Eye on Bankruptcy Course Materials Covering April & May 2015

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

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Supreme Court

Commentary:

The Supreme Court's unanimous Bullard decision held that denial of a confirmation order is not a final order appealable as of right.

The opinion, not surprising in itself, requires greater reliance on motions for interlocutory appeals. I have concern that dicta near the end of the Chief Justice's opinion may lead to mischief.

In holding that that not all contested matters are appealable, he mentioned an order declining to extend time as not appealable. What about a committee's motion to extend time for objecting to validity of a secured claim? Perhaps his statement went too far. Thank goodness it was dicta (or should be but maybe isn't).

Supreme Court Limits Appeals from Denials of Bankruptcy Plans

The U.S. Supreme Court needed only one month to rule unanimously that denial of approval of a bankruptcy plan is not a so-called final order and isn't automatically appealable.

The decision involved an individual in a Chapter 13 debt adjustment proceeding but appears also to govern the ability to appeal when the bankruptcy court refuses to approve a corporate reorganization plan in Chapter 11.

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

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

Chief Justice John G. Roberts, writing for the unanimous court, sided with the majority. He said appealability turns on whether the decision "alters the status quo and fixes the rights and obligations" of the bankrupt. In contrast to approval of a plan, he said that denial of confirmation, so long as the bankrupt can propose another plan, "changes little."

Roberts said that every appeal from denial of confirmation could slow the case a year, causing "delays and inefficiencies." He wanted a rule providing "meaningful constraint on the availability of appellate review."

The U.S. Solicitor General, the government's advocate in the Supreme Court, argued on the side of the bankrupt and wanted the court to make confirmation denial appealable. Roberts didn't go along and rejected the government's contention that any ruling that disposes of a so-called contested matter is appealable.

The Chief Justice said the "concept of finality cannot stretch to cover, for example, an order resolving a disputed request for an extension of time."

Although the Bullard case dealt with a person in Chapter 13, the decision may have its biggest impact in Chapter 11 corporate reorganizations. Roberts' comment, saying that denial of more time can't be appealed automatically, will be cited in later cases when appeals are attempted in the midst of a company's reorganization.

The case is Bullard v. Blue Hills Bank, 14-116, U.S. Supreme Court (Washington).
Published May 4, 2015

Commentary:

Writing for the unanimous Court, Justice Ginsburg held in Harris v. Viegelahn that undistributed wages in possession of a Chapter 13 trustee go to the debtor, not to Chapter 13 creditors. It was conceded that the statute doesn't permit distributing the funds to the Chapter 7 trustee.

Ginsburg's decision, a model of clarity, teases the result out of a statute that doesn't address the issue head on. It is a plain meaning decision without saying so.

At argument, the justices were saying that the statute wasn't helpful. Perhaps to encourage Justices Scalia and Thomas to join, the opinion ends up driving the answer from two statutes and a rule that don't address the issue directly.

The opinion is not pure plain meaning. Ginsburg tried to divine Congressional policy from the statute to end up with a holding consistent with the statute and evident Congressional intent.

U.S. Supreme Court Decides Case in Favor of Bankrupt Consumers

A consumer who made an unsuccessful stab at Chapter 13 is entitled to recover wages that the bankruptcy trustee hadn't distributed to creditors, the U.S. Supreme Court ruled.

The unanimous decision resolves a split among lower courts and softens the blow for consumers who attempt, but fail, to pay some of what they owe creditors.

The case involved a man who initially filed a Chapter 13 petition to save his home from foreclosure. When he couldn't make mortgage payments, he exercised his right to convert the case to a liquidation in Chapter 7.

To keep his property in Chapter 13, the man would have been required to pay a portion of his future wages to creditors over five years before all his debt would have been wiped out. In Chapter 7, the bankrupt's debt is wiped out immediately, at the cost of losing all property not exempt from creditor claims.

At the time of conversion, the Chapter 13 trustee was holding about $5,500 in wages she hadn't distributed to creditors under the Chapter 13 plan.

The bankruptcy court and the district court on a first appeal both ruled that the undistributed wages should go to the bankrupt. The U.S. Court of Appeals in New Orleans reversed in July, concluding that undistributed wages should go to creditors in the Chapter 13 case to avoid handing a windfall to the debtor.

Writing for a unanimous court on May 18, Justice Ruth Bader Ginsburg reversed the New Orleans decision and reached the same conclusion that the U.S. Court of Appeals in Philadelphia came to in 2012.

Ginsburg said Section 348(f) of the Bankruptcy Code doesn't ``expressly'' answer the question. That section says that in a Chapter 13 case converted to Chapter 7, the Chapter 7 trustee gets only ``property of the estate'' at the time of the initial Chapter 13 filing.

The ``most sensible reading'' of Section 348(f) calls for returning wages to the bankrupt, according to Ginsburg.

Ginsburg said Section 348(e) informed the court's ruling. That section terminates the services of the Chapter 13 trustee immediately on conversion to Chapter 7. Among the terminated services is the duty to make distributions to creditors.

The justices also looked to Rule 1019(5)(B)(ii) of the Rules of Bankruptcy Procedure, which lists duties of a Chapter 13 trustee after conversion. Those duties don't include distributions to creditors.

Ginsburg concluded by knocking down the argument that giving the money to the bankrupt would constitute a windfall. She saw no windfall in giving ``a fraction of the wages he earned and would have kept had he filed under Chapter 7 in the first place.''

With the May 18 ruling, the Supreme Court has decided only two of the five bankruptcy cases argued this term. The last three decisions will come down by the end of June.

The case is Harris v. Viegelahn, 14-400, U.S. Supreme Court (Washington).

Published May 18, 2015

Splits

Commentary:

The Ninth Circuit handed down a dubious but well reasoned opinion concluding that an insider can avoid preference liability by waiving an indemnification claim against the debtor. Court are divided on the issue, as was the panel. Expect a motion for rehearing en banc.

Circuit Court Finds Loophole Protecting Insider from Preference

Addressing an issue that has split lower courts, a divided U.S. Court of Appeals in San Francisco ruled that a company executive who waives a right of indemnification has no preference liability if the company pays off a debt the executive guaranteed.

The majority opinion for the three-judge Ninth Circuit was written by U.S. Circuit Judge Ronald Lee Gilman of the appeals court in Cincinnati, who was sitting by designation. Judge Susan P. Graber of the Ninth Circuit dissented.

The president of a company gave a secured lender his personal guarantee and secured the guarantee with his own property. Shortly before bankruptcy, the president directed a customer to pay a $5 million debt to the secured lender, thus decreasing exposure on his personal guarantee.

After bankruptcy, the creditors' committee sued the president for a preference. Ultimately, the bankruptcy court decided that the president had validly waived his indemnification claim at the insistence of the lender.

Because the president therefore was not a creditor, the bankruptcy court dismissed the preference claim because the payment to the lender was not also ``to or for the benefit of a creditor," under Section 547(b)(1) of the Bankruptcy Code. On a first appeal, the district court affirmed.

The case involves the infamous Deprizio opinion in 1989, in which the U.S. Court of Appeals in Chicago ruled that the preference period looks back for one year for a lender if the debt was guaranteed by a company insider.

Congress ``fixed" the Deprizio problem in 1994 by amending the Bankruptcy Code to say that the preference period only goes back the normal three months for a creditor with an insider's guarantee.

Gilman said the lower-court split developed immediately after the 1994 amendments.

One group of courts, he said, follow the text of the statute, and the other finds liability on the part of the insider by saying ``such waivers are simply not valid."

Analyzing the facts to mean that the indemnification waiver was not a sham, Gilman said he was ``not at liberty to depart from the text in favor of a generalized notion of public policy."

Although he said the public-policy argument was ``far from frivolous," Gilman absolved the president of preference liability while observing that the policy issue ``is more properly addressed to Congress."

In dissent, Graber said she would follow every bankruptcy court that decided the issue since 1994 and hold insiders liable ``even if they nominally waived their right to indemnity."

She said ``waivers are invalid for purposes of the Bankruptcy Code because they attempt to defeat the one-year look-back period via contract."

The case is Stahl v. Simon (In re Adamson Apparel Inc.), 12-57059, 2002 BL 25227, U.S. Ninth Circuit Court of Appeals (San Francisco).
Published May 7, 2015

Commentary:

The Ninth Circuit is creating a split of circuits by holding that a claim based on former stock ownership is always subordinated under Section 510. Lower courts in New York and Delaware held otherwise.

Split Develops on Subordination of Claims from Stock Redemption

Courts are split on whether a judgment based on former stock ownership is a claim automatically subordinated under Section 510(b) of the Bankruptcy Code.

Differing with lower courts in Delaware and New York, the U.S. Circuit Court of Appeals in San Francisco decided on April 2 that any claim "arising from" stock ownership is automatically subordinated.

A woman had been a shareholder in a privately-held company. She exercised her right to withdraw and got an arbitrator's award that the stock was worth $415,000. The award was converted to judgment in state court before the company filed bankruptcy.

The bankruptcy court and the appellate panel both concluded that the judgment was subordinated. Section 510(b) says that a "claim arising from" the "purchase or sale of a security" is subordinated to all claims of equal or senior status.

The former stockholder argued that she was no longer a stockholder at the time of bankruptcy, because her equity interest had been converted to a debt claim.

Writing for the three-judge panel of the Ninth Circuit, Circuit Judge John B. Owens noted that lower courts in Delaware and New York agreed with her argument. He rejected the theory, because the statute refers to claims that "arise from" stock ownership. The statute does not base the outcome on a snapshot at the time of bankruptcy, he said.

The statute, according to Owens, inquires whether the claim arose from securities. Since the stockholder assumed the risk of stock ownership, Owens said she couldn't be allowed to dilute the recovery by bona fide creditors.

The case is Pensco Trust Co. v. Tristar Esperanza Properties LLC (In re Tristar Esperanza Properties LLC), 13-60023, U.S. Ninth Circuit Court of Appeals (San Francisco).

Published April 7, 2015

Commentary:

The Seventh Circuit, noting a split among lower courts throughout the country, held that a secured creditor must file a Chapter 13 claim by the deadline established under Bankruptcy Rule 3002. The creditor cannot wait to file a claim until the eve of confirmation.

The opinion makes eminent good sense in terms of practice, although the result is difficult to tease from the language of the rule. Because it's a rule established by the courts themselves not a statute, I suppose there is more liberality in departure from the plain language principle.

Claim-Filing Deadline Applies to Secured Claims, Circuit Says

Secured creditors must file claims in Chapter 13 cases by the same deadline that applies to unsecured creditors, the U.S. Court of Appeals in Chicago ruled on May 11, resolving an issue that divides lower courts.

A secured bank lender filed a claim three months after the deadline established by a notice sent to creditors under Rule 3002 of the Federal Rules of Bankruptcy Procedure. The bankruptcy judge permitted the late claim, following some lower courts in holding that Rule 3002 applies only to unsecured creditors.

The bankruptcy judge thought secured creditors could file a claim any time before confirmation of a Chapter 13 plan.

The issue went directly on appeal to the U.S. Court of Appeals for the Seventh Circuit, where U.S. Circuit Judge Diane P. Wood reversed for a three-judge panel.

Confusion arises because Rule 3002(a) mentions and applies only to unsecured creditors. Wood parsed the remainder of the rule to conclude that it otherwise establishes deadlines equally applicable to secured creditors.

Holding the rule applicable to secured creditors is supported by ``principles of sound judicial administration," Wood said. Were it not applicable, a secured creditor could ``swoop in at the last minute and upend a carefully constructed payment schedule," she said.

Wood said her conclusion is buttressed by an amendment to the rule being considered by the advisory committee that fashions new bankruptcy rules. That revision would explicitly make the Rule 3002 deadline applicable to secured claims.

The case is In re Pajian, 14-2052, U.S. Court of Appeals for the Seventh Circuit (Chicago).

Published May 12, 2015

The Circuits

Commentary:

As expected, the Fifth Circuit overruled Pro-Snax en banc. The opinion was written by Judge Prado, who also wrote the panel opinion in July and recommended rehearing en banc.

The opinion is not a complete victory for lawyers, because it pays homage to Pro-Snax by saying that the court should rigorously examine fee applications to see whether there was evident benefit at the time the service were rendered. The door thus remains open to fee challenges by second guessers.

Fifth Circuit Scraps Parsimonious Standard on Paying Legal Fees

Courts in Texas, Louisiana and Mississippi were the most parsimonious in paying bankruptcy lawyers because a 1998 decision from the U.S. Fifth Circuit Court of Appeals in New Orleans called Pro-Snax required showing an "identifiable, tangible, and material benefit."

The appeals court reversed itself, falling in line with other appellate courts in an opinion for 16 active circuit judges.

Circuit Judge Edward C. Prado wrote the opinion on April 9. He was also the author of a three-judge panel's opinion in July which recommended that all active judges on the circuit court reconsider Pro-Snax. The appeals court granted rehearing and unanimously overturned Pro-Snax.

The case involved an individual and his wife in Chapter 11 whose cases were converted to liquidations in Chapter 7. Lawyers who represented them in Chapter 11 sought $130,000 in fees.

The bankruptcy judge awarded less than $20,000, cutting fees by 85 percent, citing Pro-Snax as the governing law, and disallowing most of the requested fees for lack of success.

Prado said that the "highsight" or "material benefit" requirement from Pro-Snax "conflicts with the text and legislative history" of the governing statute, Section 330 of the Bankruptcy Code.

That section makes services compensable if they were necessary or beneficial "at the time at which the service was rendered." In adopting Section 330, Prado said Congress "specifically rejected an actual benefit test."

Embracing the standards employed by the courts of appeal in New York, Philadelphia, and San Francisco, Prado said that legal work is compensable if the "services were reasonable when rendered but which ultimately may fail to produce an actual, material benefit."

In his earlier opinion, Prado noted that Pro-Snax was specifically rejected by the three other circuit courts.

For details on the first decision last year, click here for the July 17 Bloomberg bankruptcy report.

The case is Barron & Newburger PC v. Texas Skyline Ltd. (In re Woerner), 13-50075, U.S. Fifth Circuit Court of Appeals (New Orleans).

Published April 9, 2015

Commentary:

Judge Carolyn King wrote an astute opinion for the Fifth Circuit with an abusive tax shelter as the backdrop. Notably, she departed from holdings by lower courts around the country in ruling that an affiliate of the debtor can be the issuer of securities and subordination under Section 510(b) will still apply.

Investor in Abusive Tax Shelter Shown No Sympathy on Appeal

The U.S. Court of Appeals in New Orleans said a bankruptcy judge gave too much slack to someone who invested in an abusive tax shelter that later went bankrupt.

In the process, the appeals court disagreed with several bankruptcy courts around the country regarding automatic subordination of claims based on securities.

The case involved a creditor who made ownership investments in companies designed to develop affordable housing. An affiliate guaranteed the investments. The deal structure was an abusive tax shelter, according to the bankruptcy court.

In bankruptcy, the investor filed a claim against the affiliate based on the guarantee. The bankruptcy judge ruled that the investments were subordinated to creditors' claims under Section 510(b) of the Bankruptcy Code. That section subordinates a claim arising from the purchase or sale of a security.

The investor argued that the section didn't apply because his claim was against the affiliate for a debt on a guarantee, not against the company where his investment gave him an ownership interest.

U.S. Circuit Judge Carolyn King, writing for a three-judge appeals panel, concluded that Section 510(b) properly applied because the investor bought a security and the section applies equally to claims against affiliates.

King said ``Congress clearly intended'' that claims based on securities ``of entities over which the debtor exercised sufficient control'' must be treated no differently than ``claims arising from the purchase of securities of the debtor itself.''

King differed with lower court decisions elsewhere not subordinating claims when they weren't made against the company that issued the securities.

King said it wasn't necessary to reach the question of whether participation in an abusive tax shelter by itself is enough to subordinate a claim under other theories.

On other issues in the appeal, the bankruptcy court had dismissed the trustee's claims for fraudulent transfers, saying the creditor was entitled to the good faith defense under Section 548(c) of the Bankruptcy Code. King disagreed and sent the case back to the bankruptcy court.

The lower court found good faith because, the bankruptcy judge said, the investor didn't defraud other investors. King remanded the case for the lower court to determine whether the investor ``was aware (or on inquiry notice) of insolvency or fraud.''

The case is Templeton v. O'Cheskey (In re American Housing Foundation), 14-10563, U.S. Court of Appeals for the Fifth Circuit (New Orleans).

Published April 30, 2015

Commentary:

Living in a community property state ain't all it's cracked up to be.

Judge Clement held for the Fifth Circuit that a wife can lose her discharge even if she's not liable with her husband on a personal guarantee, so long as the creditor could collect against community property.

Rather than resting the result on logical policy considerations, the result depended on interpretation of a string of defined terms in the Code.

The case is another example of using a statute to arrive at a conclusion, although not necessarily the best or correct result.

Non-Debtor Spouse Loses Discharge in Community Property State

While the concept of community property can confer great benefit on a spouse, it's a double-edged sword that cost a spouse discharge in bankruptcy, according to the U.S. Court of Appeals in New Orleans.

A couple filed jointly in Chapter 7 in Texas, a community-property state. A bank was owed $19 million by the husband's company. The husband personally guaranteed the loan; the wife didn't.

The bank objected to the discharge of both and won in bankruptcy court and on a first appeal in district court.

On the second appeal, to the Fifth Circuit in New Orleans, the wife argued that she was entitled to a discharge because the bank wasn't her creditor, since she hadn't guaranteed the debt.

U.S. Circuit Judge Edith Brown Clement rejected the wife's arguments in an April 13 opinion for a three-judge appeals panel.

Clement rested her opinion on a string of definitions in the Bankruptcy Code, beginning with ``claim." Combining several sections, she concluded that a creditor with a claim against a non-bankrupt spouse, who has no claim against the bankrupt spouse, is nonetheless a creditor of the bankrupt so long as the creditor could satisfy the claim from community property.

A case holding the contrary from Massachusetts didn't apply, because it isn’t a community-property state, Clement said.

Clement ruled on several grounds that the couple wasn't entitled to a discharge because they didn't keep adequate books.

The case is Buescher v. First United Bank & Trust (In re Buescher), 14-40361, 2015 BL 104069, U.S. Court of Appeals for the Fifth Circuit (New Orleans).

Published April 15, 2015

Commentary:

The Fifth Circuit teaches that rules governing when claims accrue against a debtor are not the same as those deciding when a claim by the debtor accrues against a third party. The result is logical because the definition of "claim" encompasses liabilities not yet matured to the point of permitting suit.

Claim Accrual Rules Aren't Interchangeable, Circuit Court Rules

Rules determining when a claim accrues against a bankrupt don't control if the question is when claims by a bankrupt accrue against a third party.

The case confronting the U.S. Court of Appeals for the Fifth Circuit in New Orleans involved a couple in Chapter 11 who hired an attorney who evidently wasn't qualified. The reorganization converted to a Chapter 7 liquidation, where the couple's discharge was denied.

After conversion, the couple sued their former lawyer for malpractice. The Chapter 7 trustee said the malpractice claim belonged to the bankrupt estate. When the suit settled for $280,000, proceeds were held in escrow to abide the outcome of a separate suit to determine ownership.

The couple contended that the claim was theirs, saying it didn't accrue until after conversion.

The bankruptcy court ruled in favor of the trustee and was upheld in district court. The trustee won again in the Fifth Circuit.

In an April 16 opinion for a three-judge panel, U.S. Circuit Judge Gregg Costa said a 1997 Fifth Circuit decision called Swift requires using the so-called accrual method.

To accrue, there must be both wrongful conduct and ``some form of legal injury." Costa said there was both.

The lawyer made several mistakes to constitute required wrongful conduct. Injury also took several forms, including the depletion of assets stemming from the lawyer's mistakes, along with payment of the lawyer's fees.

The more significant part of the opinion is the section in which Costa says accrual of a claim against a bankrupt for the purpose of knowing when to file claim doesn't apply when the question is the accrual of a claim by a bankrupt against a third party.

The two methods aren't interchangeable, Costa said, because the word ``claim" has a very broad definition in the Bankruptcy Code.

The case is Cantu v. Schmidt (In re Cantu), 14-40597, U.S. Court of Appeals for the Fifth Circuit (New Orleans).

Published April 23, 2015

Commentary:

The Eleventh Circuit teaches that the lack of a lawyer's signature on a corporation's notice of appeal doesn't make the notice invalid in meeting filing deadlines.

Missing Signature Doesn't Require Dismissal Automatically

The lack of a lawyer's signature on a notice of appeal isn't ``jurisdictional'' and doesn't require dismissal of an appeal, the U.S. Court of Appeals in Atlanta ruled on May 11.

A corporation that was a creditor in a bankruptcy filed a notice of appeal signed only by a company officer who wasn't a lawyer. The district court dismissed the appeal on several grounds. Among them, the judge said that a notice of appeal not signed by a lawyer didn't comply with the 14-day deadline for filing an appeal.

In an unsigned opinion that won't be officially published, a three-judge panel of the Atlanta court reversed.

The appeals court said it was a correct statement of the law that a corporation cannot file papers in federal court unless signed by an attorney.

Nonetheless, the opinion said that the lawyer requirement isn't a ``creation of Congress.'' Rather, the principle is a ``judicial interpretation'' of Section 1654 of the Judiciary Code, which provides that litigants may proceed in ``their own cases personally or by counsel'' in accordance with court rules.

As a result, the requirement of counsel ``does not implicate a court's jurisdictional grant from Congress,'' the opinion says.

Rather than dismiss the appeal, the district court should have given the company time to retain counsel.

The case is In re Strickland & Davis International Inc., 14-13104, U.S. Court of Appeals for the 11th Circuit (Atlanta).

Published May 13, 2015

Chapter 11

Commentary:

District Judge Briccetti in New York upheld Robert Drain on all counts in a crucial case on the application of Till in determining the interest rate on a new note crammed down on an abundantly secured creditor.

Drain's more lengthy opinion is the more definitive of the two. Both judges find that Till applies in Chapter 11 and that the old lenders are not entitled to the rate required were the exit loan being made by new lenders.

Both opinions found no makewhole owing when debt was accelerated automatically by bankruptcy. Like the Second Circuit's similar conclusion in an AMR appeal, the result turned on the language of the indenture.

Stay tuned for a Second Circuit appeal.

Momentive Ruling Makes New York Safe for Big Company Chapter 11

Momentive Performance Materials Inc. defeated several groups of secured and unsecured lenders when U.S. District Judge Vincent L. Briccetti upheld the Chapter 11 reorganization the company implemented in October.

An opinion going the other way might have disinclined big companies in the future from reorganizing in New York.

The senior lenders advanced numerous arguments claiming the bankruptcy judge shortchanged them by hundreds of millions of dollars. Unsecured subordinated noteholders said it was a mistake to pay them nothing at all.

None of the arguments got traction with Bricetti.

In its simplest terms, Bricetti's May 4 opinion means that companies reorganizing in New York can pay secured creditors in full with new notes at below-market interest rates, at least in the case of debt that automatically came due as a result of bankruptcy.

Several creditor groups appealed. First-lien lenders and so-called 1.5-lien lenders, the highest in creditor rankings, complained because the plan didn't give them a so-called make-whole premium and paid existing debt in full with new notes at rates below the market.

The subordinated noteholders argued that they should have been on the same footing as second-lien lenders.

The most significant part of the opinion deals with the rate of interest that must be paid when lenders with collateral covering a claim in full are paid with new notes.

The senior-most lenders argued that their new notes should bear interest they would command in an ``efficient market," as though they were making a new loan to finance an emergence from bankruptcy.

The lenders relied on a U.S. Supreme Court opinion from 2004 called Till, involving the interest that must be paid in a consumer's Chapter 13 plan. There has been controversy among lower courts and commentators about the applicability of Till to corporate reorganizations in Chapter 11. In substance, Bricetti said Till doesn't apply in Chapter 11, a conclusion reached by some other courts.

Bricetti said an interest rate equivalent to a new loan would pay the lenders more than their debt and therefore isn't required in a so-called Chapter 11 cramdown.

The judge also agreed with U.S. Bankruptcy Judge Robert Drain, who wrote the decision in the lower court, that the interest rate on the new loan should be based on Treasury securities, not on the prime rate.

The senior-most lenders also lost when they claimed entitlement to a make-whole premium for early repayment of the loan. Although they didn't know it at the time, their fate was sealed in 2013 when the U.S. Court of Appeals in Manhattan ruled that similarly worded loan documents didn't require a make-whole in the reorganization of AMR Corp., the parent of American Airlines.

Based on his reading of the loan documents, Bricetti said a make-whole isn't owed when an automatic acceleration provision advances the maturity date as a consequence of bankruptcy.

The subordinated noteholders contended that Drain was mistaken because, in their view, subordination applied only to unsecured debt, not to subordinated secured second-lien notes.

Bricetti disagreed, saying that the ``plain language'' of the loan documents makes a distinction between payment subordination and lien subordination.

Momentive wanted Bricetti to dismiss the appeal as moot, because the plan canceled four issues of existing securities, issued new publicly held debt and moved around $600 million in cash. The judge didn't need to reach that issue.

For a discussion of Drain's opinion approving the plan, click here for the Sept. 11 Bloomberg bankruptcy report. For details of the plan, click here for the May 14 report.

Momentive Performance, which filed under Chapter 11 in April 2014, was acquired in 2006 by Apollo Global Management LP in a $3.8 billion transaction. Before the plan was put into effect, Apollo had about 90 percent of the existing equity and some of the second-lien debt that was converted to new equity.

One appeal is BOKF NA v. Momentive Performance Materials Inc. (In re MPM Silicones LLC), 14-7492, and the other is U.S. Bank NA v. Wilmington Savings Fund Society SFB (In re MPM Silicones LLC), both in the U.S. District Court, Southern District New York (White Plains).

The bankruptcy is In re MPM Silicones LLC, 14-bk-22503, U.S. Bankruptcy Court, Southern District of New York (White Plains).

Published May 5, 2015

Commentary:

Delaware and Ontario judges wrote complementary opinions pronouncing a novel theory we can call substantive consolidation lite. The judges were deciding how to allocate $7.3 billion in proceeds from selling assets of Nortel Networks.

The judges said the facts did not justify traditional substantive consolidation. Because the corporate records did not provide a valid basis for allocating proceeds among the Nortel countries around the world, they decided to make pro rata distributions to each company based on the proportion of its debt to the group's total debt.

The allocation methodology seems like more of a compromise than a theory of remedies.

Because the case dealt with unique facts stemming from a huge multinational liquidation, the opinions may fade into obscurity unless appealed. The opinions may nonetheless give birth to subcon-lite as basis for compromise or distribution for a debtor with a disputed, complex corporate structure.

Were Nortel in bankruptcy only in the U.S. and Canada, the judges might have opted for traditional substantive consolidation. They perhaps used subcon-lite because they could not control parallel liquidations in Europe.

Nortel Judges Ignore Corporate Records to Allocate $7.3 Billion

Judges in the U.S. and Canada were critical of the warring factions in the liquidation of Nortel Networks Inc. who couldn't reach agreement on how to distribute $7.3 billion from the sale of the patents and technology.

After a 21-day trial conducted simultaneously by video hookup, the two judges handed down 223 pages of opinions on May 12 coming up with a method for allocating sale proceeds pro rata among the Nortel companies in Canada, the U.S. and Europe.

U.S. Bankruptcy Judge Kevin Gross in Delaware said the parties' ``self-serving allocation positions" were ``not determinative or helpful." He said the varying approaches left ``virtually no middle ground."

Gross said the contending parties advocated allocation methodologies that do ``not comport with the manner in which Nortel operated" a business that once was North America's largest communications equipment provider.

Gross and Justice Frank J.C. Newbould of the Ontario Superior Court of Justice came up with an allocation methodology of their own. Gross called it an ``extraordinary result."

The two judges decided that sale proceeds should go to each Nortel company according to the correct amount of claims against it. Gross said that the U.S. and European creditors both took ``strong exception" to the courts' notion of a pro rata distribution. He said the U.S. and foreign creditors argued that the court's methodology ``is not legally or factually supportable."Gross quoted

Each company will distribute proceeds to its own creditors according to governing law. Gross took pains to say that the judges were respecting the existence of every company and aren't effecting a so-called substantive consolidation, in which all assets and all debt are thrown into one pot, with all creditors receiving the same percentage recovery.

Gross said the facts wouldn't support substantive consolidation.

Bonds issued by one company and guaranteed by another get unique treatment. The company principally obligated on the debt will make a pro-rata distribution. The shortfall will become a claim against companies that guaranteed the debt. Ordinarily, the full amount of a claim is made against the principal borrower as well as the guarantors.

The focus of the trial was Nortel's Master Research & Development Agreement, or MRDA, dealing with ownership, revenue and expenses related to patents and intellectual property, making up most assets that generated the $7.3 billion.

According to Gross, the MRDA didn't capture the ``economic reality" of how the companies operated. According to the Canadian faction, the MRDA should have given them 83 percent of ownership, with 14 percent remaining for the U.S.

Conversely, the U.S. claimed 73 percent of proceeds, with 11 percent for Canada.

Gross said the MRDA was a ``tax document" that ``does not even purport to govern inter-company allocation of the proceeds from liquidated Nortel assets."

At the end of his opinion, Gross admonished the dueling groups to settle to avoid ``prolonging the hardship and depleting the remaining estate." Otherwise, appeals could run for years, costing more in what Newbould called an already ``unimaginable expense."

Newbould urged everyone to allow ``interim distributions" that ``would be especially important for the predominantly elderly pension population" that makes up much of the creditor body.

The Canadian judge addressed the notion that ignoring corporate documents like the MDRA would roil the markets. He said there was ``no evidence that the pro rata allocation in this case will detrimentally affect the capital markets and the ability of issuers to issue bonds in the future."

The Nortel companies filed for bankruptcy reorganization in January 2009 in the U.S., Canada and U.K.

The bankruptcy case is In re Nortel Networks Inc., 09-bk-10138, and the parent's Chapter 15 case is In re Nortel Networks Corp., 09-bk-10164, both in U.S. Bankruptcy Court, District of Delaware (Wilmington).

Published May 13, 2015

Commentary:

Bankruptcy Judge Chapman in New York established a significant precedent for the proposition that an indemnity claim can arise later than the warranty on which it is based. The applicability of the opinion may be limited because it was based on a Lehman contract with mortgage originators.

Lehman Wins Big Test Case Victory over Mortgage Originators

Lehman Brothers Holdings Inc. used a small case to make big law giving the reorganized investment bank valid claims against mortgage lenders that sold defective mortgages.

Between 2006 and 2007, Lehman bought two mortgages totaling less than $200,000 from Hometrust Mortgage Co. Lehman then sold the mortgages, along with thousands of others, to Fannie Mae. After Lehman filed bankruptcy in 2008, Fannie Mae made claims contending that it bought mortgages that didn't meet required underwriting standards.

Eventually, Lehman settled in 2014, giving Fannie Mae an approved unsecured claim for $2.15 billion. Lehman turned around and made a claim against Hometrust, saying it sold defective mortgages, causing the loss to Fannie Mae.

After Lehman sued last year, Hometrust first attempted to have the suit moved to district court. When that failed, Hometrust filed a motion to dismiss, claiming the suit didn't begin until after the six-year statute of limitations lapsed.

U.S. Bankruptcy Judge Shelley C. Chapman ruled in Lehman's favor on May 7, resolving a legal issue where some courts went the other way.

Lehman argued, successfully as it turned out, that its claim against Hometrust didn't ripen under an indemnification clause until it paid Fannie Mae. Hometrust took the view, unsuccessfully, that Lehman only had a breach of contract claim for violating a warranty and should have started the suit within six years of the sale of the mortgages.

The case turned on the language of the contract documents. Chapman said that Hometrust's arguments were "at odds with fundamental principles of contract interpretation." She read the contract as giving Lehman both a contract claim and an indemnification that could be brought years later.

Unless Chapman allows, the issue can't yet go up on appeal, if Hometrust wants to challenge the ruling, because the judge only denied a motion to dismiss and didn't definitively say that the loan originator is liable to Lehman. The opinion nonetheless is significant because it implies that Chapman will rule the same way on Lehman's indemnification claims against other originators that sold loans ending up in the Fannie Mae settlement.

Unless loan originators settle with Lehman, Chapman's rulings may not be the final word. The mortgage lenders can contend that they are entitled to final rulings in district court.

Lehman Brothers Holdings Inc. and its brokerage unit began separate bankruptcies in September 2008. The New York-based parent's Chapter 11 plan was approved in December 2011 and implemented in March 2012. The parent has made seven distributions since then.

The lawsuit is Lehman Brothers Holdings Inc. v. Hometrust Mortgage Co. (In re Lehman Brothers Holdings Inc.), 14-02392, U.S. Bankruptcy Court, Southern District New York (Manhattan).

The parent's case is In re Lehman Brothers Holdings Inc., 08-bk-13555; the brokerage liquidation is Securities Investor Protection Corp. v. Lehman Brothers Inc., 08-01420, U.S.

Bankruptcy Court, Southern District of New York (Manhattan).

Published May 8, 2015

Commentary:

Bankruptcy Judge Kevin Carey in Delaware held that a debtor can apply a credit against a 503(b)(9) claim. It's a big issue in the case. We can look forward to an appeal when there is a final order.

Supplier Priority Claims Reduced in Ruling by Delaware's Carey

U.S. Bankruptcy Judge Kevin J. Carey in Delaware cut down on the size of a claim a supplier is otherwise entitled to collect in full when a customer files for bankruptcy.

The case centered on Section 503(b)(9) of the Bankruptcy Code, which says a supplier who provides goods within 20 days of bankruptcy has a priority claim that must be paid in full.

In a May 5 opinion, Carey found an exception to the rule: The bankrupt is entitled to reduce a 503(b)(9) claim by any credits owing under the contract between the supplier and the bankrupt.

The issue arose in the Chapter 11 liquidation of Associated Wholesalers Inc., which provided food and other products to 800 supermarkets and retailers. Two dozen or more suppliers filed 503(b)(9) claims for goods provided within 20 days of bankruptcy.

Associated countered by saying the suppliers owed various credits, including reductions in the purchase price for promotions, advertising, and overpayments. The bankrupt wholesaler claimed the right to offset or recoup the credits against 503(b)(9) claims.

The suppliers argued, in substance, that their 503(b)(9) claims were sacrosanct and must be paid in full because they had the rank of priority claims. Carey disagreed.

He said the rights of setoff for a bankrupt and a creditor have different origins in the Bankruptcy Code. For a creditor, the right is in Section 553, where prepetition setoff rights can be applied only against other prepetition obligations.

By contrast, a bankrupt's setoff rights derive from Section 558. Carey cited cases for the proposition that a bankrupt's setoff rights are viewed as though bankruptcy hadn't occurred. As a result, he said, the prepetition-postpetition distinction is of no moment.

Consequently, a bankrupt can apply credits in its discretion against secured, prepetition unsecured, postpetition or 503(b)(9) claims, the judge said. Since it's probably more advantageous, a bankrupt is therefore at liberty to apply credits against debt that otherwise would be paid in full, such as 503(b)(9) claim.

Creditors affected by Carey's ruling can't appeal until he decides exactly how much is owing to each supplier.

Suppliers affected by the ruling include Kellogg Co., Dannon Co., PepisCo Inc., Kraft Foods Group Inc. and ConAgra Foods Inc.

The case is In re AWI Liquidation Inc., 14-bk-12092, U.S. Bankruptcy Court, District of Delaware (Wilmington).

Published May 7, 2015

Commentary:

A New Jersey district judge, following a Delaware district court opinion, held that one publication in a national newspaper is insufficient notice to unknown creditors. The issue is working its way to the Third Circuit from the Delaware case.

Big Companies Coming Up Short in Giving Notice to Creditors

Companies in Chapter 11 reorganization hoping to shed debt owing to unknown creditors are advised to give broad and early notice by publication in several newspapers.

The latest case arose from the reorganization of Brookstone Inc., a specialty retailer whose Chapter 11 plan was approved with a confirmation order from a Delaware bankruptcy judge in June 2014.

A consumer filed suit after Brookstone emerged from Chapter 11, alleging he was injured by a product and was unaware of the bankruptcy. U.S. District Judge William H. Walls in Newark, New Jersey, allowed the suit to continue in an April 1 opinion.

Walls said the plaintiff was in the category of an unknown creditor for whom notice by publication might be sufficient.

Brookstone published notice once in the national edition of USA Today 26 days before the bankruptcy judge signed the confirmation order.

Walls said that cases from the Third Circuit, which includes Delaware and New Jersey, found notice was adequate if published in multiple newspapers. He also said that 26 days ``may have deprived potential claimants of any realistic opportunity to file claims.''

He pointed to a Delaware district court opinion from August 2014 involving New Century TRS Holdings Inc. where publication only once 39 days before a deadline was inadequate. For discussion of that case, click here for the Aug. 22 Bloomberg bankruptcy report. That case is on a further appeal to the Court of Appeals.

Although Walls declined to dismiss the complaint as barred by the Chapter 11 discharge, he left the door open to show him the content of the published notice and decide if it was adequate under the circumstances. He also did not decide whether the buyers of reorganized Brookstone might have other valid defenses.

The case is Muldrow v. Brookstone Inc., 14-07937, U.S. District Court, District of New Jersey (Newark).

Published April 7, 2015

Commentary:

District Judge Orrick in San Francisco explained why the expanded notion of finality in bankruptcy does not apply to an order within an adversary proceeding. He decision came down a few days before Bullard.

Flexible Appellate Rules Don't Apply in Adversary Proceedings

Although there's more flexibility in allowing appeals in bankruptcy, the ordinary rule on so-called finality governs with regard to orders in adversary proceedings, a San Francisco federal judge ruled.

A trustee sued the bankrupt company's insiders for receipt of fraudulent transfers. The insiders filed counterclaims for money they were owed.

The claims and counterclaims were made in an adversary proceeding, which is akin to an ordinary lawsuit although within the larger bankruptcy.

The bankruptcy judge dismissed the insiders' counterclaims, saying they were only entitled to file a claim and had no right to obtain a judgment in the suit on account of the debt.

The insiders appealed, but U.S. District Judge William H. Orrick dismissed the appeal, because it didn't involve a so-called final order.

In his April 27 opinion, Orrick acknowledged that there's a more flexible notion of finality in bankruptcies. He explained how the federal circuit court in San Francisco allows bankruptcy appeals if the issue resolves substantive rights and finally determines a discrete issue.

The judge went on to say that the flexible approach isn't used for appeals from orders in adversary proceedings. In those situations, the more rigid finality test from ordinary federal court suits is applied.

Under the traditional approach, Orrick dismissed the appeal because it wasn't final. Even if the flexible approach were employed, Orrick said, he would dismiss on that ground too.

The case is Brady v. Otton, 15-cv-757, 2015 BL 122897, U.S. District Court, Northern District of California (San Francisco).

Published April 30, 2015

Commentary:

Having a "claim," under the expansive notion of the term, does not grant standing to appeal, according to a Minnesota district judge.

Petters Ponzi Scheme Makes Law on Standing to Appeal

A defendant in a fraudulent-transfer lawsuit who's not already a creditor doesn't have standing to appeal a substantive consolidation order, U.S. District Judge Patrick J. Schiltz ruled in the wake of the Thomas Petters Ponzi scheme.

The trustee persuaded the bankruptcy judge to substantively consolidate Petters's main company with eight affiliates that had no assets. Substantive consolidation throws all assets and debt of all related companies into one pot. Some creditors benefit while others don't, because creditors of all companies are treated the same.

The trustee was simultaneously suing several Petters lenders who were so-called net winners. That is, they managed to take out more than they put in before the fraud blew up.

The lenders attempted to appeal from the substantive consolidation order until Schiltz dismissed the appeal because they lacked ``standing."

Standing to appeal, he said, is more limited that standing to participate in a bankruptcy. Due to the broad nature of ``claim," someone with a contingent claim has standing to participate in bankruptcy.

On appeal, it's another issue. Appellate standing requires the person to be ``aggrieved" and have a pecuniary interest directly and adversely affected by the order on appeal.

The defendant lenders conceded they aren't already creditors because they were fully paid. They argued that they are contingent creditors with the right to appeal because they will have claims when and if the trustee recovers in the fraudulent-transfer suits.

Schiltz rejected the idea that a contingent claim is enough for appellate standing.

If there were no substantive consolidation, the defendants said they would have additional defenses that might block the suits. Schiltz said loss of defenses, or being required to defend a suit, doesn't make someone aggrieved.

Schiltz threw the trustee a curve at the end of the opinion. He said in a footnote that the defendants might be able to raise the consolidation issue anew in the fraudulent-transfer suits.

Petters was convicted in December 2009 on 20 counts including fraud, conspiracy and money laundering. He's serving a 50-year prison sentence.

The case is WestLB AG v. Kelley, 13-3611, 2015 BL 117080, U.S. District Court, District of Minnesota (Minneapolis).

Published April 27, 2015

Consumer

Commentary:

Although Judge Rovner doesn't come out and say so, her opinion for the Seventh Circuit appears to erect an objective standard for deciding if a debtor had intent to hinder or delay.

The case looks like an example of hard cases making bad law. The circuit judges simply couldn't fathom why the bankruptcy judge granted a discharge to a bad-acting debtor and had to find a means for overcoming the clearly erroneous rule.

Intent to Defraud Judged by Objective Compliance with State Law

A federal appeals court in Chicago established an objective standard to employ in deciding whether a bankrupt should be denied a discharge for concealing property with intent to hinder or defraud creditors within a year of bankruptcy.

A woman was saddled with a $168,000 judgment in state court. The plaintiff issued what's known in Illinois law as a citation to discover assets. It contained an exhaustive list of documents and information that must be provided.

Despite several orders to produce in state court, the soon-to-be bankrupt gave up few documents and said she had almost no assets. Just before a hearing in state court to compel document production, she filed in Chapter 7.

In bankruptcy, the woman filed lists of property that showed ownership of assets and income she hadn't disclosed in state court. The plaintiff sued to deny her a discharge under Section 727(a)(2)(A) of the Bankruptcy Code for concealing property within a year of bankruptcy with intent to hinder, delay or defraud.

A bankruptcy judge held a trial, granted a discharge and was upheld on the first appeal in district court in Chicago. On the second appeal, U.S. Circuit Judge Ilana D. Rovner reversed, concluding that the bankruptcy court's findings of fact were clearly erroneous.

Rovner said in her April 28 opinion for the three-judge panel that it was ``no surprise" the district judge showed ``lukewarm acceptance" of the bankruptcy court's findings of fact that the bankrupt ``did not subjectively intend to hinder, defraud or delay."

It was legal error, Rovner said, to interpret state law as requiring disclosure of only what the bankrupt ``owned or knew about" on the date of her examination under oath in the Illinois court.

Given the ``explicit language of the citation" to disclose assets, Rovner said ``no reasonable debtor (and particularly one represented by counsel)" would conclude she had no obligation to disclose employment and income.

At least for people represented by counsel, Rovner appears to require full compliance with state law regardless of someone's subjective intent or understanding of state law.

The case is Jacobs v. Marcus-Rehtmeyer (In re Marcus-Rehtmeyer), 14-1891, 2015 BL 122013, U.S. Court of Appeals for the Seventh Circuit (Chicago).

Published May 4, 2015

Commentary:

The Ninth Circuit BAP shows how Bullock raised more questions than it answered on what is or isn't a defalcation when operating in a fiduciary capacity. If the case goes to the circuit, don't be surprised by a reversal. The dissent was convincing.

Bullock Drew Indistinct Lines Describing Nondischargeable Debts

An attorney inexperienced in probate law incurred a nondischargeable debt for being 13 months late in filing a decedent's estate tax return.

The lawyer took on the role of an estate's administrator even though ``she was not competent to perform" the work, U.S. Bankruptcy Judge Randall L. Dunn wrote April 15 in a split decision for the Ninth Circuit Bankruptcy Appellate Panel.

The estate was assessed $440,000 in interest and penalties for filing a tax return 13 months late. The probate court surcharged the administrator for the interest and penalties.

The administrator then filed for bankruptcy, to be met by a complaint seeking to have the debt declared nondischargeable as a defalcation while acting in a fiduciary capacity under Section 523(a)(4) of the Bankruptcy Code. Based on the probate court's decision and uncontested facts, the bankruptcy judge found the debt not discharged.

The bankrupt appealed and lost in a 2-1 decision that turned on an interpretation of the U.S. Supreme Court's 2013 Bullock decision.

Dunn said that Bullock means there is neither a ``strict liability" nor a ``no fault" basis for a nondischargeable debt for defalcation while acting in a fiduciary capacity. Dunn said it remains ``not so clear" where to draw the line.

Dunn said the administrator ``consciously and recklessly disregarded" the risks of filing a late tax return. She was grossly negligent, the judge said, and thus the debt was not discharged.

U.S. Bankruptcy Judge Frank L. Kurtz dissented. He interpreted Bullock as requiring conduct that rises to ``a criminal level of recklessness."

Because the inquiry is ``predominately subjective in nature," Kurtz said ``summary judgment almost never will be appropriate."

Dunn noted that the Ninth Circuit, before Bullock, would bar discharge for ``even innocent acts of failure to account." The majority's opinion shows the appellate panel as hewing closer to the circuit's pre-Bullock law.

For a discussion of the Bullock opinion, click here for the May 14, 2013, Bloomberg bankruptcy report.

The case is Heers v. Parsons (In re Heers), 14-1468, 2015 BL 107621, U.S. Bankruptcy Appellate Panel for the Ninth Circuit (Las Vegas).

Published May 20, 2015

Commentary:

In a major defeat for consume debtors, a North Carolina district judge held that curing defaults on a home mortgage in Chapter 13 does not entitle the bankrupt to reinstatement of the lower non-default interest rate.

The judge reasoned that the higher default rate was invoked automatically following a payment default before the Chapter 13 filing.

Curiously, the judge held the lender only entitled to non-default interest before the plan became effective because the lender elected to foreclose. In foreclosure, the interest rate reverted to the non-default rate under the terms of the mortgage.

Chapter 13 Can't Reinstate Non-Default Mortgage Interest Rate

When the default rate on a mortgage kicked in before bankruptcy, the homeowners were not entitled to reinstate the lower interest rate under a Chapter 13 plan, according to U.S. District Judge Louise W. Flanagan in Raleigh, North Carolina.

Before bankruptcy, the interest rate automatically increased 2 percent annually for the remainder of the term of the 30-year loan. Later but again before bankruptcy, the lender accelerated and initiated foreclosure.

The Chapter 13 plan initially called for curing defaults on the loan, reinstating the mortgage and paying off the debt at the lower interest rate for the remaining term of the loan. The difference in the interest rates amounted to about $300 a month.

The bankruptcy judge upheld the lender's objection to the plan and required the ``cured'' loan to pay interest at the higher default rate.

The homeowners appealed and lost.

Flanagan said that the ability to ``cure'' under Section 1322(b)(2) of the Bankruptcy Code doesn't address the question of the applicable interest rate. The right to cure only deals with extending the maturity of the loan.

The proper interest rate is a function of ``maintenance of payments'' under Section 1322(b)(5). That section in turn looks to the mortgage and state law, Flanagan said.

Since the default rate was invoked before bankruptcy, that must be the rate from the date the plan became effective until maturity, Flanagan said.

Flanagan ruled that the applicable interest rate during bankruptcy was the lower rate, because the mortgage only allowed charging lower interest after acceleration. The mortgage by its terms imposed the higher default rate only if the loan weren't accelerated.

When acceleration was reversed by the cure, Flanagan concluded that the interest rate bounced higher again.

The case means that by accelerating the lender wasn't bound to have the lower interest rate imposed if defaults were cured during bankruptcy.

The case is Anderson v. Logan (In re Anderson), 14-690, U.S. District Court, Eastern District of North Carolina (Raleigh).

Published April 17, 2015

Commentary:

The Fourth Circuit dismissed a discharge complaint because the Chapter 7 trustee failed to give notice of an adjourned date of the creditors' meeting. The circuit declined, however, to lay down a bright-line rule with remedies automatically for violation of Rule 2003(e).

Court Avoids Bright-Line Rule on Adjourning Creditors' Meetings

A mistake by a trustee resulted in a discharge for a bankrupt who otherwise would have been ineligible.

A Chapter 7 trustee said at the end of the creditors' meeting that it wasn't concluded and would be continued. Nonetheless, the trustee never filed a notice of an adjourned date, and another meeting was never held.

Bankruptcy Rule 4004 prescribes that a complaint objecting to discharge must be filed within 60 days of the end of the meeting. The trustee filed the complaint on the 69th day.

Although the bankruptcy judge denied a discharge and was upheld in district court, the U.S. Court of Appeals in Richmond, Virginia, reversed, saying the complaint came too late.

Writing for a three-judge panel, U.S. Circuit Judge Diana Gribbon Motz said the trustee committed an ``undeniable" violation of Bankruptcy Rule 2003(e) which now requires that a trustee must ``promptly" file ``a statement specifying the date and time to which the meeting is adjourned." She said the rule was amended in 2011 to end the practice of adjourning creditors' meetings sine die, that is, without specifying a new date.

Because the creditors' meeting was never resumed, Motz found that it had been concluded, making the complaint nine days late.

Motz still refused to impose a bright-line rule making a complaint untimely every time there is a violation of Rule 2003(e). She said that approach could be ``draconian."

The case is Jenkins v. Simpson (In re Simpson), 14-1385, U.S. Court of Appeals for the Fourth Circuit (Richmond, Virginia).

Published April 28, 2015

Commentary:

An Oregon district judge held that a Chapter 13 plan cannot compel a lender to take title to real property.

Chapter 13 Can't Force Lender to Take Title to a Condominium

A Chapter 13 plan can't force a lender to take title to a condominium and thus impose liability on the lender for common-area charges.

That was the ruling on April 22 by Chief U.S. District Judge Ann Aiken in Portland, Oregon.

A couple in Chapter 13 owned a condominium that had secured debt exceeding the value of the home. They owed common-area charges arising both before and after bankruptcy.

A bankruptcy court confirmed a plan containing a so-called non-standard provision under Section 1322(b)(9) of the Bankruptcy Code under which the condo would ``vest'' in a secured lender. As the transfer of ownership, vesting would shift liability for post-bankruptcy common charges to the lender.

The couple needed to rid themselves of ownership because merely ``surrendering'' the property wouldn't shed their liability for common charges arising after bankruptcy.

The lender didn't want to take title and objected unsuccessfully to confirmation in bankruptcy court. Aiken reversed on appeal.

In substance, Aiken said a bankrupt cannot vest property in a third party absent that party's consent. She said that forced vesting is at odds with the plain language of the statute and decisions by other courts. She said the bankruptcy court read words into the statute that don't exist.

Aiken found a solution for the couple. To escape common charges, they could modify the plan to provide for sale of the condo, she said.

The case is Bank of New York Mellon v. Watt, 14-02051, 2015 BL 116981, U.S. District Court, District of Oregon (Portland).

Published April 27, 2015

Commentary:

The Ninth Circuit BAP held that the time limit for moving to set aside discharge is jurisdictional while the time limit for objecting to discharge is not.

Discharge Revocation Deadline is Jurisdictional, Denial Isn't

The one-year deadline for moving to revoke a discharge is jurisdictional, even though the deadline for objecting to discharge is only an affirmative defense, the U.S. Bankruptcy Appellate Panel for the Ninth Circuit ruled in an April 22 opinion.

After a man in Chapter 7 got his discharge, creditors discovered he hid assets. Creditors reopened the bankruptcy, and the trustee later filed a complaint under Section 727(d)(1) of the Bankruptcy Code to revoke his discharge, for having gained relief from debt through fraud.

The trustee, unfortunately, didn't attempt to revoke discharge until more than one year after it had been granted.

Section 727(e)(1) prescribes a one-year window for filing a complaint to revoke discharge after it's granted. In bankruptcy court, the bankrupt didn't raise that defense because he was representing himself.

After having his discharge revoked, the bankrupt got a lawyer, appealed and won, because the attempt at revoking discharge came too late.

The trustee unsuccessfully argued that the one-year limitation was only an affirmative defense that can be waived, relying on the U.S. Supreme Court's 2004 Kontrick decision. That case says that the time limitation in Bankruptcy Rule 4004(a) for objecting to discharge is only an affirmative defense that can be waived.

In an opinion by U.S. Bankruptcy Judge Jim D. Pappas, the three-judge panel took sides with its sister appellate panel from Boston.

The result is different for revocation because bankruptcy rules, not adopted by statute, can't limit a court's subject-matter jurisdiction.

On the other hand, the revocation deadline is prescribed by statute. Since it's therefore is jurisdictional, it can't be waived and must be raised by the court on its own. Consequently, Pappas said it was error for the bankruptcy court to revoke discharge under Section 727(d)(1).

The case is Elliott v. Weil (In re Elliott), 14-1321, 2015 BL 115875, U.S. Ninth Circuit Bankruptcy Appellate Panel (Pasadena, California).

Published May 27, 2015

Commentary:

The Seventh Circuit holds that child support payments ordinarily are not included in the calculation of disposable income.

Creditors Don't Get a Bankrupt Mother's Child Support Payments

Child-support payments are ordinarily excluded from the calculation of how much someone must pay creditors under a Chapter 13 plan, according to an April 23 decision from the U.S. Court of Appeals for Seventh Circuit in Chicago.

A bankrupt mother had monthly income of $6,600, including $400 a month in child support paid by the father under an order from state matrimonial court. The Chapter 13 trustee contended that the $400 shouldn't be excluded from the calculation of income.

Section 1325(b)(2) of the Bankruptcy Code provides that ``reasonably necessary'' child support payments are excluded from the calculation of disposable income. Citing that section as authority, the bankruptcy judge allowed the mother to exclude all child-support payments from the money available to pay creditors' claims.

The trustee appealed, arguing that exempting child support often results in duplication because many of the expenses in childrearing are included within standardized living expenses for which there is already a deduction. The trustee would only have allowed additional expenses not otherwise deducted under Section 1325.

Writing for the appeals court, U.S. Circuit Judge Joel M. Flaum said the trustee's proposed scheme was both ``unnecessary and unworkable.'' Employing it would ``burden bankruptcy court by mandating fact-intensive examinations of all child support expenses.''

The 2005 amendments to the Bankruptcy Code weren't only designed to increase a bankrupt's payments to creditors, Flaum said. Some, like those in subsection (b)(2), were designed to protect dependent children.

Flaum relied in part on Illinois law, which, like the Bankruptcy Code, commands that child support must be reasonable and necessary. Nonetheless, a state court's determination, although given ``significant weight,'' isn't binding on bankruptcy courts.

Flaum said that, in rare cases, he would limit deduction of child support payments that ``are so excessive in comparison to acceptable expenses that they cannot be deemed reasonably necessary.''

The case is In re Brooks, 14-2856, 2015 BL 116756, U.S. Court of Appeals for the Seventh Circuit (Chicago).

Published May 24, 2015

FDCPA

Commentary:

The Supreme Court as yet won't decide whether the Bankruptcy Code supersedes the Fair Debt Collection Practices Act. The Court denied certiorari presumably because the issue wasn't properly raised in the Eleventh Circuit, which was trying to stamp out a practice where debt collectors file claims on obligations they know are barred by the statute of limitations.

Debt Collection Issue Won't Be Heard by the U.S. Supreme Court

The U.S. Supreme Court declined for now to decide whether a debt-collection agency violates the federal Fair Debt Collection Practices Act, or FDCPA, by filing a bankruptcy claim on a debt that's already stale and uncollectable under a state's statute of limitations.

After holding a conference April 17, the justices announced on April 20 that they won't review a case from the U.S. Court of Appeals in Atlanta, which came down on the side of consumers.

That case, LVNV Funding LLC v. Crawford, represented an effort by the appeals court to stamp out the practice by collection agencies of filing claims in bankruptcy on debts they know are no longer valid outside of bankruptcy.

Lower federal courts are divided over several questions at the intersection of the Bankruptcy Code and the FDCPA. The biggest is whether the code supersedes the FDCPA, thus barring suit by anyone who filed for bankruptcy.

For example, the U.S. Court of Appeals in Manhattan ruled that the Bankruptcy Code has its own and sufficient remedies for consumers when a debt collector files a claim that's no longer collectible.

In Crawford, the consumer who won in the appeals court urged the justices to reject the case by pointing out that the Atlanta court expressly declined to decide whether the FDCPA is superseded by the Bankruptcy Code for borrowers in bankruptcy.

The issue is likely to come back to the Supreme Court soon, because there have been several recent lower court decisions in the area, some involving LVNV, the lender in the Crawford case.

As is customary, the high court didn't give reasons for declining to hear Crawford.

To read about the Crawford decision in the appeals court, click here for the July 14 Bloomberg bankruptcy report.

The case is LVNV Funding LLC v. Crawford, 14-858, U.S. Supreme Court (Washington).

Published May 20, 2015

Commentary:

An opinion by a Philadelphia district judge is another victory for collection agents who routinely file claims that are barred by the statute of limitations. The judge fails to acknowledge that trustees (or Chapter 13 debtors' lawyers) may not be inclined or have the resources for objecting to bad claims in cases with few assets. Stale claims can dilute already meager recoveries.

Debt Collectors Win Another Bout over Consumers on Stale Claims

Among lower courts, the balance is tipping more in favor of debt-collection agencies on the question of whether there is a violation of the federal Fair Debt Collection Practices Act, or FDCPA, when the creditor files a stale claim in bankruptcy that's no longer collectible under state law.

U.S. District Judge Eduardo C. Robreno from Philadelphia had a case where a creditor filed a $550 claim in an individual's bankruptcy based on a debt more than four years old that was barred by the Pennsylvania statute of limitations.

The bankrupt in Chapter 13 sued, contending that the FDCPA bars filing stale claims in bankruptcy. Robreno dismissed the suit, concluding that the FDCPA cannot coexist with the Bankruptcy Code.

Robreno noted that the courts of appeal disagree, with the Second Circuit in Manhattan barring similar FDCPA suits and the Eleventh Circuit in Atlanta permitting them. He said the closest authority from the Third Circuit in Philadelphia doesn't yield a ``definitive result.''

The judge therefore examined ``additional considerations'' in finding an answer.

The Second Circuit's Simmons case from 2010 ``wins the day,'' Robreno said.

The FDCPA aims to protect unsophisticated consumers not represented by counsel from being duped into paying no-longer-collectible debts. That risk, he said, is ``attenuated'' for people in bankruptcy because they are already under protection from the court.

Robreno also noted that the Bankruptcy Code provides sanctions under Rule 9011, although they are less easily available than under the FDCPA.

The U.S. Supreme Court may decide this month whether it will resolve a split among the lower courts by allowing an appeal from the Third Circuit opinion, called Crawford.

The case is Torres v. Calvary SPV I LLC, 14-5915, U.S. District Court, Eastern District Pennsylvania (Philadelphia).

Published April 9, 2015

Commentary:

Yet another district judge held that filing a stale claim in bankruptcy is no violation of the Fair Debt Collection Practices Act.

A core of the opinion from Indiana is based on the notion adopted by other judges: Filing a stale claim isn't prohibited in bankruptcy given the broad definition of "claim." Apart from the Eleventh Circuit, the courts haven't focused on how debt collection agencies are attempting to collect debt they know is no longer owing.

Courts that find no FDCPA violation also ignore how filing stale claims hurts other creditors with valid claims whose recoveries are lower.

Claim on a Stale Debt Doesn't Violate Federal Collection Law

Consumers lost another attempt at holding a collection agency liable for filing bankruptcy claims based stale debts no longer enforceable under state law.

In Indianapolis, a man filed a Chapter 13 petition and listed a debt owed to a collection agency. The debt was old and barred from collection by the state statute of limitations. The debt collector filed a claim, properly disclosing information indicating when the statute of limitations would have run out.

Although the bankrupt never objected to the claim, he sued in U.S. district court alleging a violation of the federal Fair Debt Collection Practices Act, or FDCPA.

U.S. District Judge Larry J. McKinney dismissed the suit, concluding that filing a time-barred claim is no violation of the FDCPA. He didn't reach the question of whether the Bankruptcy Code supersedes the FDCPA.

On an issue favoring the consumer, McKinney said filing a claim is act to collect a debt, and on that basis falls within the FDCPA. He then examined whether filing a claim on a stale debt violates the act.

Like some other judges, McKinney said the debt still exists even if it's no longer collectible. Consequently, filing the claim didn't misrepresent the debt and thereby violate the FDCPA.

Again like some other judge's, McKinney said the Bankruptcy Code doesn't prohibit filing a claim based on a stale debt.

He said there was nothing ``unconscionable'' or ``unfair'' about a claim that was known by the bankrupt, as shown on the list of liabilities. Similarly, a claim ``is not like a letter from a debt collector to an unsophisticated consumer," he said.

McKinney said he was aware that some district and circuit courts had reached contrary conclusions. He said those cases were different because the bankrupts had objected to the claims.

The U.S. Supreme Court is scheduled to hold a conference on April 17 to decide whether it will allow an appeal in a similar case involving the same debt collector and the FDCPA.

The case is Donaldson v. LVNV Funding LLC, 14-01979, U.S. District Court, Southern District of Indiana (Indianapolis).

Published April 13, 2015

Commentary:

Here is another FDCPA case. This time, the consumer wins. The case came from Florida, where the Eleventh Circuit's Crawford opinion resides, so the result wasn't in doubt.

As it now stands, the Seventh and the Eleventh Circuits are on one side, with courts elsewhere pretty much holding that the Code supersedes the FDCPA. Too bad, because the FDCPA is a very effective tool for preventing lenders from collecting stale debt or violating the stay.

Consumers Win Latest Round in FDCPA-Bankruptcy Code Dispute

Consumers won the latest round in the continuing debate over whether the Bankruptcy Code supersedes or impliedly repeals the federal Fair Debt Collection Practices Act, or FDCPA.

The newest case, in Jacksonville, Florida, involved a debt collector that sued in state court after a consumer filed for bankruptcy. The consumer responded by suing in district court under the FDCPA.

The debt collector sought dismissal, contending the Bankruptcy Code supersedes the FDCPA. U.S. District Judge Timothy J. Corrigan in Jacksonville allowed the suit to continue, finding no implied repeal.

Corrigan was most persuaded by decisions from the circuit courts of appeal in Chicago and Atlanta, the latter being the circuit that makes law for Florida federal courts.

The Chicago court's 2004 case, known as Randolph, said that the FDCPA and the Bankruptcy Code merely overlap when a creditor violates the automatic stay. The court said that when two federal statutes are in possible conflict, the question is whether there was implied repeal, not pre-emption.

In the 2014 Atlanta case, called Crawford, the court found that filing a time-barred claim could be a violation of the FDCPA. The court in Crawford didn't reach the issue of implied repeal. In April, the U.S. Supreme Court declined to allow an appeal in Crawford.

Corrigan followed Randolph by finding no irreconcilable conflict between the two statutes. He said it would be ``easy'' to enforce both.

Using the logic of Randolph, Corrigan ruled that the Bankruptcy Code doesn't pre-empt the FDCPA when there's a stay violation as the result of a creditor's action outside of the bankruptcy court.

Corrigan's decision can be read as not deciding whether there might be pre-emption when the creditor's action is in bankruptcy court, such as through filing a time-barred claim, where the Bankruptcy Code provides a remedy by means of a claim objection.

The case is Hernandez v. Dyck-O'Neal Inc., 14-cv-1124, 2015 BL 131012, U.S. District Court, Middle District Florida (Jacksonville).

Published May 7, 2015

Commentary:

Here's another case on the filing of stale claims as a violation of the FDCPA. This time, District Judge Magnus-Stinson in Indianapolis held against the bankrupt and found no FDCPA violation. In April, the Supreme Court denied certiorari in the Crawford case from the Eleventh Circuit that tried to raise the issue.

Collection Agent Wins Another Round Over Filing Stale Claims

Courts are divided on the question of whether a debt collector violates the federal Fair Debt Collection Practices Act, or FDCPA, by filing a bankruptcy claim on a debt that's already stale and uncollectable under a state's statute of limitations.

The newest opinion on the issue comes down on the side of the collectors, finding they do nothing wrong by filing claims in bankruptcy that are no longer collectable under state law.

U.S. District Judge Jane E. Magnus-Stinson in Indianapolis decided two cases on April 22 involving people who had filed Chapter 13 petitions. In both cases, a debt collector filed claims that had been had been invalid for years under the state's statute of limitations.

The bankrupts' lawyers objected to the claims, and they were kicked out by the bankruptcy judge. In both cases, the bankrupts then went to district court to sue the collectors for penalties for violating the FDCPA. Magnus-Stinson dismissed both suits, finding no violation of the FDCPA.

Magnus-Stinson said the U.S. Court of Appeals in Chicago hasn't ruled on whether filing stale claims violates the FDCPA. She said courts in her state and elsewhere are divided on the issue.

The judge said the FDCPA was intended to eliminate ``abusive debt collection practices'' and protect ``unsophisticated consumers.'' She said communications aimed at a consumer's lawyer ``are judged by a different standard.''

Although the U.S. Court of Appeals in Atlanta tried to stamp out the stale claim-filing process, in a case called Crawford, Magnus-Stinson found no violation of FDCPA.

Magnus-Stinson relied on the fact that the claims forms all noted how the debts had been charged off years before, implying that they were uncollectable under the statute of limitations.

Even if the bankrupts didn't have lawyers of their own, they each had a Chapter 13 trustee whose responsibilities entail knocking out invalid claims.

Magnus-Stinson said there was no violation of the FDCPA because there was nothing false or deceptive in the claims as filed.

This month, the U.S. Supreme Court refused to allow an appeal in the Crawford case. To read about the Crawford decision in the appeals court, click here for the July 14 Bloomberg bankruptcy report.

The cases are Birchman v. LVNV Funding LLC, 14-713, 2015 BL 114942, and Owens v. LVNV Funding LLC, 14-2083, 2015 BL 114885, both in the U.S. District Court, Southern District Indiana (Indianapolis).

Published May 28, 2015

Commentary:

A district judge from the Eleventh Circuit didn't take a hint from the circuit and dismissed a FDCPA suit on the ground of preemption by the Code.

District Judge Defies His Circuit Court on Consumer Law Issue

Although the U.S. Court of Appeals in Atlanta last year tried to stop a practice where debt collectors file claims in bankruptcy that are no longer valid under state law, that court didn't close the door to an argument a lower court used in allowing the practice to continue.

In Crawford v. LVNV Funding LLC, the Atlanta's Eleventh Circuit ruled that filing a claim is an act to collect a debt barred by the federal Fair Debt Collection Practices Act, or FDCPA. The appeals court didn't consider and left open the question of whether the Bankruptcy Code supersedes the FDCPA and allows filing claims based on stale debts.

U.S. District Judge William H. Steele from Mobile, Alabama, published an opinion on March 23 where he declined to follow the direction indicated by the circuit court and ruled that collection agencies can file stale claims in bankruptcy without being sued under the FDCPA.

Steele analyzed Alabama law as meaning that the statute of limitations only extinguishes the remedy, not the debt itself. He then surveyed the Bankruptcy Code and its broad definition of "claim," to conclude that it permits filing a claim barred by the statute of limitations.

"A clearer demonstration of irreconcilable conflict would be difficult to imagine," Steele said. The judge added that "numerous courts" agree.

The two statutes can't be given effect simultaneously, the judge said, because the FDCPA prohibits filing a claim that the Code permits. The two laws, he said, "are positively repugnant and cannot mutually exist."

Steele therefore dismissed the FDCPA suit.

The case is Johnson v. Midland Funding LLC, 14-03222, 2015 BL 80952, U.S. District Court, Southern District Alabama (Mobile).

Published April 6, 2015

Commentary:

The split widens on whether the FDCAP is preempted by the Bankruptcy Code.

Split Widens on Sanction for Filing Claims Based on Stale Debt

A federal district judge in Chicago took the side of consumers on an issue the Supreme Court ducked in April by denying a petition for certiorari.

The question is: Is filing a claim in bankruptcy a violation of the federal Fair Debt Collection Practices Act, or FDCPA, if the debt was already barred by the statute of limitations?

The U.S. circuit courts of appeal are split. The Second Circuit in New York ruled in 2010 that filing a claim cannot be a FDCPA violation. In July, the Eleventh Circuit in Atlanta came down soundly on the side of consumers by finding a violation of the FDCPA if a collection agency files a claim based on a stale debt that can't be collected under state law.

The defendant debt collector in the Chicago case was also the loser in the Atlanta appeal. It filed a petition for review in the U.S. Supreme Court in January. The last briefs were filed this month. The high court may hold a conference in mid-April and decide whether to permit an appeal from the Atlanta decision.

In the Chicago case, LVNV Funding LLC filed claims in two consumer bankruptcies, both based on stale credit-card debts. In both cases, the trustees knocked out the claims because they were time-barred under state law.

The two former bankrupts filed a class suit in district court in Chicago. District Judge Elaine E. Bucklo refused to dismiss the suit in an opinion on March 27.

She said the Seventh Circuit in Chicago is yet to rule on whether filing a claim can give rise to a claim under the FDCPA. She said lower courts in the circuit are split.

Bucklo was persuaded by the Seventh Circuit's 2004 Randolph opinion holding that the Bankruptcy Code and the FDCPA can have overlapping remedies unless there is an "irreconcilable conflict." She said Randolph "implicitly overruled" two district court opinions saying the Bankruptcy Code provides the exclusive remedy for filing inflated claims in bankruptcy.

For the latest case showing courts in disagreement over the viability of FDCPA claims brought by bankrupts, click here for the Feb. 10 Bloomberg bankruptcy report. For discussion of the Atlanta court's Crawford decision, click here for the July 14 report.

The Chicago case is Reed v. LVNV Funding LLC, 14-cv-8371, U.S. District Court, Northern District Illinois (Chicago).

Published April 1, 2015