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EYE ON BANKRUPTCY

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***'Value' doesn't mean 'present value'
in Section 1325(b)(1)(A),
Judge Lorch says.***

Courts Split over Interest on Unsecured Claims in 100% Chapter 13 Plans

On an issue where the lower courts are about evenly divided, Bankruptcy Judge Basil H. Lorch, III of Evansville, Ind., ruled that a chapter 13 debtor who is not devoting all disposable income to the plan can confirm the plan by paying unsecured creditors in full, *without interest*.

The debtor would have disposable income of more than $80,000 over the course of the proposed five-year plan. Timely filed proofs of unsecured claims amounted to some $17,000, and payments under the plan would total about $51,000. Although the chapter 13 plan would pay unsecured claims in full, the debtor was not proposing to pay interest on unsecured claims.

The chapter 13 trustee objected to confirmation, contending that Section 1325(b)(1) requires interest on unsecured claims. The trustee argued that the statutory language in subsection (b)(1), "as of the effective date of the plan," modifies the word "value" in subsection (b)(1)(A) to mean that the plan must pay the present value of the claims and therefore includes interest.

Also relying on Section 1325(b)(1), the debtor contended that unsecured creditors are not entitled to interest. The debtor interpreted the quoted language as modifying both subsections (A) and (B) by specifying the date when the court must make the calculation.

Listing decisions coming down on both sides, Judge Lorch said in his September 13 opinion that the courts are "equally divided." The *Norton* and *Collier* treatises take opposite positions on the outcome, with *Collier* on the debtor's side.

Judge Lorch adopted the approach of Bankruptcy Judge Thomas L. Perkins of Peoria, Ill., in *In re Gillen*, 568 B.R. 74 (Bankr. C.D. Ill. 2017). To read ABI's discussion of *Gillen*, click here.

Like Judge Perkins, Judge Lorch believes that "as of the effective date of the plan" would have appeared immediately after "value" if Congress had intended for plans to pay the present value of unsecured claims.

Also like Judge Perkins, Judge Lorch observed that unsecured creditors in chapter 13 have no right to immediate payment at the beginning of the case, unlike secured creditors or even unsecured creditors in solvent chapter 7 cases.

Requiring interest on unsecured claims would produce an "anomalous result," Judge Lorch said, because Section 1322(a)(2) permits deferred payments on priority claims without interest.

Opinion Link

Why must the system require a trial to discharge student loans by a debtor in hopeless circumstances?

Functionally Illiterate, Disabled Debtor Succeeds in Discharging Student Loans

Building on existing Sixth Circuit authority, Bankruptcy Judge Mary Ann Whipple of Toledo, Ohio, held that eligibility for an income-based repayment program does not preclude an indigent debtor from discharging student loans.

Judge Whipple's October 4 opinion is a template for any judge tasked with discharging student loans owed by a debtor living below the poverty line. She analyzes and rejects most of the arguments a lender could make under similar circumstances.

Functionally illiterate, the debtor suffered from bipolar disorder and had spent part of his life living out of a car. Employed part time, he earned about $14,000 a year, which Judge Whipple described as "living in poverty." Married with a teenage step daughter, the debtor lived in a mobile home lacking a furnace and operable stove. His wife earned about $230 a month cleaning houses.

In prior years, the debtor made some payments toward the $15,000 in student loans he incurred in 1996-1997 while studying car mechanics. He did not graduate and did not work as a mechanic.

Currently, the 47-year-old debtor was eligible for an income-based repayment program where he would not be required to make payments toward the student loans given his low income. Assuming his income were not to rise, the loans would be forgiven in about 22 years, but the forgiveness might become taxable income.

Judge Whipple analyzed the debtor's circumstances under the so-called *Brunner* test adopted in the Sixth Circuit. In 2007, the Sixth Circuit had held that a debtor's failure to *apply* for an income-based repayment program did not constitute a *prima facie* showing of bad faith resulting in failure under the third prong of the three-part *Brunner* test. *Barrett v. Educational Credit Management Corp*., 487 F.3d 353 (6th Cir. 2007).

So, the lender took a different tack in opposing the debtor's adversary proceeding to declare that his student loans imposed an "undue hardship" and were dischargeable under Section 523(a)(8).

Brunner's first test inquires as to whether the debtor can maintain a "minimal" standard of living if required to repay the student loans. Because the debtor could pay nothing under an income-based repayment program, the lender contended under the first prong of *Brunner* that the student loans imposed no undue hardship because no payment was required.

Judge Whipple observed that the repayment program is "neither automatic nor permanent." It requires continual reapplication, which could be beyond the capacity of some debtors. If eligibility for the program precluded the discharge of student loans, she said that "the hardship discharge provision for student loans would be effectively eliminated for those most likely to be entitled to it."

Citing cases coming down on both sides of the issue, Judge Whipple concluded that the debtor satisfied the first prong of the *Brunner* test, even though he was eligible to pay nothing.

On the second and third prongs, the lender argued that the debtor should move to another town in pursuit of higher income. Judge Whipple rejected the argument, noting the debtor's statement that he would lose his wife if he moved. Moreover, his support system was in Toledo, where he lived.

Judge Whipple concluded that the debtor was "not acting unreasonably or unfairly to his student loan holder by continuing to make and try to build a life in Toledo."

The debtor had shown good faith by having made some payments on the loans, although the payments were never enough to reduce principal, Judge Whipple said. Even if he were to obtain a second part-time job, his poverty would continue because the increased income would end his eligibility for food stamps and leave him with no more net disposable income.

Deciding to discharge the student loans, Judge Whipple found an additional basis for finding good faith. The student loans were not the precipitating factor in the debtor's decision to file bankruptcy. He had been saddled with an $8,000 judgment in favor of a former landlord who was garnishing his wages.

Judge Whipple therefore found that the debtor met the second and third parts of the *Brunner* test, requiring a showing of a good faith attempt to repay the student loans and a demonstration that his impecunious circumstances were likely to persist.

Observation: We indeed have a curious system when a judge is compelled to conduct a trial and write a 13-page opinion to justify discharging student loans owed by an individual who is functionally disabled and living well below the poverty line. (The observation is the writer's opinion and does not represent the policy or opinion of ABI.)

Opinion Link

Courts are split on whether all educational loans are nondischargeable as an educational benefit.

Educational Loans from a Private Lender Are Held Dischargeable

Following what she called the "trending narrow view," Bankruptcy Judge Kimberley H. Tyson of Denver ruled that not all educational loans are presumptively nondischargeable. She held that an educational loan from a private lender is discharged automatically because it does not fit within one of the categories in Section 507(a)(8)(A) or (B).

In addition to concededly nondischargeable, federally guaranteed student loans, a couple had amassed almost $110,000 in educational loans from a private lender that evidently had grown to almost $250,000 with interest.

The couple confirmed a chapter 13 plan providing that the student loans would be treated as unsecured claims or "deferred until the end of the plan." During the chapter 13 case, the debtors paid almost $27,000 on the private loans.

After discharge, the lender contended that the loans were nondischargeable and continued collection activities, prompting the couple to pay an additional $37,500 toward the private loans.

More than two years after discharge, the couple reopened their chapter 13 case and filed an adversary proceeding against the lender. The debtors sought to hold the lender in contempt alongside a declaration that private loans were discharged.

The lender filed a motion to dismiss, which Judge Tyson denied in her September 24 opinion.

Citing the Supreme Court's *Espinosa* decision, the lender argued that *res judicata* precluded the debtors from contending that the private loans were discharged. Judge Tyson didn't buy the argument.

Res judicata did not apply, Judge Tyson said, because the plan did not classify the student loans as dischargeable or not.

Next, and most significantly for the developing body of case law, the lender contended that the private loans were a nondischargeable "obligation to repay funds received as an educational benefit, scholarship or stipend" under Section 523(a)(8)(A)(ii). The lender was forced to rely on subsection (A)(ii), because the loans were not qualified educational loans under subsection (B), nor were they made or guaranteed by the government or a nonprofit institution under subsection (A)(i).

With regard to subsection (A)(ii), Judge Tyson said the courts are divided, with some courts holding that private loans qualify as an "educational benefit" and are therefore nondischargeable. The Tenth Circuit has no controlling authority, she said.

Ruling in favor of the debtors, Judge Tyson in large part based her opinion on the absence of the word "loan" in subsection (A)(ii). She noted that the word "loan" does appear in subsections (B) and (A)(i).

Favorably citing a 2018 decision by Chief Bankruptcy Judge David R. Jones of Houston, Judge Tyson said that the statutory language — "an obligation to repay funds received as an educational benefit, scholarship or stipend"— "does not include a loan."

Judge Tyson also attached significance to the word "as," which she called a "qualifier" denoting "how the funds were received." In the case at bar, the funds were received as a loan, not as an educational benefit, scholarship or stipend.

If subsection (A)(ii) included loans, the other subsections would be superfluous, she said, because the categories covered by the other subsections would be subsumed within subsection (A)(ii).

The lender also argued that there is no private right of action for a discharge violation. Judge Tyson rejected this argument, saying that the court's equitable powers under Section 105(a) allow the court to remedy violations of substantive provisions of the Bankruptcy Code.

The lender contended the discharge order was not sufficiently specific to justify a finding of contempt.

Any ambiguity in the discharge order, Judge Tyson said, would be relevant to whether the discharge violation was willful. She therefore declined to dismiss on that ground, saying that the evidence at trial will determine whether there is support for the claim.

For ABI's discussion of other cases emblematic of the split, click here.

Opinion Link

***Jevic* doesn't mandate forcing professionals to disgorge interim allowances to achieve a pro rata distribution to administrative claimants in an administrative insolvency.**

Disgorgement by Professionals Is Not Required in an Administrative Insolvency

A bankruptcy judge is not required as a matter of law to order disgorgement of fees to effect a *pro rata* distribution among chapter 11 administrative claimants when the estate is administratively insolvent, according to District Judge Tanya Walton Pratt of Indianapolis.

The appeal entailed a typical case of administrative insolvency, which results when the unencumbered assets of the estate are insufficient to pay administrative claims in full.

A trustee had been appointed in a chapter 11 case. Counsel who represented the debtor before appointment of the trustee had been granted and paid two interim allowances of compensation totaling about $135,000.

The debtor's counsel filed a third interim fee application seeking another $110,000. The chapter 11 trustee objected to the third application. Approving settlement of the objection, Bankruptcy Judge Basil H. Lorch, III granted the application, but his order provided that neither the trustee nor the estate would pay any of the fee allowance.

There was about $4 million in unpaid administrative claims, but the trustee was holding only $1 million to apply toward those claims. The unpaid claims included an administrative claim of $2.6 million owing to the Internal Revenue Service for unpaid trust fund taxes.

Later, the trustee proposed a so-called structured dismissal of the chapter 11 case, where the bankruptcy court would authorize distribution of the estate's remaining funds, followed by a dismissal of the chapter 11 case without incurring the expense of a conversion to chapter 7.

In connection with dismissal, the trustee and the IRS asked Judge Lorch to order the debtor's counsel to disgorge $60,000, which would evidently allow the court to close

the case with a *pro rata* payment of administrative claims. Judge Lorch denied the motion, and the IRS appealed.

Judge Pratt affirmed in a 12-page opinion on September 26.

The IRS argued that the Supreme Court's decision in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), required the bankruptcy judge to order disgorgement to the extent necessary to result in a *pro rata* distribution among all of the chapter 11 administrative claimants, including the IRS. In *Jevic*, the Supreme Court held that a structured dismissal could not include a distribution that "deviate[s] from the basic priority rules" in Section 726(a). For ABI's discussion of *Jevic*, click here.

Judge Pratt said that *Jevic* "does not mandate disgorgement of [the debtor's counsel's] fees to achieve ultimate *pro rata* distribution among administrative claimants in this chapter 11 structured dismissal case." Similarly, she said that *Jevic* did not "concern whether a bankruptcy court can decline to order disgorgement where it has made, or makes, a final award of attorneys' fees."

Having concluded that *Jevic* did not require disgorgement, Judge Pratt asked whether the bankruptcy judge had authority to decline to order disgorgement. On that issue, she said, the case law is "relatively sparse."

In terms of statutory imperatives, Judge Pratt said that Section 330 contains "no requirement or any mention . . . that disgorgement must (or even should) be made to achieve a *pro rata* distribution among administrative claimants in a chapter 11 . . . structured dismissal . . . ."

According to Judge Pratt, the bankruptcy judge said he would not order disgorgement, even if he had power to do so, because the law firm had provided value to the estate by making the "single most important recovery" of assets.

Like the bankruptcy judge, Judge Pratt said that the value of the services was relevant to the question of disgorgement. Indeed, the bankruptcy judge had said that he would have considered a fee enhancement if the estate had sufficient assets.

Judge Pratt found "no basis" to overturn the bankruptcy judge's "weighing of the equities and his finding that [the law firm] had 'more than earned' a total fee of" $135,000.

Opinion Link

Already primed to rule on nonjudicial foreclosure, the Supreme Court might take cases involving contempt, the automatic stay and trademarks.

Status Report on the Supreme Court

The Supreme Court denied petitions for *certiorari* yesterday in two creditors' rights cases: *Credit One Bank NA v. Anderson*, 17-1652 (Sup. Ct. *cert*. *denied* Oct. 1, 2018); and *Noble Energy Inc. v. ConocoPhillips Co.*, 17-1438 (Sup. Ct. *cert*. *denied* Oct. 1, 2018).

There is one bankruptcy-related case already on the high court's docket for the term that began this week: *Obduskey v. McCarthy & Holthus LLP*, 17-1307 (Sup. Ct.), reviewing *Obduskey v. Wells Fargo*, 879 F.3d 1216 (10th Cir. 2018). The date for oral argument in *Obduskey* is yet to be set.

Anderson was a moderately attractive case for Supreme Court review. However, there was not a clear-cut circuit split.

In *Anderson*, the Second Circuit refused to enforce an arbitration agreement, thus allowing a class action to proceed in bankruptcy court alleging violations of the discharge injunction. *Credit One Bank NA v. Anderson (In re Anderson)*, 884 F.3d 382 (2d Cir. March 7, 2018).

The petitioner argued that the Second Circuit had not followed Supreme Court authority regarding the enforcement of arbitration agreements. To read ABI's discussion of the Second Circuit opinion, click here.

Noble Energy was a petition for *certiorari* to the Texas Supreme Court. Significant sums of money were involved, but the petitioner wanted the U.S. Supreme Court to review the Texas courts' interpretation of federal bankruptcy law regarding blanket assumptions of executory contracts. Were the petitioner appealing a decision by a federal court of appeals, the case would have been more attractive for Supreme Court review.

Obduskey, where the appellant's brief on the merits was filed in August, is an important case for consumers. The outcome will decide whether the federal Fair Debt Collection Practices Act applies to nonjudicial foreclosures.

Amicus briefs have been filed on behalf of liberal members of the House and Senate, the NAACP Legal Defense & Education Fund Inc., and a national consumer law organization.

Three cases percolating from the courts of appeals are attractive candidates for grants of *certiorari* later this term.

In *Lorenzen v. Taggart (In re Taggart)*, 888 F.3d 438 (9th Cir. April 23, 2018, *rehearing denied* Sept. 7, 2018), the Ninth Circuit held that a good faith belief that an action does not violate the automatic stay is a defense to contempt of the stay, even if the belief is unreasonable. There is a stark circuit split, because the First Circuit this year refused to allow good faith as a defense to a stay violation. *IRS v. Murphy*, 892 F.3d 29 (1st Cir. June 7, 2018).

The debtor in *Taggart* is expected to file a *certiorari* petition this week. To read ABI's discussions of *Taggart* and *Murphy*, click here and here.

The Tenth Circuit and the District of Columbia Circuit are the two appeals courts to hold that the automatic stay does not compel a lender or owner to return property automatically that was repossessed before bankruptcy. The courts of appeals for the Second, Seventh, Eighth, Ninth and Eleventh Circuits hold to the contrary and require the automatic return of repossessed property, on pain contempt. The circuits that compel immediate return allow the owner or lender to seek adequate protection after returning the property.

Although the outcome is a foregone conclusion, the issue was argued again in the Tenth Circuit on September 26 in *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, (10th Cir. 17-3247). The debtor is likely to file a petition for *certiorari* when the appeals court affirms on the authority of *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), where the Tenth Circuit held that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate."

To read ABI's discussions of *Davis* and *Cowen*, click here and here.

At conference on October 12, the justices will consider the *certiorari* petition in *Mission Product Holdings Inc. v. Tempnology LLC*, 17-1657 (Sup. Ct.). Granting the petition will permit the high court to decide whether the Fourth Circuit correctly decided the infamous case of *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.*, 756 F.2d 1043 (4th Cir. 1985).

In *Lubrizol*, the Richmond, Va.-based appeals court held that rejection of an executory license for intellectual property precludes the non-bankrupt licensee from continuing to use the license. The decision prompted Congress to add Section 365(n) and the definition of "intellectual property" in Section 101(35A). Together, they provide that the non-debtor can elect to continue using patents, copyrights and trade secrets despite rejection of a license.

However, Congress did not add trademarks to the list of intellectual property that a licensee could continue to use despite rejection. Most courts interpreted the omission to mean that rejection cuts off the right to use trademarks.

More recently, the circuit courts split regarding the continued use of trademarks after rejection. In *Sunbeam Products Inc. v. Chicago American Manufacturing LLC*, 686 F.3d 372 (7th Cir. 2012), the Seventh Circuit held in 2012 that rejection does not preclude the continued use of a trademark license.

However, the First Circuit pointedly disagreed this year with the Seventh by holding in *Mission Product Holdings Inc. v. Tempnology LLC (In re Tempnology LLC)*, 879 F.3d 389 (1st Cir. Jan. 12, 2018), that rejection ends the use of a trademark.

If the Supreme Court grants *certiorari* in *Mission Product*, the justices might expound broadly on the effects of rejection. The case also presents an interesting question of statutory interpretation: Did Congress intend to leave *Lubrizol* unaffected by omitting trademarks from the protection of Section 363(n)?

Opinion Link

Delaware district judge rules that the bankruptcy court has final adjudicatory power to include third-party releases in confirmation orders.

District Court Finds Constitutional Power to Grant Releases in Confirmation Orders

Unless the Third Circuit or the Supreme Court decides otherwise, bankruptcy courts in Delaware have constitutional authority to issue non-consensual, third-party releases of non-bankruptcy claims along with confirmation of a chapter 11 plan.

In an opinion on September 21, Chief District Judge Leonard P. Stark of Delaware abandoned the insinuation he made 18 months ago, adopted the analysis of Bankruptcy Judge Laurie Selber Silverstein from one year ago and held that the principles of *Stern v. Marshall*, 131 S. Ct. 2594 (2011), do not apply because confirming a reorganization plan with releases is not tantamount to a final judgment on the merits of non-bankruptcy claims.

Alternatively, Judge Stark held that the appeal from the Millennium Lab Holdings II LLC confirmation order was equitably moot because the plan had been consummated and releases could not be revoked without upsetting the plan as a whole. Judge Stark also reached the merits and held that the releases were proper because Judge Silverstein correctly applied Third Circuit criteria.

The Facts

Millennium Lab Holdings II LLC, the chapter 11 debtor, had obtained a $1.825 billion senior secured credit facility and used $1.3 billion of the proceeds before bankruptcy to pay a special dividend to shareholders.

Indebted to Medicare and Medicaid for $250 million that it could not pay, Millennium filed a chapter 11 petition along with a prepackaged plan calling for the shareholders to contribute $325 million in return for releases of any claims that could be made by the lenders. The plan did not allow the lenders to opt out of the releases.

Before confirmation, a lender holding more than $100 million of the senior secured debt filed suit in district court in Delaware against the shareholders and company executives who would receive releases under the plan. The suit alleged fraud and RICO

violations arising from misrepresentations inducing the lenders to enter into the credit agreement.

Over objection, Judge Silverstein confirmed the plan in late 2015 and approved the third-party releases. The dissenting lender appealed.

Millennium filed a motion to dismiss the appeal on the ground of equitable mootness, because the plan had been consummated in the absence of a stay pending appeal.

District Judge Stark's Remand

On appeal in district court, the objecting lender contended that the bankruptcy court lacked constitutional power to enter a final order granting third-party releases. Judge Stark's decision in March 2017 could have been read to imply, without holding, that granting the releases was beyond the bankruptcy court's constitutional power to enter a final order because the releases were "tantamount to resolution of those claims on the merits against" the lender.

Rather than rule on the constitutional issue, Judge Stark remanded the case for Judge Silverstein to decide whether she had final adjudicatory authority, either as a matter of constitutional law or as a consequence of the lender's waiver. To read ABI's discussion of Judge Stark's opinion, click here.

Judge Silverstein's Opinion Following Remand

On October 3, 2017, Judge Silverstein handed down an impassioned, 69-page opinion concluding that the limitations on the constitutional power of a bankruptcy court under *Stern* are inapplicable to granting third-party releases because a confirmation order exclusively implicates questions of federal bankruptcy law and raises no issues under state or common law.

Judge Silverstein also analyzed the record and concluded that the objecting lender never raised the constitutional question during or even after confirmation. Citing the prohibition of sandbagging in *Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015), Judge Silverstein said that the lender could not lie in the weeds and raise constitutional infirmities for the first time on appeal. On the ground of waiver alone, Judge Silverstein found that she was entitled to enter a final order. To read ABI's discussion of Judge Silverstein's opinion, click here.

The objecting lender appealed again to Judge Stark.

The Bankruptcy Court's Confirmation Power Is Unimpaired

Judge Stark's 42-page opinion on September 21 contains a meticulous analysis of Judge Silverstein's decision and a detailed recitation of the parties' arguments. He upheld Judge Silverstein's conclusion that the bankruptcy court had constitutional power to approve third-party releases in a confirmation order. He also granted the motion to dismiss other issues in the appeal on the ground of equitable mootness.

Alternatively, Judge Stark reviewed the merits and ruled that the releases were proper under Third Circuit authority.

As he had done before, Judge Stark said it was proper to consider the constitutional issue before entertaining the motion to dismiss for equitable mootness.

On the constitutional issue, Judge Stark said that *Stern* was inapposite. In the case before the Supreme Court, the bankruptcy judge had conducted a bench trial and ruled on the merits of a counterclaim under state law. Persuaded by Judge Silverstein's opinion on remand, Judge Stark said that she "determined only that the bankruptcy-specific standards for approving nonconsensual releases in a plan were satisfied."

Judge Stark adopted Judge Silverstein's narrow reading of *Stern*. He said the Supreme Court did not address any context other than counterclaims, nor did it "'announce a broad holding addressing every facet of the bankruptcy process,'" quoting Judge Silverstein. To determine the applicability of *Stern*, he said that the "operative proceeding" was plan confirmation, where the bankruptcy court has final adjudicatory power. He explained that approving the releases did not entail an analysis of the merits of the lender's non-bankruptcy claims.

Because he decided the merits of the constitutional issue, Judge Stark did not decide, one way or another, whether the lender had waived the *Stern* question.

Turning to equitable mootness, Judge Stark said that the Third Circuit requires analysis of whether the plan has been substantially consummated and whether granting relief on appeal would "fatally unscramble the plan" or significantly harm third parties.

Substantial consummation was not an issue. However, the lender contended that the appellate court could grant relief without unscrambling the plan. The lender wanted Judge Stark to strike the releases only with respect to its claims and otherwise leave the plan intact.

Rejecting the argument, Judge Stark said that striking the release only as to the lender "would severely undermine the Plan and necessarily harm third parties." He said that the releases "cannot equitably be excised as they were the very centerpiece of the plan." They were, he said, "the inducement for the Equity Holders' $325 million contribution, and without this contribution, there could not have been a reorganization."

He said it would be inequitable were he to allow the lender to sue while also permitting the lender to retain the plan distribution made possible with the contribution from the released parties.

Judge Stark concluded that the plan was equitably moot because it was "unclear" to him "what other practicable relief" he could give the objecting lender.

Finally, Judge Stark examined the merits of the releases, as though he had ruled that the appeal was not equitably moot and the bankruptcy court lacked power to issue a final order with releases.

Because the debtor had indemnified the released parties, Judge Stark said the bankruptcy court had subject matter jurisdiction to issue the releases because there was a conceivable effect on the estate. In view of the bankruptcy court's "extensive findings upon the substantial and uncontroverted record," he said that releases were permissible under Third Circuit precedent.

Opinion Link

Courts split on allowing compensation to a chapter 7 trustee when the case is converted to chapter 13 before distributions were made.

Chapter 7 Trustee Is Paid in a Case Converted to Chapter 13

Courts are split on whether a chapter 7 trustee earns a fee if the case converts to chapter 13 before the trustee makes distributions.

In a case pending before Bankruptcy Judge Elizabeth D. Katz of Springfield, Mass., the chapter 7 trustee and his counsel ran up some $12,000 in time charges investigating the debtor's potentially nonexempt assets. Before the trustee collected any assets or made any distributions, the debtors converted the case to chapter 13 over the trustee's objection.

The trustee sought an allowance of compensation for himself and his attorneys as an expense of administration in the chapter 13 case. Although not contesting the reasonableness of the fees, the debtor argued that the trustee was not entitled to compensation under Section 326(a).

"In a case under chapter 7 or 11," that section provides that the court "may allow reasonable compensation under section 330 . . . for the trustee's services not to exceed" a sliding scale that begins at 25% and shrinks to 3% "upon all moneys disbursed or turned over in the case by the trustee . . . ."

The courts are split, Judge Katz said. A majority allow reasonable compensation based on *quantum meruit* for pre-conversion work. More recently, she said, courts are shifting away from *quantum meruit* and disallowing compensation under Section 326(a) if the trustee has made no disbursements.

Judge Katz took a different tack. She did not read Section 326(a) as precluding an award of compensation in a converted case. The section, she said, "is explicitly reserved for limiting trustee compensation '*[i]n a case under chapter 7 or 11*.'" [Emphasis in original.]

Judge Katz therefore allowed the full amount of compensation sought by the trustee because the debtor had only objected under Section 326(a).

Opinion Link

Law firm suspended 90 days for multiple violations of rules of professional conduct.

Sanctions Upheld Against 'Nationwide' Law Firm for Violating Section 526

A district judge in Shreveport, La., upheld sanctions imposed by the bankruptcy court against a self-described "national consumer law firm." The significance of the opinion lies in coercing compliance with state rules of professional conduct and Section 526, regulating "debt relief agencies."

According to the September 24 opinion by District Judge Elizabeth Erny Foote, the parties agreed that the case was "horribly screwed up." Based on findings in other cases, the firm advertises nationally, has non-attorneys perform intake over the telephone, has the client sign a retainer agreement, collects the retainer, and assigns the case to an attorney presumably admitted to practice where the debtor will file bankruptcy.

The shortcomings in the particular debtor's case included initially assigning a local counsel not licensed to practice in Louisiana, later assigning a local attorney located 350 miles from the chapter 7 debtor, never sending the debtor a retainer agreement signed by a lawyer admitted to practice in the state, employing a retainer agreement violating the Louisiana Rules of Professional Conduct, making oral representations that contradicted the written retainer agreement, repeatedly breaking promises to the debtor, and failing to supervise the local attorney properly.

With regard to the local counsel, the bankruptcy judge found that she "consistently" failed to contact the debtor, delayed filing the first petition, negligently allowed the first petition to be dismissed, falsely "indicated" that the debtor had signed the second petition, and allowed the second petition to be dismissed by failing to file required documents.

Judge Foote said the bankruptcy court found "professional negligence on the part of both [the nationwide firm] and [the local counsel], including multiple, continuous violations of the Louisiana Rules of Professional Conduct."

With regard to the nationwide firm, sanctions imposed by the bankruptcy court included disgorgement of fees paid by the debtor, suspension from practice in the

district for 90 days, precluding the firm from accepting a retainer until the client had consulted with a lawyer in the district, requiring the retainer agreement to comply with Louisiana's Rules of Professional Conduct, requiring the client's wet signature on all documents filed in court that purport to bear the client's signature, requiring the client's wet signature on the engagement agreement, precluding the firm from accepting a retainer before the client signs the engagement agreement, and requiring local counsel to obtain a separate PACER login for cases where the attorney is representing a client though the nationwide firm.

The nationwide firm appealed, without success.

The firm argued that the 90-day suspension did not comply with Federal Rule 65(d) governing injunctions. Judge Foote ruled that courts have power to determine who may practice before them independent of Rule 65, based on Fifth Circuit authority. Furthermore, she said, a suspension is not an injunction.

Judge Foote found jurisdiction in the bankruptcy court to impose the sanctions, even though she said that nothing other than the 90-day suspension was a sanction or discipline. She also found no violation of the firm's due process rights.

Judge Foote rejected the notion that the bankruptcy court was required to make specific findings of bad faith based on clear and convincing evidence. With regard to state rules of professional conduct, she said the Fifth Circuit had held that a bad faith finding is not required to exercise authority under local rules.

Findings in the bankruptcy court's order required the nationwide firm's retainer agreement to include the provision of "all services integral to a chapter 7 filing." The firm argued that the order was not clearly defined and violated the specificity requirements under Rule 65.

Judge Foote said that "services integral to a chapter 7 filing" was not "ambiguous" when read in context with the bankruptcy court's opinion.

The firm objected to being characterized by the bankruptcy court as a "referral service" or a "marketer of legal services."

Judge Foote said that the statements were not intended as findings of fact, but if they were, "they are not clearly erroneous."

Opinion Link

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Host

Prof. Charles J. Tabb is the Mildred Van Voorhis Jones Chair in Law at the University of Illinois College of Law in Champaign, Ill., and a former ABI resident scholar. He served as interim dean of the College during the 2007-08 academic year and was the associate dean for academic affairs from 2003-05, and is currently Of Counsel with the law firm of Foley & Lardner LLP in Chicago. Before joining the Illinois faculty, he practiced bankruptcy and commercial law in Dallas, where his cases included the Braniff Airways and Continental Airlines chapter 11 reorganizations. Prof. Tabb is considered one of the nation's leading bankruptcy scholars, specializing in bankruptcy, contracts and commercial law, and has authored or co-authored several dozen articles and several books, most recently *The Law of Bankruptcy* (Foundation Press, 3d Ed. 2013), *A Debtor World: Interdisciplinary Perspectives on Debt* (Oxford University Press 2012) and *Bankruptcy Law: Principles, Policies & Practice* (LexisNexis, 3d Ed. 2010). He was also editor of *Bankruptcy in Practice, Fifth Edition* (ABI 2015) and *Best of ABI: The Year in Business Bankruptcy* (ABI 2014). Prof. Tabb practiced law with Carrington Coleman in Dallas before joining the Illinois faculty in 1984. He has won numerous teaching awards and has served as a visiting professor in Texas and Colorado, as a visiting scholar at Cambridge University and Nottingham, England, and as the SBLI Distinguished Visiting Professor at Georgia State. He is also on the global law faculty at Católica Global School of Law, Universidade Católica Portuguesa, in Lisbon, Portugal. In 1993, Prof. Tabb was appointed by Chief Justice Rehnquist to the Advisory Committee on the Federal Rules of Bankruptcy Procedure of the Judicial Conference of the United States, for which he served two terms. He also served as a commissioner from Illinois for the National Conference of Commissioners on Uniform State Laws from 1997-2001. Prof. Tabb advised the Chinese government on the reform of its enterprise bankruptcy law, which then went into effect in June 2008. He is a member of the American Law Institute and a Fellow of the American College of Bankruptcy, for which he served on its Board of Regents. Prof. Tabb received his bachelor's degree *summa cum laude* and Phi Beta Kappa from Vanderbilt University, and his J.D. from the University of Virginia, where he served on the *Virginia Law Review* and was elected to the Order of the Coif.

Guests

Hon. Rebecca B. Connelly is Chief U.S. Bankruptcy Judge for the Western District of Virginia in Harrisonburg. She became the court's first female judge when she was appointed in 2012. Judge Connelly began her career as a law clerk to Martin V.B. Bostetter, Jr., then went on to practice bankruptcy law in Washington, D.C., and Virginia. She was next appointed as standing chapter13 trustee and as chapter 12 trustee for the Western District of Virginia. Judge Connelly received her undergraduate degree from the University of Maryland and her J.D. from Washington & Lee University.

Rosa J. Evergreen is a partner in the Washington, D.C., office of Arnold & Porter Kaye Scholer LLP in its Bankruptcy and Restructuring group. She has experience in all aspects of bankruptcy and corporate restructuring, including complex chapter 11 cases, asset dispositions and bankruptcy litigation, as well as out-of-court restructurings and receivership cases. Ms. Evergreen has acted on behalf of corporate debtors, secured and unsecured creditors, bondholders, lenders, trade vendors and suppliers, private-equity funds, investors and asset-purchasers, and individuals and businesses involved in bankruptcy court litigation. She is active in many bankruptcy-related professional organizations, including ABI, the International Women's Insolvency & Restructuring Confederation and the Turnaround Management Association. She also frequently writes and lectures on a number of bankruptcy-related topics. Ms. Evergreen has received numerous recognitions, including *Chambers USA* as "Up and Coming," *Washingtonian Magazine*, *The Best Lawyers in America* and *Washington, DC Super Lawyers*, and she was recognized by *Turnaround & Workouts* as an "outstanding young restructuring lawyer" for 2017. Prior to joining Arnold & Porter, she was a law clerk to Hon. Stephen C. St. John of the U.S. Bankruptcy Court for the Eastern District of Virginia. Ms. Evergreen received her B.A. from Georgetown University and her M.B.A. and J.D. from William & Mary.

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