000,000	$5,812,563
Ledger Holdings Inc.	$4,098,480	-	-	$4,098,480
FTX TURKEY TEKNOLOJİ VE TİCARET ANONİM ŞİRKET	$36,682	$3,069,526	-	$3,106,208
FTX Europe AG	$2,979,584	-	-	$2,979,584
FTX Trading Ltd	$375,726	$2,600,324	-	$2,976,050
Maclaurin Investments Ltd.	$2,529,814	-	-	$2,529,814
Blockfolio, Inc.	$2,396,067	-	-	$2,396,067
Ledger Prime LLC	$2,230,765	-	-	$2,230,765
Crypto Bahamas LLC	$900,000	-	-	$900,000
FTX Ventures Ltd	$779,542	-	-	$779,542
West Realm Shires Financial Services Inc.	$576,831	-	-	$576,831
FTX Lend Inc.	$484,738	-	-	$484,738
FTX Trading GmbH	$146,059	-	-	$146,059
FTX Switzerland GmbH	$16,799	-	-	$16,799

Entity	Unrestricted Cash	Custodial Cash	Other Restricted Cash	Total Cash
Total Debtor Entities	**$96,166,614**	**$68,191,615**	**$5,446,532**	**$169,804,762**
Non-Debtor Entities				
LedgerX LLC	$13,644,269	$24,103,085	$265,603,056	$303,350,409
FTX Digital Markets Ltd	-	-	$49,999,600	$49,999,600
Embed Clearing LLC.	-	-	$29,978,776	$29,978,776
FTX Philanthropy Inc	$10,877,387	-	-	$10,877,387
Embed Financial Technologies Inc	$395,371	-	-	$395,371
Total Non-Debtor Entities	**$24,917,027**	**$24,103,085**	**$345,581,432**	**$394,601,543**
Total	**$121,083,641**	**$92,294,700**	**$351,027,964**	**$564,406,305**

53. The Debtors have been in contact with banking institutions that they believe hold or may hold Debtor cash. These banking institutions have been instructed to freeze withdrawals and alerted not to accept instructions from Mr. Bankman-Fried or other signatories. Proper signature authority and reporting systems are expected to be arranged shortly.

54. Effective cash management also requires liquidity forecasting, which I understand was also generally absent from the FTX Group historically. The Debtors are putting in place the systems and processes necessary for Alvarez & Marsal to produce a reliable cash forecast as well as the cash reporting required for Monthly Operating Reports under the Bankruptcy Code.

C. Financial Reporting

55. The FTX Group received audit opinions on consolidated financial statements for two of the Silos – the WRS Silo and the Dotcom Silo – for the period ended December 31, 2021. The audit firm for the WRS Silo, Armanino LLP, was a firm with which I am professionally familiar. The audit firm for the Dotcom Silo was Prager Metis, a firm with which I am not familiar and whose website indicates that they are the “first-ever CPA firm to officially open its Metaverse headquarters in the metaverse platform Decentraland.”[4]

[4] https://pragermetis.com/news/prager-metis-opens-first-ever-cpa-firm-metaverse/.

56. I have substantial concerns as to the information presented in these audited financial statements, especially with respect to the Dotcom Silo. As a practical matter, I do not believe it appropriate for stakeholders or the Court to rely on the audited financial statements as a reliable indication of the financial circumstances of these Silos.

57. The Debtors have not yet been able to locate any audited financial statements with respect to the Alameda Silo or the Ventures Silo.

58. The Debtors are locating and securing all available financial records but expect it will be some time before reliable historical financial statements can be prepared for the FTX Group with which I am comfortable as Chief Executive Officer. The Debtors do not have an accounting department and outsource this function.

D. Human Resources

59. The FTX Group's approach to human resources combined employees of various entities and outside contractors, with unclear records and lines of responsibility. At this time, the Debtors have been unable to prepare a complete list of *who* worked for the FTX Group as of the Petition Date, or the terms of their employment. Repeated attempts to locate certain presumed employees to confirm their status have been unsuccessful to date.

60. Nevertheless, there is a core team of dedicated employees at the FTX Group who have stayed focused on their jobs during this crisis and with whom I have established appropriate lines of authority and working relationships. The Debtors continue to review personnel issues but I expect, based on my experience and the nature of the Debtors' business, that a large number of employees of the Debtors will need to continue to work for the Debtors for the foreseeable future in order to establish accountability, preserve value and maximize stakeholder recoveries after the departure of Mr. Bankman-Fried. As Chief Executive Officer, I am thankful for the extraordinary efforts of this group of employees, who despite difficult

personal circumstances, have risen to the occasion and demonstrated their critical importance to the Debtors.

61. The Debtors are preparing one or more motions to address issues relating to continuing employees and contractors. The Debtors also may hire new employees and officers with turnaround or other relevant experience in core functions where I determine that new leadership is required. I anticipate that the Debtors will be able to file these motions in the coming days.

E. Disbursement Controls

62. The Debtors did not have the type of disbursement controls that I believe are appropriate for a business enterprise. For example, employees of the FTX Group submitted payment requests through an on-line 'chat' platform where a disparate group of supervisors approved disbursements by responding with personalized emojis.

63. In the Bahamas, I understand that corporate funds of the FTX Group were used to purchase homes and other personal items for employees and advisors. I understand that there does not appear to be documentation for certain of these transactions as loans, and that certain real estate was recorded in the personal name of these employees and advisors on the records of the Bahamas.

64. The Debtors now are implementing a centralized disbursement approval process that reports to me as Chief Executive Officer.

F. Digital Asset Custody

65. The FTX Group did not keep appropriate books and records, or security controls, with respect to its digital assets. Mr. Bankman-Fried and Mr. Wang controlled access to digital assets of the main businesses in the FTX Group (with the exception of LedgerX, regulated by the CFTC, and certain other regulated and/or licensed subsidiaries). Unacceptable

management practices included the use of an unsecured group email account as the root user to access confidential private keys and critically sensitive data for the FTX Group companies around the world, the absence of daily reconciliation of positions on the blockchain, the use of software to conceal the misuse of customer funds, the secret exemption of Alameda from certain aspects of FTX.com's auto-liquidation protocol, and the absence of independent governance as between Alameda (owned 90% by Mr. Bankman-Fried and 10% by Mr. Wang) and the Dotcom Silo (in which third parties had invested).

66. The Debtors have located and secured only a fraction of the digital assets of the FTX Group that they hope to recover in these Chapter 11 Cases. The Debtors have secured in new cold wallets approximately $740 million of cryptocurrency that the Debtors believe is attributable to either the WRS, Alameda and/or Dotcom Silos. The Debtors have not yet been able to determine how much of this cryptocurrency is allocable to each Silo, or even if such an allocation can be determined. These balances exclude cryptocurrency not currently under the Debtors' control as a result of (a) at least $372 million of unauthorized transfers initiated on the Petition Date, during which time the Debtors immediately began moving cryptocurrency into cold storage to mitigate the risk to the remaining cryptocurrency that was accessible at the time, (b) the dilutive 'minting' of approximately $300 million in FTT tokens by an unauthorized source after the Petition Date and (c) the failure of the co-founders and potentially others to identify additional wallets believed to contain Debtor assets.

67. In response, the Debtors have engaged forensic analysts to identify potential Debtor assets on the blockchain, cybersecurity professionals to identify the parties responsible for the unauthorized transactions on and after the Petition Date and investigators to begin the process of identifying what may be very substantial transfers of Debtor property in the

days, weeks and months prior to the Petition Date. The Debtors' team includes business, accounting, forensic, technical and legal resources that I believe are among the best in the world at these activities. It is my expectation that the Debtors will require assistance from the Court with respect to these matters as the investigation and these Chapter 11 Cases continue.

68. Although the investigation has only begun and must run its course, it is my view based on the information obtained to date, that many of the employees of the FTX Group, including some of its senior executives, were not aware of the shortfalls or potential commingling of digital assets. Indeed, I believe some of the people most hurt by these events are current and former employees and executives, whose personal investments and reputations have suffered. These are many of the same people whose work will be necessary to ensure the maximization of value for all stakeholders going forward.

G. Custody of Other Assets and Investments

69. The FTX Group had billions in investments other than cryptocurrency, as suggested above in the descriptions of the four Silos. However, the main companies in the Alameda Silo and the Ventures Silo did not keep complete books and records of their investments and activities.

70. The Debtors are creating a balance sheet and other financial statements for the Alameda Silo and the Ventures Silo as of the Petition Date. The Debtors are doing so from the 'bottom-up' by using the records of cash transactions at the Debtors, and also are reviewing various third-party sources to locate investments.

H. Information and Retention of Documents

71. One of the most pervasive failures of the FTX.com business in particular is the absence of lasting records of decision-making. Mr. Bankman-Fried often communicated

by using applications that were set to auto-delete after a short period of time, and encouraged employees to do the same.

72. The Debtors are writing things down. The investigative effort underway is led by myself and a team at Sullivan & Cromwell that reports directly to me, including a former Director of Enforcement at the SEC, a former Director of Enforcement at the CFTC, and a former Chief of the Complex Frauds and Cybercrime Unit of the United States Attorney's Office for the Southern District of New York. I regard ensuring the comprehensiveness, professionalism and integrity of this investigation as an essential part of my job as Chief Executive Officer.

73. Transparency with regulators around the world is an important objective for the Debtors. Since Friday, the Debtors have been in contact with dozens of regulators throughout the United States and around the world, and will continue to be as these cases continue.

I. Regulated and Licensed Subsidiaries

74. The FTX Group included regulated or licensed subsidiaries in many jurisdictions that may or may not have valuable going concern franchises. The Debtors will soon be taking efforts to preserve these subsidiary businesses to the extent practicable under the circumstances. The Debtors also are engaging a leading investment bank to assist the Debtors in valuing these businesses and potentially conducting sales efforts.

J. Access to Data

75. The Debtors have cryptocurrency, digital assets and other critically sensitive data in repositories that have been the subject of unauthorized attempts to access. The Debtors have implemented certain defensive measures. The Debtors have been advised that attempts to access this property of the estate may create a risk of its loss to unauthorized persons.

The Debtors expect to seek special relief from the Court to authorize measures to access this information as safely as possible. The Debtors are unable to create a list of their top 50 creditors that includes customers without access to the data repositories at issue, and may seek related relief from the Court as well if the problem cannot be promptly resolved.

K. Corporate Communications

76. Finally, and critically, the Debtors have made clear to employees and the public that Mr. Bankman-Fried is not employed by the Debtors and does not speak for them. Mr. Bankman-Fried, currently in the Bahamas, continues to make erratic and misleading public statements. Mr. Bankman-Fried, whose connections and financial holdings in the Bahamas remain unclear to me, recently stated to a reporter on Twitter: "F*** regulators they make everything worse" and suggested the next step for him was to "win a jurisdictional battle vs. Delaware".

I declare under penalty of perjury that the foregoing is true and correct.

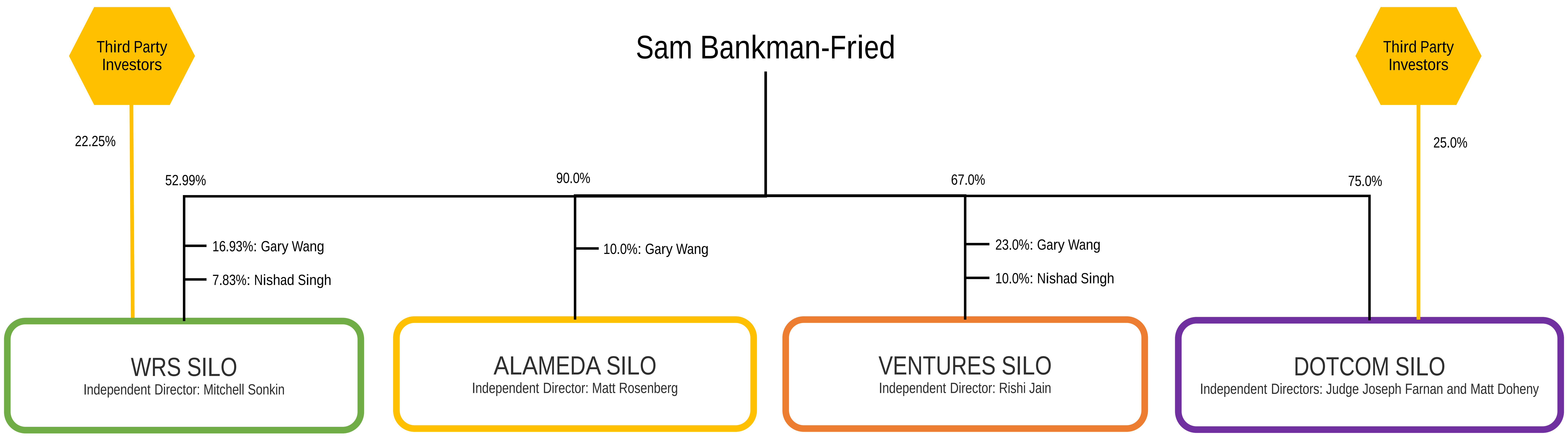
Dated: November 17, 2022

/s/ John J. Ray III
Name: John J. Ray III
Title: Chief Executive Officer

<u>Exhibit A</u>

Summary of the Silos and Indicative Assets

FOUR SILOS FOR RECOVERY PURPOSES



Indicative Assets by Silo

WRS Silo

- **Cash and Cash Equivalents**
- **Cryptocurrency**
- **FTX US**
- **LedgerX**
- **FTX Derivatives**
- **FTX Capital Markets**
- **Embed Clearing**
- **FTX Vault**
- **FTX Gaming**
- **FTX NFTs**
- **BlockFi Loans**

Alameda Silo

- **Cash and Cash Equivalents**
- **Cryptocurrency**
- **Other Digital Assets**
- **Treasuries**
- **Crypto ETFs**
- **Venture Investments**
  - ***Genesis Digital Assets***
  - ***Modulo Capital***
  - ***Pionic (Toss)***
  - ***Others***

Ventures Silo

- **Venture Investments**
  - ***Anthropic***
  - ***K5***
  - ***Dave Inc.***
  - ***Sequoia Capital***
  - ***Mysten Labs***
  - ***Others***

Dotcom Silo

- **Cash and Cash Equivalents**
- **Cryptocurrency**
- **FTX.com**
- **Real Estate**
- **Licensed Subsidiaries in Non-US Jurisdictions**

<u>Exhibit B</u>

Preliminary Corporate Structure Chart

PRELIMINARY ORGANIZATIONAL CHART

Last updated: Draft of November 17, 2022

* Percentages directly held by each of Sam Bankman-Fried, Gary Wang and Nishad Singh in individual entities varies.

** Indicates non-operational subsidiary entity.

Role of Subchapter V Trustee

I. Written Role of Subchapter V Trustee (11 U.S.C. § 1183)

   a. Disinterested person (11 U.S.C. § 1183(a))

   b. Duties (11 U.S.C. § 1183(b))

      i. Similarities to role of chapter 7 trustee

         1. Accountable for property

         2. Review proofs of claim and object as necessary

         3. Assess proposed discharge of debtor

         4. Provide information about bankruptcy estate

         5. Make final report and accounting

      ii. If requested by the court or a party in interest, and for cause, expand duties to:

         1. Investigate debtor's operations and activities

         2. File report on investigation

      iii. Appear and be heard at status conferences and significant hearings

      iv. Ensure debtor timely complies with confirmed plan obligations

      v. Expanded duties if debtor fails to be a debtor-in-possession

      vi. "Facilitate the development of a consensual plan of reorganization" (11 U.S.C. § 1183(b)(7))

   c. Mediator-ish role

      i. Trustee is not a neutral because trustee has obligation to report to court and to protect interests of creditors

      ii. Refer to Federal Rule of Evidence 408 to protect settlement discussions and increase level of disclosure to trustee

II. "Facilitation" of Consensual Plan

   a. 1183(a)(8) obligation has been considered most important role of Subchapter V Trustee. *In re Louis*, No. 20-71283, 2022 WL 2055290, at *50 (Bankr. C.D. Ill. June 7, 2022).

   b. Affirmative action should be taken by Subchapter V Trustee to negotiate consensual plan. *In re Louis*, at *59.

   c. Timing of efforts to facilitate consensual plan

      i. Following appointment, contact debtor

      ii. At 341 meeting of creditors, communicate with debtor and creditors

      iii. At 11 U.S.C. § 1188 status conference, communicate with parties and court

iv. Communicate with parties in advance of 11 U.S.C. § 1189(b) deadline for debtor to file plan

v. Consider scheduling settlement conference to seek agreement

III. Payment for Subchapter V Trustee Services

a. Subchapter V Trustee is paid on an hourly basis

b. Subchapter V Trustee fees should be minimized

i. $10,000-$13,000 trustee fee may be excessive. *In re Louis*, at *59.

ii. Ensure fees incurred relate to duties set forth in 11 U.S.C. § 1183(b)

iii. Ensure fees incurred show prompt efforts by Subchapter V Trustee to "facilitate" consensual plan confirmation

c. Fees for Subchapter V Trustee's professionals

i. Courts can be reluctant to allow appointment of professionals for trustee. *In re Penland Heating and Air Conditioning, Inc.*, at *1-*2.

ii. Subchapter V Trustee will want to show immediate need for professionals

IV. Open Questions about Role of Subchapter V Trustee

a. Is the Subchapter V Trustee a fiduciary for creditors?

b. What professionals would a Subchapter V Trustee be warranted in retaining?

c. What level of fees for a Subchapter V Trustee would be excessive?

V. Proposed Amendment to § 1183

a. Modify duties

i. Add requirement to investigate financial affairs of debtor and file periodic reports with the court

ii. Eliminate duties to provide information on property of the estate and make final reports

2020 WL 3124585
United States Bankruptcy Court, E.D. North Carolina,
New Bern Division.

IN RE: PENLAND HEATING AND AIR CONDITIONING, INC., Debtor

CASE NO. 20-01795-5-DMW
|
Signed June 11, 2020

Attorneys and Law Firms

Clayton W. Cheek, The Law Offices of Oliver & Cheek, PLLC, New Bern, NC, for Debtor.

ORDER DENYING APPLICATION TO EMPLOY ATTORNEY

David M. Warren, United States Bankruptcy Judge

***1** This matter comes before the court upon the Trustee's Application to Employ Attorney ("Application") filed on May 15, 2020 by John G. Rhyne, Esq. ("Trustee"), Subchapter V trustee for Penland Heating and Air Conditioning, Inc. ("Debtor"). The court conducted a video hearing on June 10, 2020. The Trustee appeared on his own behalf, Clayton W. Cheek, Esq. ("Mr. Cheek") appeared for the Debtor, and Parker W. Rumley, Esq. appeared for the United States Bankruptcy Administrator ("BA"). Based upon the case record and representations of counsel, the court makes the following findings of fact and conclusions of law:

Background

On May 1, 2020, the Debtor filed a voluntary petition for relief under Subchapter V of Chapter 11 of the United States Bankruptcy Code ("Subchapter V") and is operating as a debtor-in-possession pursuant to 11 U.S.C. § 1184. On May 4, 2020, the BA appointed the Trustee to serve as trustee in the case pursuant to 11 U.S.C. § 1183.

The Debtor operates a heating and air conditioning business that performs services throughout the state of North Carolina. The Debtor is currently winding down its business and intends to file a plan to provide for the liquidation of its assets after completion of jobs in progress.

On May 27, 2020, the court entered an Order Authorizing Employment of Attorney for Debtor, allowing the Debtor's employment of Mr. Cheek and the Law Offices of Oliver & Cheek, PLLC as attorney to advise and represent the Debtor throughout the case. In the Application, the Trustee seeks similarly to employ the law firm of John G. Rhyne, Attorney at Law to serve as attorney for the Trustee pursuant to 11 U.S.C. § 327(a).

Discussion

Subchapter V was created as part of the Small Business Reorganization Act of 2019 ("SBRA"), enacted on August 23, 2019 and taking effect on February 19, 2020. With the SBRA, "Congress intended to streamline the reorganization process for small business debtors because small businesses have often struggled to reorganize under chapter 11." *In re Ventura*, ––– B.R. ––––, 2020 WL 1867898, at *7 (Bankr. E.D.N.Y. Apr. 10, 2020) (citing H.R. Rep. No. 116-171, at 1-2 (2019)).

Unlike in a traditional Chapter 11 case, the BA shall appoint a trustee in every Subchapter V case. *See* 11 U.S.C. § 1183(a). The *Ventura* court summarized the Subchapter V trustee's duties enumerated in 11 U.S.C. § 1183(b) as follows:

> The subchapter V trustee will act as a fiduciary for creditors, in lieu of an appointed creditors' committee. The subchapter V trustee is also charged with facilitating the subchapter V debtor's small business reorganization and monitoring the subchapter V debtor's consummation of its plan of reorganization.

Ventura, 2020 WL 1867898, at *7. The role of a Subchapter V trustee is like that of a trustee in Chapters 12 and 13, and a Subchapter V debtor remains in possession of assets and operates the business. Paul W. Bonapfel, *A Guide to the Small Business Reorganization Act of 2019*, 93 Am. Bankr. L.J. 571, 582-83 (2019).

In his article, Judge Bonapfel recognizes that the SBRA does not restrict a Subchapter V trustee from employing attorneys and other professionals under 11 U.S.C. § 327(a); however, he cautions that—

> ***2** employment of attorneys or other professionals has the potential to substantially increase the administrative expenses of the case. In view of the intent of the SBRA to streamline and simplify chapter 11 cases for small business debtors and reduce administrative expenses, courts may be reluctant to permit a sub V trustee to retain attorneys or other professionals except in unusual circumstances.

Id. at 591. The Department of Justice's handbook for Subchapter V trustees instructs that a limitation of employment of professionals—

> is especially important in cases in which the debtor remains in possession and the debtor already has employed professionals to perform many of the duties that the trustee might seek to employ the professionals to perform. The trustee should keep the statutory purpose of SBRA in mind when carefully considering whether employment of the professional is warranted under the specific circumstances of each case.

U.S. Dep't of Justice, *Handbook for Small Business Chapter 11 Subchapter V Trustees* 3-17–18 (2020).

At the hearing, the Trustee stated that he filed the Application as a matter of course but did not have any current need for legal representation in the Debtor's case.[1] The court understands the desire to have professional employment secured, because this procedure is a prerequisite for compensation under 11 U.S.C. § 330(a); however, authorizing a Subchapter V trustee to employ professionals, including oneself as counsel, routinely and without specific justification or purpose is contrary to the intent and purpose of the SBRA.[2] In this case, the Debtor is operating in possession of its assets and has employed counsel to represent it in legal matters. At this time and without further evidence, the Trustee does not need legal assistance to fulfill his basic duties to monitor and facilitate the Debtor's reorganization. If during the case the Trustee identifies a specific need for the employment of an attorney or other professional, then the court will consider another request; now therefore,

It is ORDERED, ADJUDGED, and DECREED that the Application be, and hereby is, denied without prejudice.

SO ORDERED.

All Citations

Slip Copy, 2020 WL 3124585, 68 Bankr.Ct.Dec. 228

Footnotes

1 The court routinely allows Chapter 7 panel trustees and Chapter 11 trustees to hire themselves and their law firms to provide legal services that are outside the scope of the administrative trustee duties. The court has found allowing trustees to employ themselves or their firms provides an economical efficiency to case administration.

2 The court cautions overzealous and ambitious Subchapter V trustees that unnecessary or duplicative services may not be compensated, and other fees incurred outside of the scope and purpose of the SBRA may not be approved. The court absolutely does not imply that the Trustee in this case had even a remote thought of performing services outside the scope of the SBRA. The Application was filed out of an abundance of caution and as a standard of practice like in Chapter 7 cases, and the court appreciates this opportunity to provide some guidance for this new legislation.

End of Document

Neutral
As of: September 26, 2022 4:24 PM Z

In re Louis

United States Bankruptcy Court for the Central District of Illinois

June 7, 2022, Decided; June 7, 2022, Filed

Case No. 20-71283, Chapter 11 Subchapter V

Reporter
2022 Bankr. LEXIS 1586 *; 2022 WL 2055290

In Re RYAN LOUIS, Debtor.

Core Terms

confirmation, Properties, amended plan, cases, fee application, monthly, scheduled, tax claim, returns, liquidation, documents, real estate, deadline, provisions, balloting, proposed order, appointment, matters, status conference, small business, projections, converted, exhibits, filings, spent, amended claim, initial plan, expenses, Savings, notice

Case Summary

Overview

HOLDINGS: [1]-The fee applications filed by the debtor's attorney and the ***Subchapter*** V trustee were approved in full, under *11 U.S.C.S. § 330*, because, while both the attorney and the trustee fell short of the court's expectations for competency, both applicants reduced their fees, the United States Trustee had neither objected to nor commented on the fee requests, confirmation of a consensual Chapter 11 ***Subchapter*** V plan was achieved, and as a result, the debtor was granted his discharge and would have an opportunity at a fresh start.

Outcome
Fee applications allowed.

LexisNexis® Headnotes

Bankruptcy Law > Procedural Matters > Jurisdiction > Core Proceedings

HN1[] **Jurisdiction, Core Proceedings**

Matters involving the administration of the estate, the allowance of claims against the estate, and the adjustment of the debtor-creditor relationship are core proceedings. *28 U.S.C.S. § 157(b)(2)(A)*, *(B)*, *(O)*. These matters arise from the debtor's bankruptcy itself and from the provisions of the Bankruptcy Code and may therefore be constitutionally decided by a bankruptcy judge.

Bankruptcy Law > ... > Examiners, Officers & Trustees > Appointment > Compensation

Bankruptcy Law > ... > Retention of Professionals > Compensation > Debtor's Attorney

HN2[] **Appointment, Compensation**

11 U.S.C.S. § 330 provides the statutory authority for awarding compensation for the services and reimbursement for the expenses of properly employed professionals.

Bankruptcy Law > ... > Examiners, Officers & Trustees > Appointment > Compensation

Evidence > Burdens of Proof > Allocation

Bankruptcy Law > ... > Retention of Professionals > Compensation > Interim Compensation

Bankruptcy Law > ... > Retention of Professionals > Compensation > Limitations on Compensation

Bankruptcy Law > ... > Retention of Professionals > Compensation > Debtor's Attorney

HN3[] **Appointment, Compensation**

Generally, a court may award professionals, including attorneys and trustees, reasonable compensation for actual, necessary services rendered and reimbursement of actual and necessary expenses. *11 U.S.C.S. § 330(a)(1)(A)-(B)*. In order for compensation to be awarded, a fee application must be filed with the court which details the work done and expenses advanced for which compensation is sought. *Fed. R. Bankr. P. 2016(a)*. The applicant bears the ultimate burden of proving entitlement to the fees asserted in its application.

Bankruptcy Law > ... > Examiners, Officers & Trustees > Appointment > Compensation

Civil Procedure > ... > Costs & Attorney Fees > Attorney Fees & Expenses > Reasonable Fees

Bankruptcy Law > ... > Retention of Professionals > Compensation > Debtor's Attorney

HN4[] **Appointment, Compensation**

Regardless of whether interested parties object to awarding compensation, the court has an independent duty to examine the reasonableness of fee requests. To that end, *11 U.S.C.S. § 330* provides that the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including but not limited to the time spent, the rates charges, and whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, the case. *11 U.S.C.S. § 330(a)(3)*. Services that the court determines were not reasonably likely to benefit the estate or were not necessary to the administration of the case are not compensable. *11 U.S.C.S. § 330(a)(4)(A)(ii)*.

Bankruptcy Law > ... > Examiners, Officers & Trustees > Appointment > Compensation

Civil Procedure > ... > Costs & Attorney Fees > Attorney Fees & Expenses > Reasonable Fees

Bankruptcy Law > ... > Retention of Professionals > Compensation > Debtor's Attorney

HN5[] **Appointment, Compensation**

In the context of *11 U.S.C.S. § 330*, fee applications must provide sufficient information for a court to understand what services were actually provided and to determine whether the fees requested are reasonable and the services rendered were necessary and beneficial. It is therefore imperative that they include not only a detailed statement of each service performed, the time expended, and the compensation sought but also a narrative explaining the necessity of those services. Such detailed applications establish the actual, while an accompanying narrative explanation of the how and why establishes the necessary. The narrative portion of a fee application provides the opportunity for a professional to establish that the work done was necessary and beneficial to the estate. Simply providing details of the time spent and the task completed is often insufficient to make the case that the time should be compensated. Courts are not required to scour the record to find justification for awarding compensation where the applicant has not endeavored to do so.

Bankruptcy Law > ... > Bankruptcy > Debtor Benefits & Duties > Small Business Debtors

HN6[] **Debtor Benefits & Duties, Small Business Debtors**

A trustee appointed in a ***Subchapter*** V case serves in a unique role. Of course, ***Subchapter*** V trustees have many of the same duties as their counterparts in Chapters 7, 11, 12, and 13. They must account for all property received, examine proofs of claims if a purpose would be served, respond to information requests from parties in interest, and make a final report and accounting on the administration of the estate. *11 U.S.C.S. §§ 704(a)(2)*, *(5)*, *(7)*, and *(9)*, *1106(a)(1)*, *1183(b)(1)*, *1202(b)(1)*, 1302(b)(1). They are required to appear and be heard at the *11 U.S.C.S. § 1188* status conference, as well as any hearing concerning the value of encumbered property, plan confirmation or modification, and the sale of estate property. *11 U.S.C.S. §§ 1183(b)(3)*, *1202(b)(3)*, 1302(b)(2). But it is another duty that sets ***Subchapter*** V trustees apart. The ***Subchapter*** V trustee's primary duty is to facilitate the development of a consensual plan of reorganization. It is a significant distinction shared by no other trustee in bankruptcy. And it makes the ***Subchapter*** V trustee's role more like that of a mediator than other trustees who have traditionally taken on a more adversarial role.

Counsel: **[*1]** For Ryan Louis, Debtor: Joseph Camiel Pioletti, Pioletti & Pioletti, Eureka, IL.

For U.S. Trustee, U.S. Trustee: James Anthony Salinas, Office of United States Trustee, Peoria, IL; Mark D Skaggs, Peoria, IL; U.S. Trustee, Office of the U.S. Trustee, Peoria, IL.

Judges: Mary P. ***Gorman***, United States Bankruptcy Judge.

Opinion by: Mary P. ***Gorman***

Opinion

OPINION

Before the Court are fee applications filed by the Debtor's attorney and the ***Subchapter*** V trustee. Because both the Debtor's attorney and the ***Subchapter*** V trustee fell short of the Court's expectations for competency, their conduct and fee requests will be discussed at some length. But because both applicants have reduced their fees and the United States Trustee has neither objected to nor commented on the fee requests, both applications will be allowed despite the Court's reservations.

I. Factual and Procedural Background

Ryan Louis ("Debtor") commenced this case by filing a voluntary petition under Chapter 13 of the Bankruptcy Code on December 3, 2020. It was his second Chapter 13 case; his first Chapter 13 case, filed August 31, 2020, was dismissed on November 24, 2020, because his scheduled debts exceeded the statutory debt limits, making him ineligible for relief **[*2]** under Chapter 13.[1] The Debtor was represented in both filings by Attorney Joseph Pioletti.

Nearly two weeks into this case, the Debtor filed a motion to extend the automatic stay, asserting that he had liquidated certain collateral since his first case was dismissed and was now within the Chapter 13 debt limits. The motion further asserted that the case was filed in good faith, noting that an issue raised in the prior case regarding his failure to file tax returns was no longer an issue because "all returns have now been filed." The Debtor also filed his statement of financial affairs, the required schedules, a disclosure of attorney compensation, a statement of current monthly income, and a Chapter 13 plan several weeks after the case was commenced.

The schedules disclosed the Debtor's interest in his principal residence subject to a mortgage debt in favor of Bank and Trust Company, ownership of a TD Ameritrade account subject to a lien of First Federal Savings Bank of Champaign-Urbana ("First Federal Savings Bank"), and his interest in several businesses. He identified himself as the sole owner of HRL Properties & Management LLC, valuing his interest at $520,000 and listing numerous **[*3]** encumbered properties owned by the entity. He listed a 50% ownership stake in Grow Properties LLC along with the properties and respective debt obligations in the entity's portfolio, valuing his interest at $70,000. First Bankers Trust Company and West Central Bank were scheduled as creditors having claims secured by properties owned by HRL Properties and Grow Properties. The Debtor also disclosed ownership of Louis Trucking LLC, which he valued at $20,000 and identified as his sole source of income—roughly $8500 per month. The schedules reflected secured debt totaling approximately $1.17 million, nearly $300,000 of which the Debtor categorized as actually undersecured, and other unsecured debts totaling approximately $264,000.[2] The disclosure of attorney compensation filed with the Debtor's schedules said that Attorney Pioletti had agreed to accept $4250 as compensation, with the full balance outstanding.

First Bankers Trust Company objected to the motion to extend the automatic stay, at least to the extent that it might impact its right to proceed with a foreclosure sale of property owned by HRL Properties and located in Riverton, Illinois. The objection alleged that the Debtor, who **[*4]** guaranteed the commercial debt of HRL Properties secured by the real estate, did not have an ownership interest in the specific property. West Central Bank also objected to the motion to extend stay, similarly

[1] The Debtor scheduled nearly $2 million in secured debt, more than half of which he described as being undersecured, and close to $350,000 in other unsecured debt. Claims filed in the case exceeded $2 million. Thus, no matter how the debt was allocated, the Debtor necessarily exceeded the $419,275 unsecured and/or $1,257,850 secured debt limits applicable at the time his first case was filed. *See **11 U.S.C. § 109(e)***.

[2] The same statutory debt limits that applied in the Debtor's first case were applicable in his second case.

to the extent that extension of the stay would impair its rights to proceed with its prepetition foreclosure action involving several properties located in Springfield, Illinois, and owned by either Grow Properties or HRL Properties. The Debtor was alleged to be the guarantor or maker of the notes secured by the real estate but to have no ownership interest in the specific properties.

The Chapter 13 Trustee filed a response to the motion to extend stay, questioning the Debtor's good faith in filing the second case as it appeared that, when accounting for both general unsecured debts and the unsecured portions of secured debts, the Debtor's unsecured debt still exceeded the statutory limits. The Debtor then filed a motion to convert his pending Chapter 13 case to Chapter 11 ***Subchapter*** V, as well as a response to the objections to his motion to extend the automatic stay contending that he did, in fact, have an interest in the real estate referenced in the objections because he was **[*5]** the sole member of HRL Properties and a 50% shareholder of Grow Properties. The Debtor also defended his filing of the second Chapter 13 case, citing the complex nature of how his debts were structured and his efforts in liquidating collateral between filings.

At a hearing on the Debtor's motion to extend stay, Attorney Pioletti conceded that the automatic stay, if extended, would not stay actions against properties owned by entities other than the Debtor. He also admitted that, due to the manner in which the debts were scheduled, the unsecured portions of secured debt appeared to put the Debtor over the debt limits. But he maintained that the issue was complicated and that there was an argument to be made that the Debtor was within the debt limits. Attorney Pioletti offered that, because of the way he was required to enter information into his bankruptcy software, some portions of debts that were cross-collateralized by multiple properties may have been double counted. He did not explain why, if that was the case, he had not created and filed a separate spreadsheet to more accurately identify the assets and debts of the Debtor. The attorney for the Chapter 13 Trustee disagreed that **[*6]** the Debtor was even arguably within the debt limits but said he would not oppose extension of the automatic stay subject to the case being converted to Chapter 11. The Court cautioned that the Debtor might not fare much better in a converted case, noting the increased expenses of Chapter 11 and its own reservations about the Debtor's ability to fund the venture, but asked Attorney Pioletti whether he would be satisfied with the limited extension of the stay proposed by the attorney for the Chapter 13 Trustee. Attorney Pioletti said that such limited relief would be acceptable and that the Debtor intended to proceed with conversion. An order partially granting the motion to extend stay was accordingly entered, and the Debtor's motion to convert was noticed for objections.

On January 22, 2021, in the absence of objection, the Debtor's Chapter 13 case was converted to a case under Chapter 11 ***Subchapter*** V. Attorney Sumner Bourne was appointed ***Subchapter*** V Trustee in the converted case. Trustee Bourne filed a verified statement of disinterest in which he also stated his acceptance of the appointment and intent to seek compensation at an hourly rate of $250. The Debtor filed an application **[*7]** to employ Attorney Pioletti to represent him, also at an hourly rate of $250. At a hearing held March 9, 2021, on the application to employ, Attorney Pioletti acknowledged that he had not handled a Chapter 11 case before and the Court reiterated its concerns about the Debtor's financial standing, noting the absence of a retainer paid to Attorney Pioletti and the likelihood that additional professionals would need to be hired and paid to help with financial reporting. Still, the application to employ was allowed subject to further Court approval for any compensation ultimately sought.

In accordance with the provisions of Chapter 11 ***Subchapter*** V, an order was entered setting an initial 60-day case status conference, a claims bar date, and other deadlines for the Debtor to file statutorily-required documents. Per the order, the Debtor filed a copy of his 2019 federal income tax return, as well as several documents stating that he did not have a cash flow statement, balance sheet, or statement of operations to provide. In anticipation of the status conference, the Debtor also filed his status report stating that he was in the process of obtaining a valuation of his primary residence and **[*8]** negotiating the retention of several pieces of real estate with a secured creditor and that he was optimistic that a confirmable plan would be filed "pursuant to *§ 1181(b)*."[3]

The initial status conference was held March 23, 2021, as scheduled. The Court noted the Debtor's "bare-bones"

[3] *Section 1181* recites which provisions of Chapter 11 do not apply in ***Subchapter*** V cases. It does not provide for the filing or confirmation of a plan. Rather, *§ 1191* deals with confirmation of a plan filed under ***Subchapter*** V. As will be explained elsewhere, it appears that Attorney Pioletti copied the report from another case without checking the accuracy of the citations contained therein.

status report and asked Attorney Pioletti if he had anything to add. He said that the Debtor was in the process of compiling documents and preparing financial statements for the United States Trustee ("UST") and that he had filed an application to employ a bookkeeper to assist with such tasks. He said that the Debtor was making good progress and still hoped to file a confirmable plan by the deadline, but he admittedly did not have any specifics to report. When asked for input, Trustee Bourne said that he did not have anything to add and that he was just waiting for the filing deadline for the plan; he did not suggest that he was working with the Debtor or creditors to facilitate the formation of a plan that could be consensually confirmed.

The attorney for the UST, however, expressed concern about the progress of the case and the approaching plan deadline. He noted that, while helpful, the application to employ a **[*9]** bookkeeper was only recently filed, and it appeared that little else had been done in the two months since the case was converted. The first two monthly operating reports had yet to be filed, and the UST was also awaiting some other documentation requested from the Debtor. In addition to the standard monthly operating reports, he specifically mentioned the Debtor's duty to file related-entity reports pursuant to *Bankruptcy Rule 2015.3*. The Court echoed the concerns raised by the UST's attorney, also noting that the Debtor's status report mentioned obtaining a valuation of real estate, yet no application to employ an appraiser had been filed. The Court noted some potential complications from the nature of the Debtor's overlapping business interests and debts and specifically mentioned that the Debtor had said on his Chapter 13 schedules that he individually owned a number of parcels of real estate but had since reported on his Chapter 11 documents that most of the real estate was owned by other entities. The Court also noted that the co-owners of the entities owning the real estate were in a pending Chapter 7 case, complicating any attempt to deal with those entities or the property owned thereby in this **[*10]** case.[4] Attorney Pioletti and the Debtor were admonished that there was quite a bit of progress that needed to be made if they expected to propose and confirm a plan.

Following the status conference, orders were entered granting previously-filed motions to sell the assets in the Debtor's TD Ameritrade account for the purpose of liquidating the collateral of First Federal Savings Bank and to make adequate protection payments to Bank and Trust Company on the note and mortgage securing the Debtor's primary residence. On April 8, 2021, the Debtor filed an application to employ a real estate evaluator. And, on April 13, 2021, the Court entered an order granting the Debtor's application to employ a bookkeeper. The Debtor filed his Chapter 11 ***Subchapter*** V plan on the April 22 deadline.

The proposed plan generally provided for the maintenance of monthly payments on the mortgage debt secured by the Debtor's principal residence, deferred payment of priority tax claims in full, without interest, over the five-year plan term, as well as payment of other secured debts of the Debtor and those of the various business entities under his control that he had personally guaranteed. With respect to income **[*11]** tax claims, the plan first provided that the priority taxes would not be put into a class of claims but then elsewhere put the priority taxes into a separate class identified as being impaired and provided for their payment through the plan by the Trustee. With respect to all but one part of the West Central Bank claim and all of the First Bankers Trust Company claim, the plan provided that the claims would be paid directly by the title holders to the real estate securing the claims. The Debtor proposed to commit all of his disposable income to the payment of unsecured claims but projected that the dividend to unsecured creditors would be 0%.

The plan asserted that nonconsensual confirmation was being sought and that the Debtor would therefore not seek to ballot the plan. No disclosure statement was included, and the plan specifically stated that a disclosure statement would not be prepared unless ordered by the Court. Despite several references to exhibits described as the Debtor's liquidation analysis, projections of cash flow and disposable income, and a proposed amortization schedule, no exhibits were attached to or filed in connection with the plan. Due to the lack of required **[*12]** exhibits and other obvious defects in the plan, the Court set a status hearing on the plan instead of entering its standard scheduling order.

Prior to the hearing, the UST filed an objection to confirmation of the plan based on the lack of financial information included with the plan, citing the Debtor's

[4] The co-owners and co-debtors are Michael and Kara Verchota. The Verchotas, also represented by Attorney Pioletti, first filed a Chapter 7 case (#20-90709) on August 14, 2020. That case was dismissed for failure to comply with court orders regarding the filing of required documents. The Verchotas, again represented by Attorney Pioletti, filed a second Chapter 7 case (# 20-90799) on September 29, 2020, which remains pending.

decision not to prepare a disclosure statement and his failure to include the documents referenced as exhibits to the plan. In addition, the UST pointed out that the Debtor had yet to file any monthly operating reports, making it impossible to determine the Debtor's financial condition and whether the plan was fair and equitable.

At the hearing, the Court agreed with the UST's objection and explained that the complete lack of any meaningful financial information provided in the case made the plan wholly defective. Further, the Court noted that, per the claims filed by the Internal Revenue Service ("IRS") and the Illinois Department of Revenue ("IDOR"), it appeared that the Debtor had not filed tax returns for several tax years.[5] Under the circumstances, the Court explained that there was no way the plan could be confirmed and was therefore reluctant to even process the document.

Attorney **[*13]** Pioletti said that he had hoped to file the referenced attachments shortly after filing the plan but also conceded that, apparently due to some last-minute adjustments and a lack of help from the recently-employed bookkeeper, the documents were still not ready for filing. He also said that the monthly operating reports were "basically" ready to be filed and that the Debtor had filed his outstanding tax returns with the exception of the 2020 returns. Pressed on whether he had the financial information to show that the Debtor would be able to fund his plan, Attorney Pioletti said that the Debtor had prepared a six-month cash flow projection, qualifying his response by noting that the Debtor's property management and rental businesses had essentially no cash flow and that his trucking business, which he expected to fund the plan, was a new venture with very little financial history to rely on. Complicating matters, when asked how soon he could get the plan attachments filed, Attorney Pioletti admitted that could not suggest a date with any certainty because the Debtor was scheduled to receive a heart and kidney transplant in the near future.

As to the Debtor's assertion in the plan that **[*14]** he did not intend to send ballots for voting because he would be seeking confirmation under the cramdown provisions of *§ 1191(b)*, Attorney Pioletti provided no explanation or rationale for the decision. The Court acknowledged that ***Subchapter*** V case law was developing but expressed concern about why the Debtor would not at least try to obtain consensual confirmation before resorting to nonconsensual cramdown. The Court also noted that the initial status report filed by the Debtor suggested that no efforts were made to obtain a consensus among creditors and appeared to be copied from a report Trustee Bourne had filed on behalf of a debtor he represented in a different case, begging the question of whether the time and attention necessary to secure confirmation was being put forth.[6] The Court also expressed concern that the Debtor had filed an incomplete plan, lacking required information and exhibits, in an effort to appear to have met the statutory deadline. The Court explained that it could have stricken the incomplete plan, thereby putting the Debtor in the position of having to seek an extension of time to file a plan based on excusable neglect. Although the plan was not stricken, the Court **[*15]** questioned whether the Debtor had really met his statutory deadline. Nevertheless, the matter was set for a further status hearing on May 20, 2021, to see what progress could be made and with the express expectation that, before that date, the Debtor would prepare and file or otherwise provide all necessary financial information to satisfy confirmation standards.

The day before the continued hearing date, the Debtor filed several documents. He filed objections to the tax claims of the IRS and IDOR, asserting that all returns had been filed. The Debtor also filed three exhibits described

[5] The IRS filed a claim on January 11, 2021, for $38,801.84, identifying $23,682.87 of that amount as a priority claim. Taxes due for 2017, 2018, and 2019 were described as estimates because returns had not been filed. IDOR filed a claim on March 16, 2021, for $2084.43, asserting that $1883.67 was entitled to priority. IDOR also reported that returns for 2018 and 2019 had not been filed and that amounts due for those years were "Unknown."

[6] Because of its concern about the lack of effort being made in the case to obtain consensual confirmation, the Court undertook a review of other Chapter 11 ***Subchapter*** V cases filed in the District, including cases assigned to another judge. The Court was curious about how the ***Subchapter*** V practice was developing and what information attorneys were providing in their 60-day status reports. As part of that review, the Court happened upon the case of *Midwest M&D Servs., Inc.* (#20-81102), a case in which Trustee Bourne represented the debtor. The 60-day status report filed there was equally as bare-bones as the report filed in this case and contained the same reference to *§ 1181(b)* instead of *§ 1191(b)*, causing the Court to conclude that Attorney Pioletti had copied from Trustee Bourne. To be clear, there is nothing wrong with an attorney looking at documents filed by other attorneys in similar cases to get an idea of how documents should be drafted. The problem for Attorney Pioletti was in copying the citation to *§ 1181(b)* without looking it up and realizing that it was an error. This Court has suggested several times that the document filed herein was copied; neither Attorney Pioletti nor Trustee Bourne have denied that suggestion.

as his liquidation analysis, income and expense projections, and plan disbursement projections. Monthly operating reports for January, February, and March 2021 were also filed. Those reports did not include related-entity reports.

The status hearing was held as scheduled. With the filing of the Debtor's various financial documents, Attorney Pioletti said that he believed the plan was ready to be processed and set for hearing on confirmation. Plan confirmation was then scheduled to be heard by video conference on July 26, 2021. The Court entered its standard orders giving notice **[*16]** of the setting and deadlines for sending ballots, voting, and filing objections. The order noted that it was up to the Debtor to decide whether to submit the plan for balloting by creditors. The certificate of service later filed by Attorney Pioletti reported that ballots had not been sent to creditors.

Thereafter, Trustee Bourne filed his first application for compensation seeking $6175 in fees, which was scheduled to be heard at the July 2021 setting on plan confirmation. The IRS and IDOR filed responses to the Debtor's objections to their claims; the objection to the IRS claim became moot due to the filing of an amended claim, but the IDOR claim objection remained unresolved and was added to the July setting. First Bankers Trust Company filed a motion to compel abandonment of the commercial real estate owned by HRL Properties and located in Riverton, Illinois; a buyer for the property had apparently been secured for a price the lender was willing to accept. It also was set for hearing on the July date.

Several objections to plan confirmation were filed. First Federal Savings Bank filed an objection stating that, although the Debtor's TD Ameritrade account had been liquidated and applied **[*17]** toward his outstanding debt, the plan proposed payment of less than half of the outstanding amount secured by citation liens on the Debtor's other assets, including his interest in Louis Trucking and HRL Properties.[7] Trustee Bourne filed an objection questioning the necessity of asserted monthly expenditures in excess of $1500 for "Child Education" and "Child Sports," as well as the necessity of retaining certain unprofitable, encumbered real property. Trustee Bourne also asserted that the plan did not satisfy the liquidation value requirements of the Code because the Debtor had not filed required related-entity reports and had not accounted for the value of transfers of real estate that might be avoided for the benefit of the estate.

The UST filed a second objection to confirmation, noting that the Debtor had not filed the required reports regarding his various business interests and raising other issues. The objection highlighted that the Debtor's recently-filed liquidation analysis failed to include the values of various pieces of real property listed on his schedules or disclosed at his creditors meetings. The UST also noted that the $400 average monthly income from HRL Properties **[*18]** as stated on the Debtor's recently-filed income and expense projections was significantly less than the amounts shown on other documentation previously provided to the UST. The UST also expressed concern about the Debtor's monthly operating reports, which showed inadequate and declining cash flows and repeated bank overdraft charges, as well as allegedly-false assertions about insurance coverage and whether premiums were timely paid. Accordingly, the UST argued, the Debtor's budget was unrealistic and the plan was not feasible.

At the July 2021 hearing on confirmation and other matters, Attorney Pioletti conceded that, based on the objections filed, the plan was not ready for confirmation absent additional information. The Court agreed, noting that many of the objections were well taken and that it still had no idea what income the Debtor actually had, where it was coming from, or how the plan would actually be funded. The Court noted that the few monthly reports that had been filed provided limited information about what was really being spent by the Debtor and showed that his cash flow was so tight that, in some months, he did not pay his mortgage or utility bills. The Court asked **[*19]** about the treatment of West Central Bank and First Bankers Trust Company and whether the Debtor really was proposing that they would be paid by the title holders to the secured properties when it appeared that many of the properties subject to their liens were in foreclosure or being disposed of through short sales. The Court also noted that the liquidation analysis filed in May failed to account for the Debtor's $15,000 homestead exemption when determining the value of the second priority judgment lien of First Federal Savings

[7] First Federal Savings Bank obtained a judgment against the Debtor pre-petition. It recorded a memorandum of judgment that created a lien on the Debtor's residence. It also served a citation to discover assets, an Illinois collection remedy, that created a lien on all of the Debtor's non-exempt personal property. *See* 735 ILCS 5/2-1402(m). One of the Debtor's primary goals in this case was to save his home by avoiding the judgment lien on his residence in part and by paying the secured value of First Federal Savings Bank's claim through his plan.

Bank on the Debtor's residence—a serious mistake not raised by the UST or Trustee Bourne. The liquidation analysis also failed to provide a value for the Debtor's interest in Louis Trucking and other assets upon which First Federal Savings Bank had a lien.

Attorney Pioletti admitted that he had made a mistake in his liquidation calculations but was adamant that, despite the issues with the Debtor's financial reporting, the income of Louis Trucking would, in time, prove to be sufficient to fund the plan. He also pointed out that a recently-filed monthly report for June showed $10,000 in additional income, although he also admitted that the funds came from a Go **[*20]** Fund Me solicitation made on behalf of the Debtor to cover his medical bills. Rather than file an amended plan, Attorney Pioletti asked for additional time to supplement the information already provided. The objecting parties reiterated their concerns about the plan and where the case was headed.

First Bankers Trust Company was heard on its motion to compel abandonment, and the motion was allowed without objection. The IDOR claim objection was also discussed, and the attorney for IDOR said that the Debtor's returns had not been processed and that the matter was therefore not yet ripe for resolution. Finally, the Court addressed Trustee Bourne's first application for compensation and expressed its intention to trace the application with plan confirmation. Trustee Bourne said he would defer to the Court but asked it to consider interim compensation in ***Subchapter*** V cases. The Court set the Trustee's application, along with the plan and unresolved IDOR claim objection, for a continued hearing on August 24, 2021. Before concluding the hearing, the Court expressed its expectation that the Debtor would provide complete and adequate information to support plan confirmation by the continued **[*21]** hearing date.

Several days before the August hearing date, the Debtor filed amended income and expense projections and an amended liquidation analysis accounting for the Debtor's $15,000 homestead exemption and valuing his previously-unaccounted-for interest in assets subject to First Federal Savings Bank's citation liens. He also filed his July monthly operating report, as well as a profit and loss statement and an exhibit purporting to show the Debtor's actual income and expenses for the period covering April 2021 through July 2021.

The first matter taken up at the August hearing was the pending objection to the IDOR claim. Mr. Pioletti reported that there was some confusion about whether the Debtor's state tax returns were ever actually filed and that he had just sent signed copies of the returns directly to the attorney for IDOR earlier that morning. As such, the claim objection was not ready to be resolved, but the attorney for IDOR appeared and said that he could process the returns within fourteen days. As to the Debtor's plan, Attorney Pioletti said he was ready to proceed toward confirmation. The UST's attorney said he still had reservations about the feasibility of the plan **[*22]** but would not stand in the way of confirmation. Trustee Bourne said he also still had some reservations but, based on the recent filings of the Debtor, believed that the Debtor should be given a chance and recommended confirmation of the plan. Despite the Court having continued concerns about significant deficiencies, because no interested parties sought to prosecute their objections, it said it would confirm the plan as filed. But, as the IDOR claim objection had still not been resolved and would inevitably impact the plan terms, both matters were set for further status a few weeks later. Trustee Bourne's fee application was continued with the other pending matters, and the Court informed both Trustee Bourne and Attorney Pioletti that they should file final applications for compensation, all of which would be taken under advisement together after confirmation—any lack of objection notwithstanding—so that the Court could take a close look at everything that had occurred in what it said was becoming an increasingly troubling case.

On September 12, 2021, Attorney Pioletti filed his First Application for Interim Attorney Fees and Reimbursed Costs of Counsel to Debtor, seeking an award **[*23]** of $7112.50 in fees and no reimbursement of costs. The application asserted $200 in fees incurred—less than one hour of time—for preparing the Debtor's amended schedules in the converted case, $450 incurred resolving disputed claims and filing motions to sell the assets of the Debtor's TD Ameritrade account and for authority to make adequate protection payments on the Debtor's home mortgage debt, $4075—more than sixteen hours—incurred for cooperating with and providing documentation to the UST and participating in several creditors meetings, $1787.50—more than seven hours—incurred drafting and filing a plan and facilitating confirmation, and $600 incurred securing employment and compensation for himself and other professionals.

On September 14, 2021—the day of the continued hearing on plan confirmation—Trustee Bourne filed as correspondence a five-page draft of a proposed confirmation order that included several new provisions and materially altered the terms of the initial plan. The proposed order made specific findings that the Debtor had complied with all applicable Code requirements and that the plan was filed in good faith, did not discriminate, was fair and equitable, provided **[*24]** for payment to impaired creditors in excess of the value that would be received through liquidation, and, among other things, was feasible and not likely to be followed by liquidation or a need for further reorganization. The proposed order also provided for a discharge of the debts owed to West Central Bank and First Bankers Trust Company even though the plan terms provided that the debts would be paid by the title holders—apparently under the original contract terms that would have extended past the plan term.

At the hearing, the Court first disposed of the pending objection to IDOR's claim, noting that an amended claim had been filed by IDOR and that the objection to the original claim was therefore moot. Moving next to plan confirmation, the Court reiterated its intent to confirm the plan that was filed but said that it would not sign the proposed order submitted by Trustee Bourne or any order like it because it included findings and assertions that were simply not true and added provisions that should have been included in the plan in the first place.[8] The Court offered three options: it could confirm the plan as filed, without incorporating the provisions of the proposed order; **[*25]** it could give the Debtor an opportunity to file an amended plan incorporating the additional provisions set forth in the proposed order, subject to the Debtor putting in the work necessary to justify any factual findings to be made regarding his satisfaction of Code requirements; or it could give the Debtor an opportunity to prove up confirmation by showing that the documents already on file supported the findings included in the proposed order. The Debtor ultimately elected to proceed with filing an amended plan and to seek consensual confirmation of the amended plan through balloting. An order was entered denying confirmation of the original plan and granting the Debtor until October 12, 2021, to file a first amended plan.

Following the hearing, Trustee Bourne filed correspondence directed to the Clerk of Court complaining that the Court had concluded the hearing without addressing his application for compensation that was being traced with plan confirmation. He stated that the application had been pending for three months and that no party in interest had filed an objection. He asked that an order be entered granting the relief requested in his application.[9]

The Court entered an order **[*26]** inviting Trustee Bourne to supplement his first application for compensation before an objection date was set and the matter taken under advisement. The Court noted that the application was being traced for confirmation and had not therefore been noticed for objections but also that the application lacked the detailed information required for the Court to conclude that the services rendered were reasonable, actual, and necessary. As such, Trustee Bourne was given an opportunity to supplement the filing before it would be fully processed and decided. Specifically, the Court asked that Trustee Bourne address his efforts to "facilitate the development of a consensual plan of reorganization" consistent with his obligations under *§ 1183(b)(7)*, his role in the Debtor's decision to forego a consensual plan early on, and how he proposed to pay himself in relation to other claims to be paid in the case. The order suggested that the Debtor might benefit by proposing the payment of priority tax claims in full as of the date of confirmation and that it appeared that Trustee Bourne was holding enough funds to make such payments. The order also noted that no one involved in the case had yet been paid—Trustee **[*27]** Bourne was not alone. Trustee Bourne then filed a motion to withdraw his application for compensation without prejudice on the basis that the Debtor was working toward a consensual amended plan that would also account for the Trustee's compensation, making consideration of his pending application unnecessary. The motion to withdraw was allowed.

The Debtor filed his amended plan on October 4, 2021. The amended plan provided for payment of

[8] The fact that many of the participating creditors had apparently approved the order was not sufficient to gain the Court's approval. The Debtor's original plan was not balloted, and creditors not present or not represented in the case could not be presumed to approve an order they had not seen and that materially changed the terms of the plan. Further, if all creditors really were in agreement, as represented by Trustee Bourne, then consensual confirmation was within reach and the Trustee had a fiduciary duty to recommend and support efforts to obtain such a confirmation. Having everyone consent to a nonconsensual confirmation made little sense and did not appear to be in the best of interest of the Debtor. The Court is not aware of any circumstance under which an unballoted cramdown plan could be modified by agreement and confirmed consensually under *§ 1191(a)* without proper notice.

[9] It is not clear why Trustee Bourne sent a letter to the Clerk to complain about the Court. The Clerk is the keeper of records and provides day-to-day operational support necessary for the Court to function. The Clerk does not play any role, however, in the substantive decision-making of the Court. Generally, if an attorney wants an order or some action from the Court, a motion is required. *Fed. R. Bankr. P. 9013*.

administrative expenses, including the Trustee's and other professionals' fees, in full upon confirmation with the exception that the Debtor's attorney's fees would be paid after confirmation in installments. It recited Trustee Bourne's agreement to cap his fees at $10,000 if confirmed. In addition, although the amended plan continued to separately classify priority tax claims, it identified such claims as unimpaired and provided for payment of those claims in full within fourteen days of confirmation. The plan still provided that West Central Bank and First Bankers Trust Company would be paid by the title holders to the secured properties but specifically provided for the discharge of the Debtor as to his personal guarantees on the debts. Referenced **[*28]** exhibits were attached to the amended plan. The Court entered its standard order setting deadlines and procedures for balloting, voting, and objections, and scheduling the hearing on confirmation for November 18, 2021.

The UST filed an objection to confirmation of the amended plan raising concerns about feasibility. The objection asserted that, based on the information provided, the Debtor's actual income in excess of expenses had never met his projections without significant outside assistance in the form of gifts or donations. Further, the Debtor was still behind in his filing of monthly operating reports, and the amended plan language remained cryptic as to the payment schedule for administrative expenses. Compounding matters, the amended plan did not provide appropriate remedies to protect creditors if and when plan payments were not made.

Prior to the hearing on confirmation, the Debtor filed monthly operating reports for August and September 2021, as well as a report on balloting that showed unanimous acceptance among impaired classes of claims. Trustee Bourne filed a confirmation report highlighting the support of creditors evidenced by the ballot report and touting his own efforts **[*29]** to facilitate consent through communication with interested parties. He asserted that the Debtor's projected disposable income was therefore not an issue but that, to the extent necessary, the Debtor had satisfied all disposable income requirements. The Trustee informed the Court that the Debtor had made preconfirmation payments totaling $10,000, which would be used to pay administrative expense priority claims first, suggesting that payment of priority tax claims could be detailed in the confirmation order. He acknowledged that the Debtor's financial reporting in the case had not been ideal but contended that better reporting could have only been obtained through retention of more professionals and at great expense to the estate. Because the Debtor made the proposed preconfirmation payments, the Trustee supported giving the Debtor the benefit of any doubt that he would be able to complete the plan.

At the November 2021 hearing on the amended plan, the Court noted the UST's objection as to plan feasibility; the UST's attorney acknowledged the filing of the missing monthly operating reports cited in the objection but said he had not had time to review them and was not prepared to withdraw **[*30]** the objection. As such, the amended plan was set for evidentiary hearing on the issue of feasibility subject to the UST's objection being resolved before then.

The Debtor later filed his monthly operating report for October 2021, and the UST moved to withdraw her objection to the amended plan having concluded that the monthly operating reports filed since the objection showed sufficient reserve funds to pay administrative claims and other costs and sufficient cash flow to satisfy the UST's concerns. The UST's motion was granted, but the hearing, scheduled for December 15, 2021, remained set to address remaining details and issues related to confirmation.

At the December hearing, with the only objection having been resolved, the Debtor asked that his amended plan be confirmed. The Court stated it would confirm the amended plan and directed Attorney Pioletti to submit the confirmation order with the signed approval of the UST and Trustee Bourne. Attorney Pioletti was also instructed to include a provision for the filing of professional fee applications within thirty days of confirmation, which would be taken under advisement after an objection period. Trustee Bourne raised two other issues **[*31]** at the hearing: he noted a discrepancy in the amended plan as to the amount of West Central Bank's claim, which he suggested could be resolved in the confirmation order, and he noted that the Debtor had not completed a financial management course, which was a prerequisite to discharge that could hold up entry of the confirmation order through which the Debtor would be granted his discharge.

Trustee Bourne, rather than Attorney Pioletti, subsequently submitted a proposed confirmation order. A notice of order deficiency was issued explaining that the proposed order was deficient and would not be signed. The notice explained that the proposed order contained provisions for the treatment of creditors not included in the plan and not otherwise specifically authorized at the December hearing. The proposed order also gave only fourteen days for the filing of fee applications as opposed to the thirty days granted by the Court at the December hearing. Finally, the notice reminded the Debtor that he had not filed a certificate of completion of a financial management course and that a confirmation order granting him a discharge could not be entered until such certificate was filed. The Debtor **[*32]** filed his certificate of completion of a financial management course on January 18, 2022, and, on January 19, 2022, an order confirming the Debtor's first amended Chapter 11 plan was finally entered.

Trustee Bourne timely filed his Final Application for Allowance of ***Subchapter*** V Trustee Compensation seeking an award of $10,000 in fees and no expense reimbursement. The application asserts $13,175 in fees actually incurred over 52.7 hours, which he broke down into ten categories. The bulk of the asserted charges fell into one of a few categories relating to plan confirmation, namely $3650 for time spent on "plan confirmation issues" and $3575 for the Trustee's efforts to "facilitate consent plan." Much of the time billed in those categories, as well as others, appeared to be spent reviewing docket entries and filings and attending hearings and proceedings. Other charges covered email communications with and the drafting and circulation of proposed orders amongst counsel for the Debtor, UST, and other interested parties.

Attorney Pioletti did not file a second fee application. After the deadline to file fee applications passed, objection date notices were issued as to the pending fee applications **[*33]** of Trustee Bourne and Attorney Pioletti. No objections were filed. The Court then took the matters under advisement, and they are now ready for decision.

II. Jurisdiction

This Court has jurisdiction over the issues before it pursuant to *28 U.S.C. § 1334*. All bankruptcy cases and proceedings filed in the Central District of Illinois have been referred to the bankruptcy judges. CDIL-Bankr. LR 4.1; *see 28 U.S.C. § 157(a)*. ***HN1***[ ] Matters involving the administration of the estate, the allowance of claims against the estate, and the adjustment of the debtor-creditor relationship are core proceedings. *28 U.S.C. § 157(b)(2)(A)*, *(B)*, *(O)*. These matters arise from the Debtor's bankruptcy itself and from the provisions of the Bankruptcy Code and may therefore be constitutionally decided by a bankruptcy judge. *See Stern v. Marshall, 564 U.S. 462, 499, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011)*.

III. Legal Analysis

Attorney Pioletti and Trustee Bourne both seek compensation under *11 U.S.C. §330*. ***HN2***[ ] That section "provides the statutory authority for awarding compensation for the services and reimbursement for the expenses of properly employed professionals." *In re Gvazdinskas, 2010 Bankr. LEXIS 935, 2010 WL 1433308, at *2 (Bankr. C.D. Ill. Apr. 8, 2010)* (citing *11 U.S.C. §330*). Attorney Pioletti's employment as the Debtor's counsel was approved on March 24, 2021, laying the foundation for his request for compensation under *§330*. Trustee Bourne is not a standing trustee; he was appointed **[*34]** as a disinterested person to serve in this case by the UST and therefore, it seems, may also seek compensation under *§330*. *See 11 U.S.C. §§326(b)*, *330(a)*, *1183(a)*; *In re Tri-State Roofing, 2020 Bankr. LEXIS 3405, 2020 WL 7345741, at *1-3 (Bankr. D. Idaho Dec. 7, 2020)* (concluding that ***Subchapter*** V trustee compensation under *§330(a)* was neither barred nor capped by *§326(b)*).[10]

[10] *Tri-State Roofing* analyzed an apparent discrepancy in *§326* regarding limitations on trustee compensation. *Subsection (a)*, which sets limits on Chapter 11 trustee compensation based on disbursements made, explicitly does not apply in ***Subchapter*** V cases. *See 11 U.S.C. §326(a)*. *Subsection (b)* clearly applies to ***Subchapter*** V cases, specifically barring compensation for the UST or a standing trustee appointed under *§586(b)*. *See 11 U.S.C. §326(b)*. But the second half of that provision, which provides for compensation under *§330* for trustees appointed under *§§1202(a)* and *1302(a)* subject to a cap of five percent of all plan payments, makes no reference to trustees appointed in the context of Chapter 11 or ***Subchapter*** V or under the provisions thereof. *See id.* The court in *Tri-State Roofing* suspected that the omission may have been the result of a legislative drafting error but ultimately concluded that the language of the statute could be enforced as written, neither precluding nor capping compensation of a ***Subchapter*** V trustee under *§330(a)*. In this case, Trustee Bourne made it apparent in his verified statement accepting appointment as trustee in the case, as well as his fee applications, that he would be seeking compensation pursuant to *§330*. No objections were raised as to his appointment or request for compensation, and it is worth noting that the UST's position, as stated in its Program Policy and Practices Manual, is consistent with the holding of *Tri-State Roofing* that compensation may be awarded to case-by-case trustees under *§330(a)* without limitation. *See* United States Trustee Program Policy and Practices Manual, Vol. 3:

HN3[] Generally, a court may award professionals, including attorneys and trustees, "reasonable compensation for actual, necessary services rendered" and reimbursement of actual and necessary expenses. 11 U.S.C. §330(a)(1)(A)-(B). In order for compensation to be awarded, a fee application must be "filed with the court which details the work done and expenses advanced for which compensation is sought." In re Vancil Contracting, Inc., 2008 Bankr. LEXIS 185, 2008 WL 207533, at *2 (Bankr. C.D. Ill. Jan. 25, 2008); *see* Fed. R. Bankr. P. 2016(a). The applicant bears the ultimate burden of proving entitlement to the fees asserted in its application. In re Earl Gaudio & Son, Inc., 2019 Bankr. LEXIS 976, 2019 WL 1429978, at *9 (Bankr. C.D. Ill. Mar. 29, 2019) (citations omitted).

HN4[] Regardless of whether interested parties object to awarding compensation, the court has an independent duty to examine the reasonableness of fee requests. *Id.* (quoting Vancil Contracting, 2008 Bankr. LEXIS 185, 2008 WL 207533, at *2); *see also* Gvazdinskas, 2010 Bankr. LEXIS 935, 2010 WL 1433308, at *2 (collecting cases). To that end, §330 further provides that "the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including" but not limited to the time spent, the rates charges, and "whether the services were **[*35]** necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of," the case. 11 U.S.C. §330(a)(3). Services that the court determines were not reasonably likely to benefit the estate or were not necessary to the administration of the case are not compensable. 11 U.S.C. §330(a)(4)(A)(ii).

HN5[] Fee applications "must provide sufficient information for a court to understand what services were actually provided and to determine whether the fees requested are reasonable and the services rendered were necessary and beneficial." Gvazdinskas, 2010 Bankr. LEXIS 935, 2010 WL 1433308, at *2. It is therefore imperative that they include not only a detailed statement of each service performed, the time expended, and the compensation sought but also a narrative explaining the necessity of those services. *Id.* Such "detailed applications establish the 'actual,' while an accompanying narrative explanation of the 'how' and 'why' establishes the 'necessary.'" In re Wildman, 72 B.R. 700, 707 (Bankr. N.D. Ill. 1987). The narrative portion of a fee application provides the opportunity for a professional to establish that the work done was necessary and beneficial to the estate. Simply providing details of the time spent and the task completed is often insufficient to make the case that the time should be compensated. **[*36]** Courts are not required to scour the record to find justification for awarding compensation where the applicant has not endeavored to do so. Earl Gaudio & Son, 2019 Bankr. LEXIS 976, 2019 WL 1429978, at *9 (citations omitted).

Both fee applications here will be approved in full. Confirmation of a consensual Chapter 11 ***Subchapter*** V plan was achieved, and as a result, the Debtor has been granted his discharge and will have an opportunity at a fresh start. But it was a long haul getting there, complicated by problems that could have been easily curtailed or avoided altogether if both Attorney Pioletti and Trustee Bourne had been more attentive to their duties. The purpose of adding the ***Subchapter*** V provisions to the Code was to streamline the Chapter 11 process and make relief more accessible and cost-effective for small business debtors. *See* In re MCM Natural Stone, Inc., 2022 Bankr. LEXIS 987, 2022 WL 1074065, at *1 (Bankr. W.D.N.Y. Apr. 8, 2022) (citations omitted). "***Subchapter*** V by its very nature is intended to be an expedited process." In re Wetter, 620 B.R. 243, 251 (Bankr. W.D. Va. 2020) (citing In re Seven Stars on the Hudson Corp., 618 B.R. 333, 346 (Bankr. S.D. Fla. 2020)). That is not what occurred here. Rather, it took the better part of a year and significant expense to confirm a plan in what was essentially a "save-the-house" case.

To some degree, the issues in this case could be attributed to a lack of experience—***Subchapter*** V is a relatively new creature of the Bankruptcy **[*37]** Code, and this case was Attorney Pioletti's first foray into the Chapter 11 practice area and, to the Court's knowledge, Trustee Bourne's first appointment as trustee. But many of the problems here were the result of perfunctory efforts made in haste and, at times, cavalier attitudes. Because the Court has serious concerns about this case setting the bar for handling ***Subchapter*** V cases going forward and the impact it might have in pricing such cases out of the market in Central Illinois, each applicant's request and their involvement in the case will be discussed in detail.

Chapter 11 Case Administration, §3-17.15.2, p. 206. Under the circumstances, the Court will not engage in protracted analysis of the application of §326 to ***Subchapter*** V cases. It suffices to recognize the potential issue created by the amendments made by the ***Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079***.

A. Attorney Pioletti's Fee Application

This case started as one under Chapter 13. It was filed on the heels of the dismissal of a prior Chapter 13 case that was problematic for several reasons, including that the Debtor's debts exceeded the statutory debt limits and that he had not filed tax returns for several years. Despite Attorney Pioletti's contention that such issues had been resolved in the nine days between the dismissal of the first case and the filing of the second case, the problems persisted and stymied the Debtor's ability to obtain relief in the second filing. In the hurried effort to refile the Debtor's **[*38]** Chapter 13 case and extend the automatic stay, Attorney Pioletti did not initially file the Debtor's schedules and other required documents, which, once prepared and filed two weeks later, reprised concerns about the Debtor's eligibility for Chapter 13 relief. Conversion to Chapter 11 ***Subchapter*** V allowed the Debtor to sidestep the issues in the short term. But as the Court mentioned at the time, Attorney Pioletti's lack of experience in Chapter 11 matters needed to be offset by diligence and hard work if he expected the Chapter 11 to be more successful than the Debtor's two Chapter 13 efforts. Unfortunately, Attorney Pioletti appears to have not put in the effort necessary to meet the challenge.

The Debtor struggled to file required documents, and those that he did file were severely lacking in worthwhile detail. For instance, his status report, filed in anticipation of the 60-day case status conference was apparently copied from a document filed by Trustee Bourne in another case, contained only a few cryptic statements about determining the liquidation value of his home and negotiating the retention of real property, and did not even address the sole statutory directive to detail **[*39]** the efforts he had undertaken and would undertake to attain a consensual plan of reorganization. *See* *11 U.S.C. §1188(c)*.

The Court and attorney for the UST expressed concerns at the status conference about the lack of financial information provided and general lack of progress in the case. Attorney Pioletti, in turn, made assurances that the needed information would be forthcoming and that a confirmable plan would be filed by the 90-day deadline. Attorney Pioletti's time records indicate, however, that, at the time of the status conference, he had engaged in one phone call with Trustee Bourne about the plan but otherwise had not expended any time on plan development. His time records show that he began work on the plan two days before it was due and spent only about two hours drafting and refining the document.

When the plan was filed, the Debtor had still not provided all required information, and the plan itself was so defective that it could not be processed. Attorney Pioletti elected not to include a disclosure statement with the plan but also failed to include the sort of financial information that would have allowed interested parties to make an informed judgment about it. The plan made reference **[*40]** to several exhibits, but no such exhibits were attached or otherwise provided. Over the next several months, financial disclosures and outstanding documents slowly trickled in, but many of the Debtor's filings raised serious additional concerns about feasibility rather than answering outstanding questions or supporting confirmation.

In hindsight, it is obvious that Attorney Pioletti was not prepared to represent the Debtor in this Chapter 11 case. Chapter 11 imposes fiduciary duties on debtors and their attorneys unlike the duties of Chapter 13 debtors with which Attorney Pioletti is familiar. *In re Ryan 1000, LLC, 631 B.R. 722, 738 (Bankr. E.D. Wis. 2021)* (citations omitted). Likewise, Chapter 11 imposes administrative tasks on debtors and their attorneys such as preparing and filing monthly operating reports and producing other financial information not typically required in the consumer cases regularly handled by Attorney Pioletti. *Id.* To competently represent a debtor in Chapter 11, an attorney must have specialized knowledge and expertise. And although "every Chapter 11 lawyer of course must have a 'first case,' courts expect attorneys to approach such cases with diligent Code compliance, attention to detail, timely completion of required **[*41]** tasks, and most likely, under the guidance of more experienced counsel." *Id. at 739*.

Attorney Pioletti's application for compensation and attached time records show a lack of diligence and little attention to detail. Not one time entry suggests that Attorney Pioletti did any basic research on Chapter 11, an area in which he was admittedly a novice, and, even more troubling, not one time entry suggests he did any research into the provisions of the new ***Subchapter*** V that he had elected for the Debtor. It seems unlikely that Attorney Pioletti fully understood the implications of bypassing consensual confirmation of a plan; his time records do not show that he researched the issues or that he talked at any length to Trustee Bourne, the attorney for the UST, creditors' attorneys, or anyone else—including the Debtor—about the issues before filing the initial plan.

Subchapter V was added to Chapter 11 to help small businesses reorganize efficiently. Many of the provisions of Chapter 11 that can impede reorganization efforts do not apply in these small business cases. *See* 11 U.S.C. §1181(a). Further if a debtor complies with all confirmation requirements and obtains what is now commonly referred to as consensual confirmation **[*42]** of a ***Subchapter*** V plan, the debtor receives a discharge at that time and property acquired after filing, with some limited exceptions, does not become property of the estate. 11 U.S.C. §§1186, 1191(a), 1192. Also, if a debtor obtains consensual plan confirmation, the trustee is discharged upon substantial consummation of the plan, saving the debtor the on-going cost of paying the trustee. *See* 11 U.S.C. §1183(c)(1). The benefits of obtaining ***Subchapter*** V consensual confirmation are significant and should have been known to Attorney Pioletti when he sought conversion. Again, unfortunately, it does not appear that he fully grasped the importance to his client of at least trying to obtain consensual confirmation.

Attorney Pioletti's application for compensation includes a breakdown of the time entries into project categories, but the narratives for each category are perfunctory and contain little helpful information. One project category is for "Discharge Matters" and shows that Attorney Pioletti spent no time on the issue. His narrative says no adversary proceedings were filed, and that is true; no one objected to the Debtor's discharge or sought to except a debt from his discharge. But helping the Debtor obtain a discharge was an important **[*43]** responsibility of Attorney Pioletti's and one that he ignored in first seeking nonconsensual plan confirmation. 11 U.S.C. §§1141(d)(5), 1181(a), 1192. The Debtor ultimately received a discharge with the entry of the consensual confirmation order, but that occurred only because the Court pushed Attorney Pioletti on the issue and refused to confirm the initial plan with the order proposed by Trustee Bourne.

Here, the Debtor has serious health problems and is starting a new business that he and Attorney Pioletti insist will grow and produce significant revenue. Getting a discharge on the front end rather than five years down the road would seem to provide obvious advantages to the Debtor that Attorney Pioletti was ready to sacrifice for no apparent reason other than that he did not research the issue. Even a fairly modest amount of research should have alerted Attorney Pioletti to the difference in the timing of the issuance of a discharge between ***Subchapter*** V debtors who obtain consensual confirmation of their plans and those who do not.[11] Attorney Pioletti never explained at any of the hearings or in his fee application why he chose to not even try to obtain consensual confirmation of the Debtor's initial plan. That failure **[*44]** is emblematic of Attorney Pioletti's lack of attention to detail and his failure to develop the necessary expertise to represent the Debtor here.[12]

The tax issues reportedly cured between the filing of Chapter 13 cases also became an obstacle in the converted case. The IRS filed a significant estimated priority claim based on several years of unfiled returns, and IDOR filed a priority claim noting unfiled tax returns and taxes due in unknown amounts. Despite claiming to have filed the missing returns between bankruptcy cases—well before the IRS and IDOR claims were filed—Attorney Pioletti did not object to the claims before filing

---

[11] If he had researched the issue, Attorney Pioletti might have found the path to an answer a little circuitous but ultimately not that hard to navigate. If he had looked at the discharge provisions for Chapter 11, he would have learned that individuals generally do not receive discharges until plan payments are completed. 11 U.S.C. §1141(d)(5)(A). But a key provision of ***Subchapter*** V is §1181(a), which lists the sections of Chapter 11 that do not apply in ***Subchapter*** V cases. 11 U.S.C. §1181(a). Section 1181(a) says that §1141(d)(5) does not apply in ***Subchapter*** V cases. Section 1181(c) also refers to special provisions regarding discharges in ***Subchapter*** V and would have led Attorney Pioletti to §1192, a provision that delays discharges for debtors who obtain confirmation of nonconsensual plans but does not impact discharges obtained through consensual confirmation. 11 U.S.C. §1192. Similarly, if Attorney Pioletti had researched the issues, he would have seen another key benefit to consensual confirmation related to property of the estate and learned that property acquired post-petition is generally not property of the estate of a ***Subchapter*** V debtor who obtains consensual confirmation. 11 U.S.C. §§1115, 1181(a), 1186.

[12] Attorney Pioletti also potentially exposed the Debtor to not having several large debts included in any discharge he received, regardless of when it was received. In his initial plan, he proposed that the debts owed to West Central Bank and First Bankers Trust Company would be paid by the title holders to the property securing such debts. Those debts were long-term mortgage loans that, by their own terms, were not likely to come due within the five-year plan term and therefore would not have been included in any discharge. 11 U.S.C. §1192(1). The initial plan provisions for these creditors seemed incorrect in many respects because many of the properties were in foreclosure, the co-debtors were in a Chapter 7 bankruptcy, and the entities holding title were operating at a loss. It appears that little thought went into these particular plan provisions. This issue was ultimately resolved favorably for the Debtor in his amended plan, but Attorney Pioletti's initial failure to identify the issue and address it remains troubling.

the Debtor's plan and instead simply proposed payment of the estimated amounts. Although concerns were raised at the April 2021 hearing on the plan, Attorney Pioletti did not file objections to the tax claims until the day before the continued hearing date a month later. The IRS claim was quickly resolved with the filing of an amended claim for half the amount of the original claim and even less asserted as being entitled to priority treatment. But the IDOR claim lingered with confusion about whether and what returns were filed until the matter was finally resolved **[*45]** by the filing of an amended claim several months later.

The lingering tax issues here were particularly frustrating because they were neither surprising nor complex. Attorney Pioletti had identified the tax issues in the Chapter 13 filings and knew that some portion of the IRS and IDOR claims were priority claims. *See* 11 U.S.C. §507(a)(8). And he most certainly knew or should have known that such priority claims would be nondischargeable. *See 11 U.S.C. §523(a)(1)(A)*. What he may not have known but should have researched is how the claims needed to be treated in the Debtor's plan. Attorney Pioletti used a variation of Official Form 425A Plan of Reorganization for Small Business under Chapter 11 in drafting the initial plan, and that document, in the preprinted portions, provides the guidance that "Under section 1123(a)(1) . . . priority tax claims are not in classes." That should have led Attorney Pioletti to §1123(a)(1) for clarification that priority tax claims described under §507(a)(8) are not separately classified and that the holders of such claims do not vote but must be provided for and paid as required by §1129(a)(9). *11 U.S.C. §§507(a)(8)*, *1123(a)(1)*, *1129(a)(9)(C)*; *In re K Lunde, LLC, 513 B.R. 587, 591-92 (Bankr. D. Col. 2014)*; *see also In re New Hope Hardware, LLC, 2020 Bankr. LEXIS 3187, 2020 WL 6588615, at *1-2 (Bankr. N.D. Ga. Sept. 9, 2020)* (***Subchapter*** V consensual confirmation allowed where debtor agreed to pay priority tax claims within five years with interest as required **[*46]** by §1129(a)(9)(C)—failure of priority tax claimants to vote for confirmation was not an issue).

Attorney Pioletti was aware of the tax issues before conversion, and both the IRS and IDOR timely filed claims showing that all returns had not been filed. Attorney Pioletti's time records do not, however, show any efforts to get the returns filed or to communicate with the attorneys for the IRS or IDOR about the filing or refiling of missing returns to expedite resolution of the claims. Only after months of no action did he file claim objections. The objection to the IRS claim prompted the filing of an amended claim that reduced the priority portion of the claim from over $23,000 to less than $3000. The objection to the IDOR claim drew a response indicating that issues still existed with the previously-unfiled returns. Ultimately, months later, IDOR filed an amended claim increasing its priority claim to $5076.38. As the Court cautioned early in the case, having all the returns on file and knowing the amounts of priority tax claims to be paid was necessary to confirm any plan. Attorney Pioletti's failure to hustle on the tax issues certainly delayed confirmation.

Initially, the plan provided for the priority **[*47]** tax claims to be paid over the full five-year term of the plan at the discretion of the Trustee. This provision was also troubling because the priority taxes appeared to be the only nondischargeable debts of the Debtor and getting them paid sooner rather than later would have benefited the Debtor if he were unable to complete his plan. Frustrated with Attorney Pioletti's lack of diligence on this issue and with the Trustee's focus on getting paid immediately and ahead of all other claimants, the Court suggested in an order entered September 16, 2021, that it would be in the Debtor's best interest to pay his priority tax claims in full as of the effective date of any confirmed plan. That provision was included in the amended plan that was consensually confirmed.

Attorney Pioletti's fee application is based on services provided only through September 12, 2021; he did not file a final application seeking compensation for any time thereafter, which would have covered the filing of and confirmation efforts regarding the amended plan that was eventually confirmed. This Court interprets the provisions of Chapter 11 ***Subchapter*** V to require at least some attempt at consensual confirmation for **[*48]** a plan to be put forth in good faith. Indeed, other courts have held that the ***Subchapter*** V provisions contemplate that creditors will vote to accept or reject a proposed plan. *See, e.g., In re Robinson, 632 B.R. 208, 216 (Bankr. D. Kan. 2021)*. Attorney Piolett's failure to explain the initial decision not to ballot remains a concern.

Again, the lack of effort, attention, and follow through in what should have been a fairly straightforward case is frustrating. This case was Attorney Pioletti's opportunity to step up his game and begin to expand his practice to include Chapter 11 cases. That he chose, at virtually every turn, not to make the effort is disappointing. The issues of consensual plan confirmation, discharge, and priority taxes already discussed were not the only problems. Mr. Pioletti's failure to account for the Debtor's homestead exemption and other encumbered property in the liquidation analysis he eventually provided, or the inexplicable delay in his client completing a financial management course that was the final hurdle to confirmation, are other examples of the avoidable problems that dogged this case. Nevertheless, a plan was confirmed, and the Debtor may be able to reorganize.

No objections were filed to Attorney Pioletti's **[*49]** fee application. Attorney Pioletti was employed at a reasonable hourly rate of $250; the compensation requested in his interim application is based on that amount. He did not file a final application. The $7112.50 requested therefore covers only a portion of the time he actually spent on the case. That amount is well within the realm of reasonable compensation for a debtor's attorney in a Chapter 11 ***Subchapter*** V case in which confirmation was achieved. Indeed, if more time had been spent, more fees would have been incurred. Attorney Pioletti could have served the Debtor better throughout the case and appears to have exercised some serious billing discretion to compensate for his mistakes. For that reason, and notwithstanding the many problems in the case, Attorney Pioletti's fee application will be approved, and he will be awarded compensation in the amount of $7112.50. The Debtor may pay the amount as he is able; the Court sets no deadline on the payment of the fees other than the expected five-year completion of the confirmed plan.

B. Trustee Bourne's Fee Application

HN6[] A trustee appointed in a ***Subchapter*** V case serves in a unique role. *In re 218 Jackson LLC, 631 B.R. 937, 946 (Bankr. M.D. Fla. 2021)*. Of course, ***Subchapter*** V trustees have many of **[*50]** the same duties as their counterparts in Chapters 7, 11, 12, and 13. They must account for all property received, examine proofs of claims if a purpose would be served, respond to information requests from parties in interest, and make a final report and accounting on the administration of the estate. *See* *11 U.S.C. §§704(a)(2)*, *(5)*, *(7)*, and *(9)*, *1106(a)(1)*, *1183(b)(1)*, *1202(b)(1)*, *1302(b)(1)*. They are required to appear and be heard at the *§1188* status conference, as well as any hearing concerning the value of encumbered property, plan confirmation or modification, and the sale of estate property. *11 U.S.C. §§1183(b)(3)*, *1202(b)(3)*, *1302(b)(2)*. But it is another duty that sets ***Subchapter*** V trustees apart.

The ***Subchapter*** V trustee's primary duty is to "facilitate the development of a consensual plan of reorganization." *11 U.S.C. §1183(b)(7)*; *In re Ozcelebi, 2022 Bankr. LEXIS 854, 2022 WL 990283, at *7 (Bankr. S.D. Tex. Apr. 1, 2022)*; UST Program Policy and Practices Manual, §3-17.1.1, p. 189 ("A trustee is appointed in every [***Subchapter*** V] case tasked primarily with facilitating a consensual plan."). It is a significant distinction shared by no other trustee in bankruptcy. *218 Jackson, 631 B.R. at 947*. And it makes the ***Subchapter*** V trustee's role more like that of a mediator than other trustees who have traditionally taken on a more adversarial role. *Id.* (citing *Seven Stars on the Hudson, 618 B.R. at 346 n.81*).

As mentioned in the discussion of Attorney Pioletti's fee application, it **[*51]** is clear that a decision was made early on in this case to forego consensual plan confirmation without any apparent attempt at negotiation. And although it was the exclusive right of the Debtor to propose a plan of reorganization, it is evident that Trustee Bourne played some part in how Attorney Pioletti and the Debtor approached the issue given that the Debtor's initial status report expressing his intention to forego consensual confirmation was clearly copied from a document filed by Trustee Bourne as counsel for a debtor in another case. Exactly how much of a part Trustee Bourne played in that decision is not known; he declined the Court's invitation to provide an explanation of his role. His time records, however, reflect little to no effort in facilitating a consensual plan for the first several months of the case.[13]

The lack of effort likely stemmed from a misunderstanding not only by Attorney Pioletti but also by Trustee Bourne of the benefits of consensual confirmation—discharge at confirmation, the exclusion of property acquired post-petition as property of the estate, and termination of a trustee's services and charges upon substantial consummation of the plan. Absent an understanding **[*52]** of the real benefits to the Debtor of pursuing consensual confirmation, both Attorney Pioletti and Trustee Bourne apparently decided early on that pursuing a consensus would not be worth their time and effort and therefore agreed to sacrifice the benefits available to the Debtor. But although the provisions of ***Subchapter*** V do not affirmatively require a debtor to try to attain a consensual confirmation—indeed there are undoubtedly circumstances under which any attempt at obtaining consensual confirmation would be futile—the Debtor's decision in this case to forego that effort from the start was certainly contrary to the spirit of the law. And,

[13] Prior to September 2021, Trustee Bourne had billed more time for reviewing the Debtor's status report that was copied from his own in another case than he had spent on any meaningful effort to facilitate a consensual plan.

as it pertains to the Trustee's role, it was contrary to both the spirit and letter of the law. *See* 11 U.S.C. §1183(b)(7); Ozcelebi, 2022 Bankr. LEXIS 854, 2022 WL 990283, at *7; UST Program Policy and Practices Manual, §3-17.1.1, p. 189.

In his narrative included with his fee application, Trustee Bourne frames the issue as one of futility based on the substantial priority tax claims that the Debtor could not have paid without impairing them; as he said, it was only after amended claims were filed that the possibility opened for a consensual plan. But the tax issues in this case were not overly complicated. And according **[*53]** to Trustee Bourne's own time records, he did not approach the tax claimants about the possibility of a consensual plan until the end of May 2021—well after the original plan was filed and the Court had raised the issues at hearing.[14] The reality, from what the Court can glean from the record, is that the tax issues were not even part of the calculus to forego a consensual plan and that Trustee Bourne did nothing to facilitate consensual confirmation until well into the case and after the Court repeatedly stressed the importance of doing so.

Equally important, Trustee Bourne appears to not be acquainted with the required treatment of priority tax claims in Chapter 11 cases. As set forth above, such claims are not classified and do not vote. 11 U.S.C. §1123(a)(1); K Lunde, 513 B.R. at 591. The Court's repeatedly-expressed concerns about the priority tax claims stemmed from the fact that the amount of such claims had to be known before confirmation to make sure that they would be paid as required. *See* 11 U.S.C. §1129(a)(9); New Hope Hardware, 2020 Bankr. LEXIS 3187, 2020 WL 6588615, at *1-2. The fact that both the IRS and IDOR were showing unfiled returns was an impediment to confirmation and should have been promptly addressed by the Trustee. But the priority tax claimants were never going to vote for or against confirmation, **[*54]** not just because they usually do not vote for or against plan confirmation, but because they were not entitled to vote.[15] 11 U.S.C. §1123(a)(1). Further, the amount of the general unsecured claims held by the IRS and IDOR were always going to be dwarfed by the unsecured portions of the claims of the bank creditors—whether the IRS or IDOR voted their general unsecured claims was of little importance.

If Trustee Bourne advised Attorney Pioletti and the Debtor to forego consensual confirmation based on his belief that the IRS's affirmative vote would be necessary for consensual plan confirmation, he gave them wrong advice. Trustee Bourne claims time for reviewing the initial plan, but that plan said on its face that, pursuant to §1123(a)(1), priority tax claims would not be classified. The plan went on then to classify and impair those same claims. Trustee Bourne should have at least noticed that inconsistency and looked into the required treatment of priority tax claims in Chapter 11 cases. If he had done some research, he would have seen the error in his initial advice.

Trustee Bourne admits that, after amended claims were filed by both the IRS and IDOR, he knew consensual confirmation was in reach. But he still took **[*55]** no action to achieve that result. He prepared an order confirming the initial plan by agreement that would have sacrificed all potential benefits to the Debtor of consensual confirmation and would have kept Trustee Bourne in the case for five years. In his narrative, Trustee Bourne queries whether he had a duty to oppose confirmation of the Debtor's initial plan once he realized a consensual confirmation was achievable. The answer to his query is that he had an absolute duty to work with the Debtor, Attorney Pioletti, and the creditors to try to achieve consensual confirmation of a plan, and at no point during the case was he relieved of that duty. The benefits to the Debtor of consensual confirmation were significant, and it is hard to imagine that the Debtor could have understood those benefits and willingly waived them. Even if Trustee Bourne charged only an hour each month of the five-year plan to account for and process payments, a minimum of $15,000 in additional fees would have been incurred over the term. An hour or two of fees per month may not seem like much to Trustee Bourne, but, for the Debtor with serious health problems and supporting himself in part with Go Fund Me **[*56]** donations, avoiding this additional cost alone more than justified starting over and obtaining

[14] The Trustee's time records also reflect that he did not reach out to other creditors until September 2021—nearly nine months into the case.

[15] Trustee Bourne correctly cites a prior decision from this Court for the proposition that the IRS generally does not vote on plans. *See* In re Sabbun, 556 B.R. 383, 390 (Bankr. C.D. Ill. 2016) (citing Internal Revenue Manual 5.17.10.9.3. https://www.irs.gov/irm/part5/irm_05-017-010 (last visited June 3, 2022)). Importantly, however, Sabbun did not deal with the treatment of priority tax claims and therefore provides no guidance on those issues here. Rather, Sabbun involved the IRS as holder of a large general unsecured claim and dealt with its failure to vote in that capacity, which resulted in no impaired classes voting in favor of the plan and prevented confirmation.

consensual confirmation.

Again, the purpose of ***Subchapter*** V is to streamline the Chapter 11 process and make relief more accessible and cost-effective for small business debtors. *See MCM Natural Stone, 2022 Bankr. LEXIS 987, 2022 WL 1074065, at *1* (citations omitted). Racking up professional fees to be paid from the estate at the expense of other claimants and to the Debtor's detriment is at odds with that purpose. There will, of course, be cases that require the ***Subchapter*** V trustee to take on a more traditional trustee role when a debtor is removed as debtor in possession or there is cause for the trustee to investigate the debtor's financial affairs. *See 11 U.S.C. §§1183(b)(2)* and *(5)*, *1185*. But this was not such a case; rather, this was a case akin to a "save-the-house" Chapter 13 with a few additional wrinkles regarding the Debtor's business interests and related debts that could have been resolved much more quickly.

To be sure, it was not Trustee Bourne's duty to babysit the Debtor and serve as his de facto co-counsel. But the Trustee incurred considerable fees for a lot of nonsubstantive work. Shadowing the Debtor's attorney and the UST's attorney is not helpful or necessary **[*57]** and should not be compensable. Even with the appointment of a ***Subchapter*** V trustee, debtors remain in possession and in control of their own cases. As the statute requires, Trustee Bourne did review claims and other filings in the case, appear and participate at hearings, account for estate property, respond to informational requests, and make objections as he deemed appropriate. And he is entitled to compensation for executing those duties. But he wholly failed at his principal duty, and that is hard to overlook.

In the two months between his appointment and the initial case status conference at which he expressed no concern about the progress being made in the case, Trustee Bourne had already incurred more than $3500 in fees. A good portion of those fees related to familiarizing himself with the case and attending necessary creditor meetings and initial Debtor interview. By the time he had filed his first interim fee application on June 2, 2021, however, that total had grown to more than $6000 despite a wholesale lack of effort on a consensual plan and still no indication that the Debtor would even be able to satisfy the requirements for cramdown confirmation. The trend continued **[*58]** in the months that followed. By the August hearing on plan confirmation at which the Debtor reported that the IDOR claim objection still had not been resolved and the plan was still not ready to be confirmed, Trustee Bourne had incurred $8475 in fees, none of which—save for $100 charged to email the tax claimants about whether they would vote on confirmation—related to facilitating a consensual plan. Over the remaining months of the case, Trustee Bourne racked up significant fees helping the Debtor draft an amended plan, soliciting ballots in favor of the plan even though all creditors had already agreed to the plan terms, drafting confirmation orders, and following up with the Debtor on his statutory obligations.[16]

If $13,000 or even $10,000 in trustee fees becomes routine in uncomplicated ***Subchapter*** V cases, what amount of fees would be expected in more complicated cases where there is a need for more substantive trustee work? The answer is an amount that would make relief under ***Subchapter*** V unavailable to many small business debtors even though it is meant to be more cost-effective and accessible than traditional Chapter 11 relief. If careful attention is not paid to the amount of **[*59]** professional fees accruing in small business cases, there will be fewer and fewer such cases in Central Illinois. The UST appoints the ***Subchapter*** V trustees and has a duty to review and, if appropriate, comment on or object to fee requests by such trustees. *28 U.S.C. §586(a)(3)*. Here, the UST offered no comments on Trustee Bourne's fee request or his serious lapse in not even attempting to fulfill his duty to try to facilitate a consensual plan. The Court's expectation is that, in future cases, the UST will at least comment on such fee requests as contemplated by statute.

Again, the role of the ***Subchapter*** V trustee should not be to push a debtor through his own bankruptcy case or

[16] The time spent drafting confirmation orders is somewhat confounding. After the Court said it would confirm the original plan as filed pending resolution of the tax claim objections, Trustee Bourne spent 3 hours preparing and submitting an agreed confirmation order that included new terms that substantively altered the plan as filed, as well as findings that the Court had not made. He does not include charges for that time in his request now before the Court, but it was time spent all the same. And when the Debtor's amended plan was apparently ripe for confirmation but for a small discrepancy in amount of one claim that was to be addressed in a proposed order from Attorney Pioletti, Trustee Bourne spent 2.5 hours creating a proposed order that again included plan changes that went beyond what was discussed and authorized at hearing. When that proposed order was rejected, he then spent another 1.5 hours drafting and circulating a revised order. The result was $1000 charge to the estate for the Trustee to draft a straightforward confirmation order that he was not asked to prepare.

to do the work a debtor's counsel is hired to do. But trustees cannot incur fees for giving bad advice or sitting back and watching a debtor stumble through Chapter 11. In the end, notwithstanding the initial lack of help from the Trustee, the Debtor here was able to confirm a consensual plan with a late effort by his own attorney and Trustee Bourne. Trustee Bourne has also agreed to limit his fees to $10,000—a reduction of more than $3000. For those reasons, and because there were no objections to the fees, Trustee Bourne's fee **[*60]** application will be approved in full and may be paid from the funds he holds from Debtor payments.

IV. Conclusion

A key goal of ***Subchapter*** V is to provide "distressed small business owners the opportunity to reorganize their businesses more quickly and at a lower cost and allowing creditors to get paid sooner." Clifford J. White III, "Small Business Reorganization Act: Implementation and Trends," XL *ABI Journal* 1, 54 (Jan. 2021). To that end, '[i]mmediately following appointment in a case, ***subchapter*** V trustees begin their primary pre-confirmation task of facilitating the development of consensual reorganization[.]" *Id.* Initial data compiled after almost one full year of ***Subchapter*** V filings suggested that, around the country, the goal was being met. Indeed, plan confirmations were generally achieved within about six months of case filings, 59% of which were reportedly consensual. Hon. Michelle M. Harner, Emily Lamasa and Kimberly Goodwin-Maigetter, "***Subchapter*** V Cases by the Numbers," XL *ABI Journal* 10, 59 (Oct. 2021). Average trustee fees were running about $8200 with the "median award being $5033." *Id.*

Here, the ***Subchapter*** V Trustee apparently agreed with the Debtor's attorney to forego **[*61]** any efforts at obtaining consensual confirmation notwithstanding published guidance to the contrary from the UST Program. Whether the decision was made due to lack of willingness to put in the effort or because of an incorrect belief that the affirmative vote of the IRS on plan confirmation would be required, the failure to even try to obtain consensual confirmation cannot be justified. The UST never raised the issue with the Court and never questioned the decision at any hearing. This resulted in a fairly simple case taking a year to reach confirmation while the Trustee incurred fees significantly higher than the reported national averages. Yet the UST still did not weigh in even to comment or to assure the Court that the published guidance from the Executive Office of the UST is understood and will be followed in future cases. What occurred in this case cannot happen again; the Court expects the UST to step up training and monitoring of ***Subchapter*** V cases and trustees to achieve the goals the statute was enacted to achieve.

Notwithstanding the Court's reservations, the fee applications will be approved.

This Opinion is to serve as Findings of Fact and Conclusions of Law pursuant to **[*62]** Rule 7052 of the Rules of Bankruptcy Procedure.

See written Order.

SIGNED THIS: June 7, 2022

/s/ Mary P. ***Gorman***

Mary P. *Gorman*

United States Bankruptcy Judge

ORDER

For the reasons set forth in an Opinion entered this day,

IT IS HEREBY ORDERED that

1. The First Application for Interim Attorney Fees and Reimbursed Costs of Counsel to Debtor (#170) is approved. Attorney Joseph C. Pioletti is awarded compensation in the amount of $7112.50, which may be paid by the Debtor, Ryan Louis, as he is able over the course of his confirmed plan.

2. The Final Application for Allowance of ***Subchapter*** V Trustee Compensation (#215) is approved. Trustee Sumner A. Bourne is awarded compensation in the amount of $10,000, which may be paid from the funds held on account of the Debtor's bankruptcy estate.

IT IS SO ORDERED.

SIGNED THIS: June 7, 2022

/s/ Mary P. ***Gorman***

Mary P. *Gorman*

United States Bankruptcy Judge

End of Document