32nd Annual
Northwest Bankruptcy Institute

Cosponsored by the
OSB Debtor-Creditor Section and the
WSBA Creditor Debtor Rights Section

Friday, April 5, 2019, 8:30 a.m.–5:30 p.m.
Saturday, April 6, 2019, 9 a.m.–Noon

Oregon: 7.5 General CLE credits, 1.25 Business Marketing credits, and 1 Ethics credit
Washington: 8.75 Law & Legal credits and 1 Ethics credit
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Save the Date!

33rd Annual
Northwest Bankruptcy Institute

Friday, April 3, 2020
Saturday, April 4, 2020
Hyatt Regency Seattle
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SCHEDULE

Friday, April 5, 2019

7:30  Registration and Continental Breakfast

8:30  Socially Awkward: Understanding the Legal Ethics of Being Online
      David Elkanich, Holland & Knight LLP, Portland, OR

9:00  Transition Break

9:30  Breakout A: Bankruptcy Bermuda Triangle: Unbundling and Factoring in Consumer
      Bankruptcy Cases
      Edward Boltz, Law Offices of John T. Orcutt, Durham, NC
      Gary Dyer, Office of the U.S. Trustee, Spokane, WA

      Breakout B: 363 Sales: Pertinent Issues and Alternatives
      Timothy Conway, Tonkon Torp LLP, Portland, OR
      John Lucas, Pachulski Stang Ziehl & Jones, San Francisco, CA
      Mark Northrup, Miller Nash Graham & Dunn LLP, Seattle, WA

10:00 Networking Break

10:30 Ninth Circuit Case Review
      The Honorable Frank Kurtz, U.S. Bankruptcy Court, Eastern District of Washington, Yakima, WA
      The Honorable Peter McKittrick, U.S. Bankruptcy Court, District of Oregon, Portland, OR
      Ann Chapman, Vanden Bos & Chapman LLP, Portland, OR

12:00 Lunch

1:30  Chapter 13 Recent Developments
      Keith Lundin, U.S. Bankruptcy Judge (Ret.), Pittsburgh, PA
      Henry E. Hildebrand, III, Chapter 13 Trustee, Middle District of Tennessee, Nashville, TN

3:15  Transition Break

3:20  Breakout C: Student Loans and Bankruptcy
      Edward Boltz, Law Offices of John T. Orcutt, Durham, NC
      Latife Neu, Attorney at Law, Seattle, WA

      Breakout D: Rethinking Cramdown Interest Rates in Chapter 11
      Kevin Badgley, Davis Wright Tremaine LLP, Seattle, WA
      Professor Diane Lourdes Dick, Seattle University School of Law, Seattle, WA
      Brian Hulse, Davis Wright Tremaine LLP, Seattle, WA

4:20  Networking Break

4:30  Breakout E: Chapter 7 and 13 Trustee Hot Topics
      Russell Garrett, Jordan Ramis PC, Lake Oswego, OR
      Wayne Godare, Office of the Chapter 13 Trustee, Portland, OR
      Michael Malaier, Office of the Chapter 13 Trustee, Tacoma, WA

      Breakout F: The Highs and Lows of Marijuana Businesses and Bankruptcy
      Thomas Buford, Bush Kornfeld LLP, Seattle, WA
      Susan Ford, Sussman Shank LLP, Portland, OR
      Dominique Scalia, D. Bugbee & Scalia PLLC, Seattle, WA

5:30  Adjourn to Hosted Reception
SCHEDULE (Continued)

Saturday, April 6, 2019

8:00  Breakfast and Late Registration

9:00  Judges Roundtables
      The Honorable Marc Barreca, *U.S. Bankruptcy Court, Western District of Washington, Seattle, WA*
      The Honorable Trish Brown, *U.S. Bankruptcy Court, District of Oregon, Portland, OR*
      The Honorable Timothy Dore, *U.S. Bankruptcy Court, Western District of Washington, Seattle, WA*
      The Honorable David Hercher, *U.S. Bankruptcy Court, District of Oregon, Portland, OR*
      The Honorable Brian Lynch, *U.S. Bankruptcy Court, Western District of Washington, Tacoma, WA*
      The Honorable Peter McKittrick, *U.S. Bankruptcy Court, District of Oregon, Portland, OR*
      The Honorable Thomas Renn, *U.S. Bankruptcy Court, District of Oregon, Eugene, OR*

10:30 Networking Break

10:45 Making Bank on Bankruptcy Using Social Media
      Daliah Saper, *Saper Law, Chicago, IL*

Noon  Adjourn
FACULTY

Kevin Badgley, *Davis Wright Tremaine LLP, Seattle, WA.* Mr. Badgley concentrates his practice on commercial real estate and finance transactions. His finance practice includes representation of both lenders and borrowers in connection with real estate term loans, construction loans, and asset-based lending transactions. He also has experience representing lenders in providing construction and permanent financing for multifamily residential projects that qualify for low-income housing tax credits and tax-exempt bond financing. He is a member of the Washington State Bar Association and the State Bar of Michigan.

The Honorable Marc Barreca, *U.S. Bankruptcy Court, Western District of Washington, Seattle, WA.* Prior to taking the bench in 2010, Judge Barreca was a partner with K&L Gates LLP, where his practice included representing Chapter 11 creditor committees and debtors-in-possession, secured and unsecured creditors, and municipalities in commercial bankruptcy cases, buyers of assets from bankruptcy estates, and creditors and debtors in workout negotiations. Judge Barreca is cochair of the American Bar Association Business Law Section Business Bankruptcy Committee Bankruptcy IP and Technology Subcommittee and past chair of the Washington State Bar Association Creditor-Debtor Section.

Edward Boltz, *Law Offices of John T. Orcutt, Durham, NC.* Mr. Boltz represents clients in Chapter 7 and 13 and related consumer rights litigation, including fighting abusive mortgage practices and developing solutions for student loans. Mr. Boltz is past president and current member of the National Association of Consumer Bankruptcy Attorneys (NACBA) Board of Directors and cochair of its Legislative Committee. He also serves on the Bankruptcy Council for the North Carolina Bar Association and the American Bankruptcy Institute Consumer Commission. In April 2008, Mr. Boltz testified on behalf of NACBA in Congress regarding the need for changes to the Bankruptcy Code to protect National Guard and Reservists from the harsh results of the means test, which was enacted as the National Guard and Reservists Debt Relief Act. Mr. Boltz is a frequent speaker on bankruptcy issues at both national and local seminars. He is a member of the North Carolina State Bar, where he has been certified as a specialist in consumer bankruptcy law.

The Honorable Trish Brown, *U.S. Bankruptcy Court, District of Oregon, Portland, OR.* Judge Brown is Chief Judge of the U.S. Bankruptcy Court for the District of Oregon. Prior to her appointment to the bench, she was in private practice focusing on bankruptcy and corporate reorganizations, loan workouts and foreclosures, real estate transactions, and mediating and arbitrating all aspects of debtor-creditor, real estate, and contract disputes. Judge Brown is a member of the Oregon State Bar Debtor-Creditor Section, chair of the National Conference of Bankruptcy Judges Finance Committee, and a member of the Commercial Law League. She is licensed in Oregon, Washington, and Virginia, and she is certified in business bankruptcies by the American Board of Certification.

Thomas Buford, *Bush Kornfeld LLP, Seattle, WA.* Mr. Buford represents clients in all aspects of commercial insolvency, including debtors, committees, trustees, and receivers, in Washington and Alaska. Prior to joining Bush Kornfeld, Mr. Buford was the Assistant United States Trustee in Seattle, Anchorage, and Portland.

Ann Chapman, *Vanden Bos & Chapman LLP, Portland, OR.* Ms. Chapman focuses her practice on complex consumer and small business bankruptcy matters for individuals in Chapter 7 and 13. She also handles workouts for small business owners and represents creditors in contested matters in Chapters 7 and 13. She is a past chair of the Oregon State Bar Debtor-Creditor Section, has served on the section’s Executive Committee, and has been an active member of many of the section’s subcommittees over the years. She is the 2014 recipient of the section’s William N. Stiles Debtor-Creditor Section Award of Merit for her service to members of the Debtor-Creditor Section, including her contributions to legal education, pro bono activities, and the promotion of professionalism among lawyers in the section.
Timothy Conway, *Tonkon Torp LLP, Portland, OR.* Mr. Conway’s practice includes Chapter 11 corporate reorganizations, workouts, debtor-creditor law, and commercial litigation. He has substantial experience representing Chapter 11 debtors-in-possession, creditors’ committees, secured and unsecured creditors, and enterprises seeking to acquire assets. He is admitted to practice in both Oregon and Washington.

Professor Diane Lourdes Dick, *Seattle University School of Law, Seattle, WA.* Professor Dick is an Associate Professor of Law at Seattle University, where she focuses her teaching and scholarship on commercial finance, corporate bankruptcy and out-of-court restructuring, mergers and acquisitions, and corporate taxation. Professor Dick regularly consults with attorneys, investors, private equity funds, and think tanks about commercial finance, bankruptcy and insolvency, and business taxation. Professor Dick is Treasurer of the Washington State Bar Association Business Law Section, and she is a member of the WSBA Legal Opinions Committee, the Washington Corporate Act Revisions Committee, and the Washington Citizen Commission for Performance Measurement of Tax Preferences. She has been invited to deliver lectures at the Harvard Kennedy School, The Brookings Institution, and professional association meetings, law schools, and graduate tax programs around the country. A prolific author, Professor Dick has published or has forthcoming articles in law reviews, peer-reviewed journals, practitioner-oriented publications, and prominent commercial law blogs. Her scholarship has been showcased by *The New York Times* and Reuters Breakingviews and has been cited and discussed by courts and litigants. She has coauthored reports in Washington and Florida providing guidance for lawyers overseeing business and commercial real estate transactions. She is admitted to practice in Washington, Florida, and the District of Columbia.

The Honorable Timothy Dore, *U.S. Bankruptcy Court, Western District of Washington, Seattle, WA.* Judge Dore was sworn in as a bankruptcy judge for the Western District of Washington on April 4, 2011. Prior to his judicial appointment, Judge Dore spent his entire 23-year legal career at the Seattle law firm of Ryan Swanson & Cleveland PLLC; he served as chair of the firm’s bankruptcy and creditors’ rights group for more than a decade. He also served a term on the firm’s executive committee. The vast majority of Judge Dore’s legal work in private practice was in bankruptcy law and situations involving financial distress. Judge Dore represented many Chapter 11 debtors in business cases and Chapter 7 trustees in all types of cases. His practice included adversary proceedings, appeals, out-of-court workouts, and receiverships. He also served as a receiver and a Chapter 11 trustee. Judge Dore has been involved in various activities supporting Consumer Education and Training Services (CENTS).

Gary Dyer, *Office of the U.S. Trustee, Spokane, WA.* Mr. Dyer is the Assistant U.S. Trustee in Spokane and Seattle, Washington, and Anchorage, Alaska. He has been with the United States Trustee’s Office for 30 years in offices in California, Washington, Oregon, and Montana.

David Elkanich, *Holland & Knight LLP, Portland, OR.* Mr. Elkanich focuses his practice on litigation, with an emphasis on legal ethics and risk management. He advises both lawyers and law firms in a wide range of professional responsibility matters. In addition, Mr. Elkanich has a commercial litigation practice, where he regularly represents clients in the financial services industry. Mr. Elkanich is an adjunct professor at Lewis & Clark Law School, where he has taught the required ethics course (Regulation and Legal Ethics) since 2012. He is an active member of the Oregon State Bar, including service on the Discipline System Review Committee and Legal Ethics Committee. He is also a member of the Multnomah Bar Association, the Association of Professional Responsibility Lawyers, and the ABA Center for Professional Responsibility. Mr. Elkanich is admitted to practice in Idaho, Washington, and Oregon.
Susan Ford, Sussman Shank LLP, Portland, OR. Ms. Ford focuses on resolving complex business problems for clients, both in and out of the courtroom. She advises businesses and individuals on strategic entity governance and restructuring issues. She specializes in Chapter 11 reorganizations, liquidations, and receiverships. Ms. Ford’s trial practice includes business and commercial litigation cases, regulatory-related actions, and bankruptcy litigation. She practices primarily in Oregon and Washington but also appears in jurisdictions outside the Pacific Northwest. Ms. Ford is the immediate past chair of the firm’s Business Restructuring and Bankruptcy Group. Ms. Ford is a member of the American Bankruptcy Institute, the American Bar Association, the Multnomah Bar Association, the Turnaround Management Association Northwest Chapter board, the National Turnaround Management Association Network of Women, the Oregon State Bar Debtor-Creditor Section, Business Litigation Section, and Business Law Section, and the Washington State Bar Association Creditor Debtor Rights Section. Ms. Ford is a regular speaker and moderator at continuing legal education programs.

Russell Garrett, Jordan Ramis PC, Lake Oswego, OR. Mr. Garrett focuses his practice on bankruptcy and creditors’ rights, commercial litigation, real estate, and general business matters. He has broad experience in a wide range of business issues, as well as bankruptcy and other commercial litigation, real property transactions, leases, and complex issues involving shareholder disputes and fiduciary representation, including receiverships and trustees. He frequently helps clients with statutory issues, LLC member disputes, easements, boundary line disputes, and other business concerns. He serves on a panel of Chapter 7 Trustees for the Western District of Washington. Mr. Garrett is a member of the American Bar Association Young Lawyer Division Fellows, the Clark County (Washington) Bar Association, the Federal Bar Association, the Oregon State Bar Debtor-Creditor Section Legislative Subcommittee, the Washington State Bar Debtor-Creditor Section; Litigation Section; Real Property Section; and Probate and Trust Section, the American Bankruptcy Institute, and the National Association of Bankruptcy Trustees. He is also a Delegate in the Oregon State Bar House of Delegates. He is admitted to practice in Oregon and Washington and before the U.S. Supreme Court.

Wayne Godare, Office of the Chapter 13 Trustee, Portland, OR. Mr. Godare has been the Standing Chapter 13 Trustee for the Portland Division of the United States Bankruptcy Court since 2010. Prior to his appointment, he was staff attorney at the trustee’s office for 10 years. He is a member of the National Association of Chapter 13 Trustees. He is admitted to practice in Arizona, Wyoming, and Oregon.

The Honorable David Hercher, U.S. Bankruptcy Court, District of Oregon, Portland, OR. Judge Hercher has been on the bankruptcy bench since 2017. Prior to that, he was an attorney and partner with Miller Nash LLP in Portland and Seattle.

Henry E. Hildebrand, III, Chapter 13 Trustee, Middle District of Tennessee, Nashville, TN. Mr. Hildebrand has served as Standing Trustee for Chapter 13 cases 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 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 (ABC) and serves on ABC’s Faculty Committee. He is chair of the National Association of Chapter 13 Trustees (NACTT) Legislative and Legal Affairs Committee and a member of the NACTT Academy for Consumer Bankruptcy Education, Inc., Board of Directors. He is an adjunct faculty member for the Nashville School of Law and St. Johns University School of Law. In addition, Mr. Hildebrand has been appointed a commissioner to the American Bankruptcy Institute Consumer Bankruptcy Review Commission.
Brian Hulse, Davis Wright Tremaine LLP, Seattle, WA. Mr. Hulse focuses his practice on real estate finance, commercial lending and transactions, loan workouts, and insolvency. He chairs the American Bar Association Commercial Finance Committee State Law Survey Task Force and was editor-in-chief and author of the Washington chapters in the books *Commercial Lending Law: A State-by-State Guide* and *The Law of Guaranties: A Jurisdiction-by-Jurisdiction Guide to U.S. and Canadian Law*, both published by the ABA. He is a Fellow and Regent of the American College of Commercial Finance Lawyers, a Fellow of the American College of Mortgage Attorneys, and a member of the Washington State Bar Association Legal Opinions Committee.

The Honorable Frank Kurtz, U.S. Bankruptcy Court, Eastern District of Washington, Yakima, WA. Judge Kurtz is a bankruptcy judge for the Eastern District of Washington and Chief Judge for the Bankruptcy Appellate Panel. Prior to his appointment to the bankruptcy bench, Judge Kurtz sat as a judge on the Washington State Court of Appeals for nine years, and before that he practiced bankruptcy law in Yakima. As a lawyer, Judge Kurtz chaired the Washington State Bar Association Creditor Debtor Rights Section. He was a founding director and first cochair of the Bankruptcy Bar Association for the Eastern District of Washington. During his tenure as a Washington state court judge, Judge Kurtz served as a member of the Court of Appeals Executive Committee and the Board for Judicial Administration. He also chaired the Washington State Judges Ethics Advisory Committee.

John Lucas, Pachulski Stang Ziehl & Jones, San Francisco, CA. Mr. Lucas represents debtors, creditors’ committees, creditors, and trustees in Chapter 11 cases and companies in out-of-court restructurings with an emphasis on transportation, financial products, food services, retail, automotive, and technology. Mr. Lucas is past cochair of the American Bankruptcy Institute Annual Southwest Bankruptcy Conference and past Advisory Board Member of the American Bankruptcy Institute Annual Southwest Bankruptcy Conference. He is admitted to practice in California and New York.

Keith Lundin, U.S. Bankruptcy Judge (Ret.), Pittsburgh, PA. Judge Lundin served on the United States Bankruptcy Court for the Middle District of Tennessee from 1982 through 2016 and on the Bankruptcy Appellate Panel for the Sixth Circuit from 1997 through 1999. He is an Adjunct Professor at Vanderbilt University School of Law and Emory University School of Law and a Visiting Professor at the University of New Mexico School of Law. He is a member of the National Bankruptcy Conference. Judge Lundin is a contributing editor for *Norton Bankruptcy Law and Practice* (West Group) (Chapter 13) and managing editor for the *Norton Bankruptcy Law Advisor* (Thomson Reuters). Judge Lundin is the author of *Lundin on Chapter 13* (Bankruptcy Press), LundinOnChapter13.com.

The Honorable Brian Lynch, U.S. Bankruptcy Court, Western District of Washington, Tacoma, WA. Judge Lynch was sworn in as a United States Bankruptcy Judge for the Western District of Washington, Tacoma Division, on June 1, 2010. He was appointed Chief Bankruptcy Judge of the District on October 1, 2014, and served as chair of the Conference of Ninth Circuit Chief Bankruptcy Judges in 2017. He serves on the Ninth Circuit ADR Committee and previously served on the Circuit Bankruptcy Judges Education and IT Committees. Prior to his appointment, he served as the Standing Chapter 13 Trustee for the Portland Division of the District of Oregon and as the Standing Chapter 12 Trustee for the District of Oregon.

Michael Malaier, Office of the Chapter 13 Trustee, Tacoma, WA. Mr. Malaier is the Chapter 13 Standing Trustee for the Western District of Washington–Tacoma/Vancouver. He oversees 17 employees, conducts 341 meetings, reviews cases prior to and following confirmation, drafts motions and memoranda concerning all issues relevant to Chapter 13, and appears in court regularly. Prior to entering the field of bankruptcy law, Mr. Malaier had a criminal defense practice representing both privately retained and publicly assigned clients.
The Honorable Peter McKittrick, *U.S. Bankruptcy Court, District of Oregon, Portland, OR.* Judge McKittrick has been a bankruptcy judge for the District of Oregon since January 12, 2015. Before his appointment, he was in private practice and spent most of his time serving as a panel Chapter 7 trustee, Chapter 11 trustee, and receiver. He was appointed as Chapter 11 and 7 trustee in one of the largest and highest-profile liquidations in the district’s history. He administrated more than 13,000 Chapter 7 cases and managed several state and federal receiverships, including large investment fraud and Ponzi scheme cases. His law practice emphasized representation of trustees and other fiduciaries, Chapter 11 debtors and committees, and small businesses in workouts. He also has taught bankruptcy law as an adjunct professor at Lewis and Clark Law School.

Latife Neu, *Attorney at Law, Seattle, WA.* Ms. Neu focuses her practice on helping student loan borrowers resolve defaults, stop wage garnishments, defend against collection lawsuits, obtain loan forgiveness or cancellation, and discharge student loans entirely. She is a member of the King County Bar Association Bankruptcy Law Section and Solo/Small Firms Section, the Washington State Bar Association Creditor Debtor Rights Section and Solo and Small Practice Section, the American Bar Association, and the National Association of Consumer Bankruptcy Attorneys.

Mark Northrup, *Miller Nash Graham & Dunn LLP, Seattle, WA.* Mr. Northrup focuses his practice on creditor-debtor relationships, including all aspects of insolvency, workouts, bankruptcy, receiverships, and business reorganizations. Although Mr. Northrup has represented both debtors and creditors committees in Chapter 11 cases, he most frequently appears as counsel for secured creditors. He is a member of the Washington State Bar Association Creditor-Debtor Section Executive Committee, where he edits the section’s newsletter. He was an early member of the committee that ultimately produced Washington’s revised Receivership Act. Mr. Northrup has been a frequent speaker at professional seminars for both institutional credit managers and attorneys.

The Honorable Thomas Renn, *U.S. Bankruptcy Court, District of Oregon, Eugene, OR.* Judge Renn was appointed to the bankruptcy bench in 2011. Prior to his appointment, Judge Renn served as a Chapter 7 Panel Trustee for the District of Oregon. In addition to his regular duties, Judge Renn serves as a member of the Ninth Circuit Advisory Board to the Justice Anthony M. Kennedy Library and Learning Center and helps coordinate the Oregon portion of the Ninth Circuit Civics Contest. Judge Renn has been active in the Oregon State Bar and is past chair of the Debtor Creditor Section. Judge Renn has been an adjunct professor teaching bankruptcy law at both the University of Oregon School of Law and Lewis and Clark Law School.

Daliah Saper, *Saper Law, Chicago, IL.* Ms. Saper is nationally recognized for helping brands protect their trademarks and copyrights online and litigating cutting-edge cases involving anonymous online defamation, revenge porn, sexting, cyberbullying, and other emerging internet law, technology, and intellectual property issues. In 2011, she made international headlines when she represented a “catfishing” victim before the Illinois Supreme Court. Ms. Saper is a commentator for national news media including CNN, Fox News, CNBC, ABC News, *Bloomberg Businessweek, The New York Times,* and *Advertising Age.* She writes a column for *Business.com* and is the author of the “Ask Daliah” series for the *American Bar Journal,* in which she answers reader questions about building a 21st-century law firm. Ms. Saper also serves as an Adjunct Professor at Loyola University Chicago School of Law. A frequent speaker, panelist, and instructor for businesses and institutions around the world, Ms. Saper has addressed a wide variety of organizations ranging from SXSW in Austin Texas to NASA.
Dominique Scalia, D. Bugbee & Scalia PLLC, Seattle, WA. Ms. Scalia focuses her practice on bankruptcy, receiverships, and commercial litigation. She has successfully represented receivers and creditors at multiple contested hearings in both state and federal courts. She is admitted to practice in Washington and New York.
Chapter 1

Socially Awkward: Understanding the Legal Ethics of Being Online

David Elkanich
Holland & Knight LLP
Portland, Oregon

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Chapter 1—Socially Awkward: Understanding the Legal Ethics of Being Online

Agenda & Introduction

» A few introductory points
  - Social media and you
  - Honesty essential
» Blogging, tweeting, Instagram, oh my
» Responding to negative reviews
» And conflicts!

» Questions
Chapter 1—Socially Awkward: Understanding the Legal Ethics of Being Online

Why do we care about social media?

The world communicates through social media

Facebook Dominates the Social Media Landscape

Monthly active users of selected social networks and messaging services*

<table>
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<tr>
<th>Platform</th>
<th>Monthly Active Users</th>
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<tbody>
<tr>
<td>Facebook</td>
<td>2,006M</td>
</tr>
<tr>
<td>Whatsapp</td>
<td>1,300M</td>
</tr>
<tr>
<td>Messenger</td>
<td>1,209M</td>
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<tr>
<td>WeChat</td>
<td>128M</td>
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<tr>
<td>Instagram</td>
<td>709M</td>
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<td>632M</td>
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<tr>
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<tr>
<td>Pinterest</td>
<td>175M</td>
</tr>
<tr>
<td>Snapchat</td>
<td>165M**</td>
</tr>
<tr>
<td>Vkontakte</td>
<td>93M</td>
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</tbody>
</table>

*Latest data (Dec '16 – Jul '17) **Daily active users

SOURCE: Company data

Holland & Knight
It is not a question of whether you will engage in social media, but rather how well you do it.

#socialmedia #twoquickintropoints

Lawyer:
"Hey all! How is it going. I am married to an incredibly beautiful woman, AND I get to hang out with high school chicks all day (and some evenings too). I have even been lucky with a few. It just doesn't get better than this."
Lesson: always a lawyer

Court:

“[I]t is necessary to identify the nexus between the lawyer's conduct and the lawyer's fitness to practice law to establish that the lawyer's conduct is of the type of conduct for which this court may call the lawyer to answer.”

Oregon RPC 8.4(a)(3); WA RPC 8.34(c)

Lesson: no anonymity

Holland & Knight
No. 2. Honesty remains an essential ingredient
Lessons learned

» Advertising rules apply online
» Oregon and WA RPC 7.1 provides:
  - A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.

» Don’t omit necessary facts (to make whole)
» Avoid unjustified expectations
» And unsubstantiated comparisons
» Consider appropriate disclaimers
Scenario #1: tweeting and blogging

Ari Gold is a bankruptcy lawyer with an active blog and twitter presence. He regularly tweets and shares his opinions about recent decisions from the Court of Appeals and the Supreme Court. Ari is excited because just this week, the Oregon Supreme Court ruled in his client’s favor on an important case he had pending before it, which is a threshold issue in his practice area. The first thing Ari does is tweet a link to the Court’s slip opinion, and later in the day, writes a blog post about the Court’s decision, including citing to several facts and holdings in the opinion. Although Ari gives his opinion about the case, he is careful not to discuss anything not in the record below or on appeal. Before heading home that night, he adds the case to his website under both “Clients” and “Representative Matters.”

» May Ari blog, tweet, and talk about the Supreme Court’s decision?

» May Ari cite the case in a brief that he is writing and is due this week?

» May Ari update his website in this manner?
Chapter 1—Socially Awkward: Understanding the Legal Ethics of Being Online

» RPC 1.6 (Confidentiality): A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

» ABA Formal Opinion 480 (2018) (Confidentiality Obligations for Lawyer Blogging and Other Public Commentary)

- Lawyers who blog or engage in other public commentary may not reveal information relating to a representation, including information contained in a public record, unless authorized by a provision of the Model Rules.

» RPC 1.6 provides no exception for information that is "generally known" or "contained in a public record."

» Client identity could be protected too. Be careful with hypotheticals.

But what does it mean to “reveal”? 

» Colo. Formal Op. 130 (2017) (“Nor is there an exception for information otherwise publicly available. For example, without informed consent, a lawyer may not disclose information relating to the representation of a client even if the information has been in the news.”);

» Hunter v. Va. State Bar, 744 S.E.2d 611 (Va. 2013) (rejecting state bar’s interpretation of Rule 1.6 as prohibiting lawyer from posting on his blog information previously revealed in completed public criminal trials of former clients). The Court said:

- “To the extent that the information is aired in a public forum, privacy considerations must yield to First Amendment protections. In that respect, a lawyer is no more prohibited than any other citizen from reporting what transpired in the courtroom.”

» Gentile v. State Bar of Nevada, 501 US 1030 (1991), recognized that attorney speech about public cases is protected by the First Amendment, but that such speech may be regulated if it poses a substantial likelihood of materially prejudicing a pending case.
Scenario #2: addressing online reviews

As part of Elizabeth’s marketing initiative, she begins to look for online reviews of her services. She is pleased to see many positive reviews but she is dismayed to find that a former client gave her a ½ star on various sites and wrote “Lawyer botched my unlosable case. Don’t hire this lawyer. She’s the worst bk lawyer ever. She lied to me, was mean to me, and simply stopped calling me back – literally abandoned me. You are warned.”

Elizabeth is shocked. Yes, she lost an adversary proceeding she filed on her client’s case, and yes, she originally thought her case was a winner and told him so. But then she learned that the client had lied to her about the case and the court found that he committed perjury during trial.

Elizabeth contacted the website and ask them to take down the review. They refuse. So she takes matters into her own hands and publishes the following response:

“You know that you lost your case because you lied under oath and the judge found you committed perjury. No lawyer would have been able to save you from your lying self.”
Commenting on comments

» Yes, we know you want to respond to every comment about your legal services on Avvo, LinkedIn, your blog, etc… but first:
  - Breathe
  - Consider the merits of the complaint

  - Then:
    1. Contact the provider
    2. Respond directly, or
    3. Do nothing

RPC 1.6(a): “A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).”

» In re Skinner, 295 Ga. 217, 758 S.E.2d 788 (2014) and In re Tsamis, Comm’n File No. 2013P00095 (Ill. 2014) (reprimands for disclosing confidential client information in response to negative online reviews)

» In re Quillian, 20 DB Rptr. 288 (2006) (Oregon 90-day suspension for disclosing client information on the OSB workers comp list serv)
Is this really the standard we want?

» NYSBA Op 1032 (2014): “The inquiry raises the question whether a lawyer may rely on this exception to disclose a former client’s confidential information in response to a negative web posting, even though there is no actual or threatened proceeding against the lawyer. We do not believe that a lawyer may do so.”

» Pennsylvania Bar Opinion 2014-30: “We conclude, therefore, that a lawyer cannot reveal client confidential information in response to a negative online review without the client’s informed consent.”

» Texas Opinion 662 (August 2016): Tx lawyer may not publish a response. But “[t]he lawyer may post a proportional and restrained response that does not reveal any confidential information or otherwise violate the Texas Disciplinary Rules of Professional Conduct.”

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« RPC 1.6 (b)(4) [Oregon] or (b)(5) [Washington]

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

» (4) 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 against 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;

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» (b) lawyer to the extent the lawyer reasonably believes necessary:

» (5) may reveal information relating to the representation of a client 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 against 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;
Comment [10]:

[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 involving the conduct or representation of a former client. 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.
Scenario #3: conflicts of interest

» Associates Ann and Mike are talking about their life at the firm. Ann says that she may just have landed a great new client (“NC”) through online social networking with a “friend” of a “friend” on Facebook.

» Ann and NC privately IM’d each other for about an hour over the weekend during which time Ann obtained detailed, otherwise secret information about NC’s messy impending divorce. Ann, wanting to show off her legal skills, provided NC with legal advice on the best way to proceed. The two agreed that NC would come in on Monday to sign a fee agreement. Ann then identifies to Mike NC’s real name and the name of her soon-to-be ex-husband.

» Mike, in shock, says that Big Partner has already agreed to handle the other side of the case and that a fee agreement with ex-husband had already been signed.

Don’t forget: watch out for conflicts

» Intended and unintended attorney-client relationships
  - Be careful online
  - Always run (and update) conflicts

» Think of clients like Velcro
» Is NC a client of Ann’s? May Ann represent NC?
» May Mike continue to represent soon-to-be-ex-husband?
» If Ann may not continue to represent Ann, must or may the soon-to-be-ex-husband be told the confidential information that was provided to Ann?
» May screening be employed for any purpose?
» From a risk management perspective, could Ann have taken different steps to avoid the issues that arose in this fact pattern?

» Difference between prospective v. current client.
  - Cf. RPC 1.18 and RPC 1.7
Questions?

David Elkanich is a partner in Holland & Knight's Portland office, where he focuses his practice on litigation, with an emphasis on legal ethics and risk management. David advises both lawyers and law firms in a wide range of professional responsibility matters, including attorney discipline matters and in related litigation.

David enjoys speaking and writing on ethics issues and is an adjunct professor at Lewis & Clark Law School, where he has taught the required ethics course (Regulation and Legal Ethics) since 2012. You can read his (occasional) musing on Twitter @DavidElkanich.

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**Relevant Oregon and Washington RPCs**

**OR and WA RPC 1.1:**

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

**OR RPC 1.6:**

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

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

1. to disclose the intention of the lawyer's client to commit a crime and the information necessary to prevent the crime;
2. to prevent reasonably certain death or substantial bodily harm;
3. to secure legal advice about the lawyer's compliance with these Rules;
4. 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 against 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;
5. to comply with other law, court order, or as permitted by these Rules; or
6. in connection with the sale of a law practice under Rule 1.17 or 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. In those circumstances, a lawyer may disclose with respect to each affected client the client's identity, the identities of any adverse parties, the nature and extent of the legal services involved, and fee and payment information, but only if the information revealed would not compromise the attorney-client privilege or otherwise prejudice any of the clients. The lawyer or lawyers receiving the information shall have the same responsibilities as the disclosing lawyer to preserve the information regardless of the outcome of the contemplated transaction.

**WA RPC 1.6:**

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

(b) A lawyer to the extent the lawyer reasonably believes necessary:
Chapter 1—Socially Awkward: Understanding the Legal Ethics of Being Online

(1) shall reveal information relating to the representation of a client to prevent reasonably certain death or substantial bodily harm;

(2) may reveal information relating to the representation of a client to prevent the client from committing a crime;

(3) may reveal information relating to the representation of a client 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 crime or fraud in furtherance of which the client has used the lawyer's services;

(4) may reveal information relating to the representation of a client to secure legal advice about the lawyer's compliance with these Rules;

(5) may reveal information relating to the representation of a client 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 against 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;

(6) may reveal information relating to the representation of a client to comply with a court order;

(7) may reveal information relating to the representation 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; or

(8) may reveal information relating to the representation of a client to inform a tribunal about any client's breach of fiduciary responsibility when the client is serving as a court appointed fiduciary such as a guardian, personal representative, or receiver.

(c) 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.

OR RPC 1.7:

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

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

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer; or
(3) the lawyer is related to another lawyer, as parent, child, sibling, spouse or domestic partner, in a matter adverse to a person whom the lawyer knows is represented by the other lawyer in the same matter.

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

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

(2) the representation is not prohibited by law;

(3) the representation does not obligate the lawyer to contend for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client; and

(4) each affected client.

**WA RPC 1.7:**

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

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

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

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

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

(2) the representation is not prohibited by law;

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

(4) each affected client gives informed consent, confirmed in writing (following authorization from the other client to make any required disclosures).

**OR RPC 1.18:**

(a) A person who consults with a lawyer about the possibility of forming a client-lawyer relationship with respect to a matter is a prospective client.
(b) Even when no client-lawyer relationship ensues, a lawyer who has learned information from a prospective client shall not use or reveal that information, except as Rule 1.9 would permit with respect to information of a former client.

(c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d).

(d) When the lawyer has received disqualifying information as defined in paragraph (c), representation is permissible if:

   (1) both the affected client and the prospective client have given informed consent, confirmed in writing, or:

   (2) the lawyer who received the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client; and

   (i) the disqualified lawyer is timely screened from any participation in the matter; and

   (ii) written notice is promptly given to the prospective client

WA RPC 1.18:

(a) A person who consults with a lawyer about the possibility of forming a client-lawyer relationship with respect to a matter is a prospective client.

(b) Even when no client-lawyer relationship ensues, a lawyer who has learned information from a prospective client shall not use or reveal that information, except as Rule 1.9 would permit with respect to information of a former client or except as provided in paragraph (e).

(c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraphs (d) or (e). If a lawyer or LLLT is disqualified from representation under this paragraph or paragraph (c) of LLLT RPC 1.18, no lawyer in a firm with which that lawyer or LLLT is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d).

(d) When the lawyer has received disqualifying information as defined in paragraph (c), representation is permissible if:

   (1) both the affected client and the prospective client have given informed consent, confirmed in writing, or:
(2) the lawyer who received the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client; and

(i) the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom; and

(ii) written notice is promptly given to the prospective client.

(e) A lawyer may condition a consultation with a prospective client on the person's informed consent that no information disclosed during the consultation will prohibit the lawyer from representing a different client in the matter. The prospective client may also expressly consent to the lawyer's subsequent use of information received from the prospective client.

OR and WA RPC 7.1:

A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.

OR RPC 8.4:

(a) It is professional misconduct for a lawyer to:

(1) violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(2) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(3) engage in conduct involving dishonesty, fraud, deceit or misrepresentation that reflects adversely on the lawyer’s fitness to practice law;

(4) engage in conduct that is prejudicial to the administration of justice; or

(5) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate these Rules or other law, or

(6) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law

(7) in the course of representing a client, knowingly intimidate or harass a person because of that person’s race, color, national origin, religion, age, sex, gender identity, gender expression, sexual orientation, marital status, or disability.
(b) Notwithstanding paragraphs (a)(1), (3) and (4) and Rule 3.3(a)(1), it shall not be professional misconduct for a lawyer to advise clients or others about or to supervise lawful covert activity in the investigation of violations of civil or criminal law or constitutional rights, provided the lawyer's conduct is otherwise in compliance with these Rules of Professional Conduct. "Covert activity," as used in this rule, means an effort to obtain information on unlawful activity through the use of misrepresentations or other subterfuge. "Covert activity" may be commenced by a lawyer or involve a lawyer as an advisor or supervisor only when the lawyer in good faith believes there is a reasonable possibility that unlawful activity has taken place, is taking place or will take place in the foreseeable future.

(c) Notwithstanding paragraph (a)(7), a lawyer shall not be prohibited from engaging in legitimate advocacy with respect to the bases set forth therein.

WA RPC 8.4:

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

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

(e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;

(f) knowingly

(1) assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law, or

(2) assist or induce an LLLT in conduct that is a violation of the applicable rules of professional conduct or other law;

(g) commit a discriminatory act prohibited by state law on the basis of sex, race, age, creed, religion, color, national origin, disability, sexual orientation, honorably discharged veteran or military status, or marital status, where the act of discrimination is committed in connection with the lawyer's professional activities. In addition, it is professional misconduct to commit a discriminatory act on the basis of sexual orientation if such an act would violate this Rule when committed on the basis of sex, race, age, creed, religion, color, national origin, disability, honorably discharged veteran or military status or marital status. This Rule shall not limit the ability of a lawyer to accept, decline, or withdraw from the representation of a client in accordance with Rule 1.16;
(h) in representing a client, engage in conduct that is prejudicial to the administration of justice toward judges, lawyers, or LLLTs, other parties, witnesses, jurors, or court personnel or officers, that a reasonable person would interpret as manifesting prejudice or bias on the basis of sex, race, age, creed, religion, color, national origin, disability, sexual orientation, honorably discharged veteran or military status, or marital status. This Rule does not restrict a lawyer from representing a client by advancing material factual or legal issues or arguments.

(i) commit any act involving moral turpitude, or corruption, or any unjustified act of assault or other act which reflects disregard for the rule of law, whether the same be committed in the course of his or her conduct as a lawyer, or otherwise, and whether the same constitutes a felony or misdemeanor or not; and if the act constitutes a felony or misdemeanor, conviction thereof in a criminal proceeding shall not be a condition precedent to disciplinary action, nor shall acquittal or dismissal thereof preclude the commencement of a disciplinary proceeding;

(j) willfully disobey or violate a court order directing him or her to do or cease doing an act which he or she ought in good faith to do or forbear;

(k) violate his or her oath as an attorney;

(l) violate a duty or sanction imposed by or under the Rules for Enforcement of Lawyer Conduct in connection with a disciplinary matter; including, but not limited to, the duties catalogued at ELC 1.5;

(m) violate the Code of Judicial Conduct; or

(n) engage in conduct demonstrating unfitness to practice law.
# Chapter 2

## Bankruptcy Bermuda Triangle: Unbundling and Factoring in Consumer Bankruptcy Cases

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The Risks and Rewards of Unbundling in Chapter 7

Presented by:
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Disclaimer:
These materials and the opinions expressed are not necessarily the position of the U.S. Department of Justice and cannot be used against the U.S. Department of Justice or the Office of the U.S. Trustee.
Outline of Presentation

- What is unbundling?
- Why unbundle services?
- How unbundle services?
- No money down cases
  - Self Financing
  - Factoring
- Statutes and Rules affecting these cases

What is unbundling?

Unbundling is the practice of limiting the scope of services that an attorney will provide—“dividing comprehensive legal representation into a series of discrete tasks, only some of which the client contracts with the lawyer to perform.” In re Seare, 493 B.R. 158 (Bankr. D. Nev. 2013) 3

Instead of traditional representation, where a lawyer handles a case from start to finish, limited scope representation, also known as “unbundling” or “discrete task representation,” involves representation in which a lawyer performs some, but not all, of the work. In re Ruiz, 515 B.R. 362 (Bankr. M.D. Fla. 2014).
Why unbundle fees?

- Provide immediate representation to the client at no or low cost.
- Retain more clients who would normally balk at initial fees.
- Obtain a competitive advantage over firms which require higher fees to begin representation.
- Increase total compensation paid if additional unforeseen work is required.

Why unbundle fees?

- Articles and academic studies have found that attorneys may steer clients towards chapter 13 based on race and class.
- These finding presume that such biases are driven by both the higher up-front costs of chapter 7 and the higher allowed fees in chapter 13.
- Recommendations from such papers have included unbundling to allow less expensive chapter 7 case.
How to unbundle fees

• Zero down vs. partial money down.
• One contract vs. two contract models.
  • See Bethea v. Robert J. Adams & Assocs., 352 F.3d 1125, 1127 (7th Cir. 2003)

Financing chapter 7 Cases

• General practice: obtain all fees from the client before filing a chapter 7 bankruptcy.
• For zero/low down fee chapter 7 cases attorneys usually use
  • Self financing
  • Factoring entity
Financing Chapter 7 Cases

- **Self Financing**
  - Firm assumes the risk of the debtor not paying
  - Must have enough income flow from other cases to cover non-payment.
  - Firms have duty to update compensation of attorney form (2016(b)) if receive money after filing.
  - Under Bankruptcy Rule 2017 the Court can examine payments received after filing.

Financing chapter 7 Cases

- **Factoring Entities**
  - Generally will pay debtor’s attorney a percentage of the fee up front
    - Either after the original attorney client agreement is signed or
    - After a 2nd post-petition agreement is signed.
  - Debtor’s attorney assigns rights to collect on fees to factoring agency.
  - Usually have a “claw back” provision between factor and attorney if the client doesn’t make payments.
Financing chapter 7 Cases

• Factoring Benefits
  • Allows attorneys who need cash immediately to obtain payment.
  • Levels the playing field between firms who can self-finance (usually larger firms) and other firms who can’t.
  • Provides “financing” to debtors who can’t (or don’t want) wait to pay their attorney’s fees in full before filing bankruptcy.

Financing chapter 7 Cases

• Factoring Detriments
  • May artificially increase the total of attorneys fees charged to compensate for the factor’s percentage of the fee.
  • The Debtor will receive collection letters and calls after filing for bankruptcy.
  • Puts the firm at risk of examination and turnover of attorneys fees. These claims are usually brought against the firm, not the factoring company.
Statutes and Rules regarding unbundling and factoring

- “A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.”
  - Rule 1.2(c)(Scope of Representation)
  American Bar Association, Center for Professional Responsibility, Model Rules of Professional Conduct.

Statutes and Rules regarding unbundling and factoring

- The issue is whether the debtor has given “informed consent”, which includes:
  - the facts and circumstances giving rise to the situation;
  - an explanation of the material advantages and disadvantages of the proposed course of conduct;
  - a discussion of options and alternatives; and
  - in some circumstances, a recommendation to seek the advice of other counsel.

- These disclosures should be in writing.
• Under the specific circumstances, determining if “informed consent” was reasonably adequate, may include review of:
  • whether the client or other person is experienced in legal matters generally;
  • whether the client or other person is experienced in making decisions of the type involved; and
  • whether the client or other person is independently represented by other counsel in giving the consent.

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Statutes and Rules regarding unbundling and factoring

• 11 U.S.C. § 329(b) allows the court to review and adjust the compensation of a debtor’s counsel if “such compensation exceeds the reasonable value of any such services.”.

• Disgorgement under § 329 is a remedy where debtor’s counsel’s services are insufficient and ineffective in order to “redress losses caused by insufficient work by counsel.” In re Moragne, 2013 WL 3336605 at *4 (Bankr. D. Haw. July 2, 2013); Hale v. U.S. Trustee, 509 F.3d 1139, 1147 (9th Cir. 2007).

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Statutes and Rules regarding unbundling and factoring

- Under §329, courts have reduced fees that were increased to cover the percentage paid to a factoring company, i.e. the normal chapter 7 fee is $1200.00, because the factor takes 25%, the fee is increased to $1,600.00. See In re Wright, Case Nos. 17-11936-M (Bankr. N.D. Okla. 2018).

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Statutes and Rules regarding unbundling and factoring

- Rule 2017 directs the court to review any payments or transfers, or agreements for either, made directly or indirectly by debtors to an attorney, either before or after the filing of the bankruptcy case, to determine if those payments or transfers are excessive.
Statutes and Rules regarding unbundling and factoring

• The advisory committee’s comments regarding Rule 2017 explain its purpose:
  • This rule ... is premised on the need for and appropriateness of judicial scrutiny of arrangements between a debtor and his attorney to protect the creditors of the estate and the debtor against overreaching by an officer of the court who is in a peculiarly advantageous position to impose on both the creditors and his client.

Statutes and Rules regarding unbundling and factoring

• A chapter 7 discharge permanently enjoins collection of “all debts that arose before the date of the order for relief.” 11 U.S.C. § 727(b).
  • The automatic stay prevents any act to “collect, assess or recover a claim against the debtor that arose before the commencement of the case.” 11 U.S.C. §§ 362(b), 523(a).
  • These sections are relevant to the argument that collection of fees post-petition is a violation of the automatic stay or discharge injunction.
Statutes and Rules regarding unbundling and factoring

- 11 U.S.C. § 526(a)(4) prohibits an attorney from advising an “assisted person” “to incur more debt ... to pay an attorney ... a fee or charge for services performed as part of preparing for or representing a debtor in a” bankruptcy case.
- This rule supports the argument that a 2<sup>nd</sup> contract signed after the petition is filed is a violation.

Statutes and Rules regarding unbundling and factoring

- 11 U.S.C. § 526(c) provides that, on motion of the United States Trustee, if the court finds that a person intentionally violated Section 526 or engaged in a “clear and consistent pattern or practice” of violating Section 526, it may enjoin the violation or impose civil penalties.
• 11 U.S.C. § 526(c)(1) states that any contract that doesn’t comply with Sections 526-528 is unenforceable.
• 11 U.S.C. § 528(a)(1) requires a written contract within 5 business days after the first instance of bankruptcy assistance.
• Bankruptcy assistance is defined at § 101(4A) very broadly to include any services provided with the purpose of providing advice, document preparation, or filing related to a bankruptcy.

These sections make the two contract model potentially problematic if a case isn’t filed within 5 days of the first instance of bankruptcy assistance.

These provisions may undercut the two-contract system supported by Bethea v. Robert J. Adams & Assocs., 352 F.3d 1125, 1127 (7th Cir. 2003)
Statutes and Rules regarding unbundling and factoring

• NACBA doesn’t have an official position on unbundling or factoring fees in a chapter 7 bankruptcy.
• However, it is very important to review the materials for this session along with your local caselaw to make an informed decision.
FURTHER READING

Utah State Bar Ethics Opinion 17-06 re “$99” or “Zero Down” Bankruptcies

In re Biggar, 110 F.3d 685 (9th Cir., 1997)


U.S. Trustee Complaint for Disgorgement of Fees, Civil Penalties, Sanctions, and Declaratory, Injunctive, and Other Relief in In re Gilmore, Case No. 6:17-bk-13682-MJ (U.S. Bankruptcy Court for the Central District of California Riverside Division, 2017)

In re Grimmett (Bankr. Idaho, 2017)

In re Grimmett (District of Idaho, 2018)


In re Hines, 147 F.3d 1185 (9th Cir., 1998)

The United States Trustee’s Amended Pretrial Statement in In re Neufville, Case No. 17-24812-NVA (Bankr. D.Md. 2018)
Attorneys’ Fees

Should ‘No Money Down’ Chapter 7s Be Allowed?

A push to ease big up-front costs of Chapter 7 bankruptcy is gaining attention as proponents seek to change bankruptcy law to help the worse off financially avoid a more painful restructuring. The American Bankruptcy Institute’s Commission on Consumer Bankruptcy has been asked to help with the effort to find a way for attorneys to file Chapter 7 cases without being paid all their fees up front, as is now the practice. Only Congress can change the Bankruptcy Code.

The issue is important for debt-ridden consumers who’d benefit more from Chapter 7, but who can’t afford a lump sum advance payment. These debtors often are forced into Chapter 13, a longer and more expensive process with less assurance of good results.

There were about 364,000 Chapter 7 petitions filed in the first nine months of 2017, according to Epiq Systems. It’s not clear how many more debtors are put off from seeking that type of relief because of cost.

Attorneys fees in Chapter 7 cases can run anywhere from $500 to $5,000 but are typically between $1,500 and $2,500 for individuals, depending on where in the country they’re filed.

Judges Advocate for Change At least two bankruptcy judges have advocated publicly for the change, arguing that without such a provision, destitute debtors who can’t afford to pay their legal fees in advance would be forced to file Chapter 13 cases, which allow for fees to be paid after the filing but can take longer and be more expensive.

In Chapter 7, a debtor’s nonexempt assets, those that cannot be kept, are liquidated by a trustee, and the proceeds distributed to creditors. Subject to certain exceptions, the debtor is awarded a discharge, effectively wiping out debts. The process can be relatively quick, with a debtor receiving a discharge within months of filing the case.

In Chapter 13, individuals receiving regular income can obtain debt relief while retaining their property. To do so, the debtor must propose a plan that uses future income to repay all or a portion of the debt over a three- to five-year period. The debtor receives a discharge only after making all the plan payments.

Forcing Debtors to Choose Ch. 13 The problem is that those who may be best suited for a Chapter 7, the poorest of the poor, are often compelled to file Chapter 13 if they want guidance from an attorney through the bankruptcy system.

“It’s an access to courts issue,” John Rao told Bloomberg Law Oct. 16. Rao is an attorney with the National Consumer Law Center, based in Boston.

Practitioners agree that filing Chapter 13 is more expensive for the debtor in the long run, and there is a much greater risk that the desired result—the granting of the discharge—won’t be realized in a Chapter 13 case. For example, the debtors may fail to make all their plan payments, Rao said.

But Chapter 13 may be the only option for debtors who can’t afford to pay their entire legal fees in advance of a Chapter 7 filing.

“Current practice nationally is to prohibit a Chapter 7 debtor from entering into an agreement to pay his attorney fees over a period of time, including the period after discharge,” Judge Rebecca B. Connelly, of the U.S. Bankruptcy Court for the Western District of Virginia, wrote in a prepared statement submitted to the commission.

“I talk to people all the time who don’t have the money to file a Chapter 7,” M. Jonathan Hayes told Bloomberg Law Oct. 16. Hayes is a member of Simon Resnik & Hayes in Sherman Oaks, Calif., and has practiced consumer bankruptcy law for 37 years in the Central District of California.

Hayes said that he would likely accept cases for $500 down and the rest paid over time if he were allowed. But he can’t accept those types of clients, who often end up trying to file themselves or going to petition preparers who are not attorneys, or seeking out less experienced counsel.

Section 524(f) allows a debtor to voluntarily reaffirm—or agree to pay—a debt that would otherwise be discharged in bankruptcy. But for a lawyer to ask a client to reaffirm a debt for attorneys’ fees would be fraught with ethical concerns. Can a lawyer demand a client reaffirm a debt that would otherwise be discharged? That arguably creates a conflict of interest for the attorney, Rao said.

In order to reaffirm the debt ethically, the debtor would need advice from an independent counsel, not a “realistic solution,” Rao said.

Creating a Fix The ABI Commission on Consumer Bankruptcy is charged with researching and recommending improvements to the consumer bankruptcy
system that can be implemented within its existing structure, according to its website.

Connelly has suggested that the commission recommend changes that would authorize a Chapter 7 debtor to contract to pay attorney fees over a period of time, from exempt assets or other non-property of the estate, or that would permit voluntary repayment of attorney fees. Alternatively, she suggested excepting debtor attorney fees in Chapter 7 from the discharge.

"I don't know that making Chapter 7 attorney fees non-dischargeable is the right way to solve the problem, but there should be some way for a lawyer to get paid after the case is filed," Hayes said.

Rao said "the simplest solution would be to have a narrow exception to the Chapter 7 discharge."

Not everyone agrees that attorneys' fees in a Chapter 7 are dischargeable. Judge Paul W. Bonapfel, of the U.S. Bankruptcy Court for the Northern District of Georgia, has stated that those fees actually create a post-petition claim, arising only upon the filing of the bankruptcy case. Post-petition claims in a Chapter 7 aren't eliminated by the debtor's discharge.

But at least one circuit court has taken a position opposite to that of Bonapfel. In Bethea v. Robert J. Adams & Assocs., the Seventh Circuit ruled that the attorneys fees were discharged and ordered that fees they collected after the case was filed be returned to the debtors.

Unethical to File a 13? Some attorneys, unable to accept a fee over time for filing a Chapter 7, instead put their clients into a Chapter 13. Most jurisdictions allow "fee-only" Chapter 13 cases.

Bonapfel has said at continuing education seminars that he doesn’t see how an attorney can ethically put a client into Chapter 13 just because it’s the only way the client can afford bankruptcy counsel without paying his legal fees in advance.

"Those fee only chapter 13 plans are a violation of professional responsibility and the lawyer's duties to the client," he told Bloomberg Law Oct. 13.

And as noted by Connelly, the common practice is that Chapter 7 fees are discharged, making it hazardous for an attorney to represent a Chapter 7 debtor without being paid in full upfront.

A question then is: could making an attorney’s fees for a Chapter 7 filing non-dischargeable solve this dilemma?

BY DANIEL GILL

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NACBA 26TH ANNUAL CONVENTION

DENVER

Rustling Up Bankruptcy Unbundling

Saturday, April 21, 2018

11:30 AM

Panelists:

Tessa Santiago, Esq., Packard, Packard & Johnson, Salt Lake City, Utah

Michael Sousa, Associate Professor, Sturm College of Law, University of Denver

Alex Dolhancyk, Esq., Peachtree City, GA
An attorney’s quest to be paid a reasonable fee for services rendered is not a new one. Chapter 7 attorneys have been using their legal imagination for decades to create a way, within the law, to ensure payment, or at least create an avenue to collect otherwise dischargeable fees. Although there is never a guarantee of payment in any business venture, it seems Chapter 7 lawyers have an uphill battle to recover for their valuable services. Not only do they have to seek payment from a client who may be unwilling or unable to pay, attorneys must carefully navigate legal parameters such as various Bankruptcy Code sections, state rules of professional conduct, and ethical considerations.

The simplest way of allowing Chapter 7 attorneys to be fairly compensated is for Congress to amend the Bankruptcy Code to add attorney’s fees as an exception to discharge. Until that happens, attorneys will continue to explore and test the boundaries of professional representation and seeking payment.

At least one court noted:

Chapter 7 attorney fees are not obligations that are compensable from the bankruptcy estate, thus a Chapter 7 lawyer must, in a perfect world, collect his fee in full from the debtor prepetition. Because Chapter 7 debtors often do not have sufficient funds to pay attorney fees up front, lawyers often enter into pre-petition agreements allowing debtors to pay part of the fees pre-petition and the balance of the fees post-petition. This arrangement, however, runs afoul of the general rule that pre-petition debts are dischargeable. In re Abdel-Hak, 2012 Bankr. LEXIS 5393 (Bankr. E.D. Mich. 2012)

To address the possible dischargeability of pre-petition fees, some attorneys attempt to divide their services into pre-petition services and post-petition services and enter into separate contracts for each; or use one contract but limit services to be performed in the case.

1. What is “unbundling”?

Unbundling is the practice of limiting the scope of services that an attorney will provide—“dividing comprehensive legal representation into a series of discrete tasks, only some of which the client contracts with the lawyer to perform.” In re Seare, 493 B.R. 158 (Bankr. D. Nev. 2013)
Instead of traditional representation, where a lawyer handles a case from start to finish, limited scope representation, also known as “unbundling” or “discrete task representation,” involves representation in which a lawyer performs some, but not all, of the work. *In re Ruiz*, 515 B.R. 362 (Bankr. M.D. Fla. 2014)

In a Chapter 13 case, attorney fees are paid with assets of the estate through confirmed plans. Chapter 13 lawyers are paid for both pre- and post-petition services. Chapter 7 attorneys are not so fortunate. *In re Abdel-Hak*, 2012 Bankr. LEXIS 5393 (E.D. Mich.)

2. What are the different versions of unbundling?
   - No money down vs. partial money down cases
   - One contract vs. two contract models

3. What is the purpose of unbundling?
   - Is there any benefit to debtors?
   - Simply to collect fees?
   - Ethical and professional considerations

4. One-contract vs. two contracts for services

5. One flat or fixed fee contract will likely not work:
   
   The Court finds the division of a flat fee arrangement into prepetition and postpetition parts to be conceptually inconsistent and therefore untenable. The Court therefore joins those other courts which hold that when a flat or fixed fee prepetition agreement is at issue, the fee must be paid in full prior to the commencement of the debtor's case or the fee is discharged under § 727(b). *In re Michel*, 509 B.R. 99 (E.D. Mich. 2014)

6. Most, if not all, state bar rules allow limiting scope of representation
   - Limit on scope of representation must be with client’s informed consent and must be reasonable
   - Example: Criminal defense attorneys may limit representation to preliminary hearing only
   - Example: Personal injury attorneys may limit representation to settlement negotiations only and no trial representation, or no representation on appeal
   - See *In re Jackson*, 2014 Bankr. LEXIS 3160 (W.D. La 2014) (discussing scope of representation)
7. Where does unbundling Chapter 7 services get off track?

- No clearly defined “end segment” as in above examples
- Not able to clearly limit services without jeopardizing the discharge
- Chapter 7 is one process—in the Code, in the local rules, in the ECF system.
- If debtor’s intent in filing Chapter 7 is to discharge debt, how does unbundling services help the client?
- Factoring attorney fee contract creates additional conflicts of interest
- Attorney’s desires to enter into post-petition non-dischargeable fee agreement conflicts with code.
- Any fees received must be applied first to outstanding filing fees. Cannot hold filing fee hostage for attorney fees. Rule 1006(a). Nor can attorney fee be received before filing fee is paid, if order to pay fee in installments is paid.

8. Case law review

- How are courts handling unbundled Chapter 7 representation model?
- Is unbundling allowed even with full disclosure?
- What is “full disclosure”? See In re Jackson

9. Local Practice Review

- Do your local rules suggest scope of representation in Chapter 7?
- Do your state’s rules of professional conduct offer guidance?

10. Are other options available for getting paid post-filing or post-discharge?

- Is any attempt to collect fees post-filing allowed?
- Are any jurisdictions allowing post-filing/discharge fee collections?
- Nothing prevents a debtor from voluntarily repaying any debt, including attorney’s fee
- Where/when is the line crossed?
- Can a debtor sign, post-filing, a reaffirmation agreement for attorney’s fees? See In re Frazier, 231 B.R. 454 (Banrk. D.Conn 1999) (inherent conflict) (also sets out factors for reasonableness of fees).
- Can an attorney seek payment based on quantum meruit?
  - Is this an action in state court or bankruptcy court?
    1. In re Abdel-Hak, 2012 Bankr. LEXIS 5393 (Bankr. E.D. Mi. 2012) (no quantum meruit recovery for services rendered post-petition because the code does not specifically except fees from discharge)
    2. In re Hines, 147 F.3d. 1185 (9th Cir. 1998) (fees are incurred when rendered and an action for quantum meruit may be justified for post-petition services)
3. However, note pending California case In re Gilmore, Bk. No. 17-13682, AP No. 01271 (C.D. Calif); In re Neufville, Bk. No. 17-24812 (Bankr. Md.) UST motion to examine fees, sanctions, BK Billing bifurcation model, same issues as in Gilmore
   - Would a judge consider a fee application in a Chapter 7 case seeking to determine that amount of fees earned post-filing?
   - Does Fed.R.Bankr.P. 2017(b) offer a basis to seek a determination of fees?

- What should your 2016(b) disclose for fees? Should it include an hourly rate for post-petition services? Should it identify pre- and post-petition services and fees for each?

Cases:

A. In re Hines, 147 F.3d. 1185 (9th Cir. 1998)

FACTS: Debtor signed one fee contract for Chapter 7 services that covered both pre- and post-petition services for a total fee of $875. $375 was paid pre-petition and the $500 balance was to be paid in tendered post-dated checks.

HELDr: Attorney could not collect the $500 fee balance because any unpaid balance was dischargeable based on the pre-petition contract. However, the court found that the attorney can look to reasonable compensation under a quantum meruit theory of recovery. An attorney has a “claim” for compensation when those services are rendered. Since the services in question were rendered post-petition, § 362 is not implicated and the attorney may recover for services actually rendered. Here, since the debtor terminated the attorney’s services post-filing the case was remanded to the bankruptcy court to determine what amount of the $500 was earned after filing but before services were terminated.

B. In re Michel, 506 B.R. 99 (E.D. Mi. 2014)

FACTS: Debtor and attorney signed a pre-petition “flat fee” agreement and debtor paid $450 of the $900 fee. The balance was to be paid after the case was filed. After the § 341 meeting was concluded debtors paid the $450 balance. Attorney amended the 2016(b) statement to reflect that the entire flat fee was paid prior to the filing of the amended 2016(b). The UST didn’t like that and asked the court to order fees returned to debtor.

HELDr: The $450 received post-petition ordered to be returned to debtor. Debtor’s single pre-petition contract “draws no distinction between pre-petition services and post-petition services to be rendered, and does not in any way apportion the $900.00 flat fee… into a fee amount for pre-petition services and a fee amount for post-petition services. The Court agrees with those cases holding that this kind of pre-petition flat fee agreement in a Chapter 7 case creates a debt that is entirely a pre-petition debt, which therefore is subject to the automatic stay and is dischargeable in the Chapter 7 case.” Quantum meruit theory of compensation denied under these facts.
C.  *Abdel-Hak* 2012 Bankr. LEXIS 5393 (Bankr. E.D. Mi. 2012)

**FACTS:** Attorney used a single, pre-petition contract and received $2,000 pre-filing. Attorney setting out an hourly rate, kept records of time spent post-filing, and sought recovery under quantum meruit after he successfully withdrew from case.

**HELD:** The court denied the request stating: Because the Code specifically identifies the types of pre-petition debts that survive discharge, and the unpaid portion of pre-petition fee agreements are not specified as debts which survive discharge, the Court cannot, under the guise of equity, find that the fees sought in the present case survive discharge.

D.  *In re Grimmett*, 2017 Bankr. LEXIS 1492 (D. Idaho 2017) (affm’d on appeal)

**FACTS:**

1. Debtor signed a pre-petition fee agreement:
   - $2,000 flat fee
   - Agreement divides legal services into pre- and post-petition services
   - $500 for certain pre-petition services; $1,500 for certain post-petition services
   - $500 paid prior to filing
   - $250 to be paid monthly after filing

2. If any fee payment was missed, debtor agreed to certain consequences: late fee of $100, entire balance due, 36% interest on unpaid balance, the filing fee might not be paid to the court, case could be dismissed without a discharge, counsel would seek to withdraw, collection action would be started, counsel could recover attorney fees, costs, and expenses

3. A skeletal petition was filed (no schedules)

4. Debtor filed an application to pay filing fee in installments (granted)

5. After the initial $500 payment debtor stopped making payments

6. While case still pending, attorney started collection activity, including numerous emails demanding payment. The court pointed out some attorney emails that contained:
   - Threats to withdraw from the case
   - Statements that the case may be dismissed/debtor would have to start all over
   - Assertions of serious consequences such as collections and default interest

7. Debtor wrote letter to judge (never good):
   - “Bankruptcy is stressful enough and humiliating, then on top I have my lawyer threatening me with having my case dismissed and having to start all
over with another attorney. My hair is falling out; I am a nervous wreck all the time and I don’t know what to believe.”

8. UST filed motion seeking cancellation of fee agreement and disgorgement of fees

9. In allowing disgorgement of all fees, the District Court upheld the Bankruptcy Court findings:

- The fee agreement could not attempt to unbundle services
- Over counsel’s argument, no recovery based on quantum meruit; counsel offered insufficient evidence to establish value of services actually provided
- The fee agreement created a conflict of interest between the attorney and debtor
- Rule 2016(b) disclosures were inaccurate
- Counsel tried to collect fees in violation of the court’s installment fee order

Where it Went Wrong:

- Multiple, inaccurate disclosure statements; court could not determine how the initial $500 was applied (to filing fee or attorney fee?); no receipts or accounting records on how funds applied; Section 329 disclosure requirement are mandatory, not permissive
- “Because the Fee Agreement did not specify that the filing fee payment would have to be paid before Counsel could collect compensation, it violated Rule 1006(b)” and the installment payment order
- Schedules filed by counsel showed debtor could not afford to pay the $250 monthly fee
- Counsel threatened to unbundle legal services, which the court construed as attempting to impermissibly withdraw as counsel in violation of local rules.
- Counsel cannot withdraw without leave of the court, notice to client, and notice and hearing
- “An attorney cannot threaten a client with future conduct that is otherwise prohibited by local rules.”
- The court denied any recovery based on value of services rendered because the record was void of any evidence of counsels’ time spent in the case: “Counsel’s right to payment does not arise until the services are actually provided. Accordingly, if Counsel seeks payment for post-petition services based on a contract signed before the bankruptcy petition is filed, it would behoove Counsel to keep contemporaneous time records to reflect when the legal services were provided.”

**FACTS:** In *In re Walton*, 454 B.R. 537 (M.D. Fla. 2011) (Part 1) the court ruled that attorney’s use of postdated checks deposited post-petition violated the automatic stay of § 362, the discharge injunction of § 524, and created a conflict of interest. The attorney’s method of doing business required clients to sign a single fee agreement with a flat fee, and payments by postdated checks after the case was filed.

After modifying its business model, the attorney adopted a two-contract procedure and the court reconsidered its position adopted in Part 1.

Part 2: The attorney now uses the following model:

- Client executes a pre-petition fee agreement for attorney to file the Chapter 7 petition ($250)
- After the pre-petition retainer is signed, attorney prepares petition and schedules
- Client comes back for second meeting to sign petition and schedules
- Attorney files petition only; then immediately prepares a post-petition retainer agreement
- Client makes arrangement to pay post-petition fees ($1,000)
- Once done, attorney files the rest of the schedules and statements

The UST filed a motion to determine if this method violated the court’s prior ruling. The court allowed this procedure with conditions:

- Debtors must be given disclosures and certain options explained in the pre-petition retainer agreement for post-petition legal services. Client must be given the following options regarding post-petition procedures:
  - Client can proceed pro se;
  - Client can retain same attorney; or
  - Client can retain another attorney
- Client cannot be forced to exercise any option the same day petition is filed; 14 day “cooling off” period
- The 2016(b) stated the pre-petition fee only
- If the attorney is retained post-petition, a new 2016(b) must be filed setting out the post-petition fee
- Attorney must continue to represent debtor during the 14 day cooling off period, and continue representation until allowed to withdraw (this must be stated in the 2016(b), too)
The court also required the attorneys to move the disclosure to a more prominent location in the retainer agreement (from the back to a separate cover sheet)

- The UST did not raise local rules or rules of professional conduct issues

Other Cases/Issues:

F. The above *Walton* model of bifurcating services (with three client options post-filing) is being challenged in California by the UST in *In re Gilmore*, Bk. Case No. 17-13682, AP No. 17-01271 (C.D. Ca.). In addition to the two-contract bifurcation model as used in Walton, the attorney here used a “zero money down” system and a factoring company, BK Billing, to finance fees. The UST seeks disgorgement of fees, cancellation of the two contracts, and other relief on the following basis:

- Material misrepresentations under §§ 526, 527, and 528; attorney did not disclose that pre-petition fees are dischargeable,
- Did not disclose to debtor that the fees would be financed with BK Billing or the terms of the financing (40% rate, total interest to be paid, payment terms)
- The advance of the filing fee was not disclosed
- Did not disclose to debtor that only the petition would be initially filed
- Did not explain the “zero money down” business model
- Filed post-petition schedules with debtor’s consent

OTHER CASES:

*In re Jackson*, 2014 Bankr. LEXIS 3160 (W.D. La. 2014): § 528(a)(1) requires a debt relief agency to execute a written contract prior to the filing of the bankruptcy petition. The court found the following to constitute material misrepresentations and ordered disgorgement of all fees:

1. The contract did not explain, clearly and conspicuously: (A) the services such agency will provide to such assisted person; and (B) the fees or charges for such services, and the terms of payment. Here, neither the pre-petition retainer agreement nor the post-petition retainer agreement identified the "terms of payment" within the meaning of § 528(a)(1)(B), including the date when the periodic installment payment was due and the amount of each payment. Instead, each agreement merely stated there would be a "flat fee of $2,400." This was a material misrepresentation. See §§ 526, 527, 528.

2. Attempting to unbundle services was in violation of local rules and rules of professional conduct that collectively impose certain required duties of the attorney, including those stated in § 521. Since the attorney could not, in fact, unbundle services (terminate services), the court deemed the contract materially misrepresented the attorneys’ duties.
3. The attorney is “required to render (and the Debtor was entitled to receive) all routine post-petition services essential to the case, such as filing documents required by § 521(a)(1)” as well as attendance at the meeting of creditors and assist client in reaffirmation/surrender decisions.

4. Because of the material misrepresentations, the court deemed both the pre- and post-petition contracts void pursuant to § 526(c)(1).

*In re Ruiz*, 515 B.R. 362 (Bankr. M.D. Fla. 2014). Pro se method; attorney prepared Chapter 7 petition, did not put his name on it or sign it, and instructed client to file petition pro se; court held cannot mask representation as an attorney if *any* legal advice is given to client.

*In re Collmar*, 417 B.R. 920 (Bankr. N.D. Ind. 2009). Attorney could not contractually limit scope of representation with debtor to exclude assistance with deciding to reaffirm a debt, a critical part of Chapter 7.

*In re Sandberg*, Bankr. No. 12-78596; AP no. 13-05050 (N.D. Ga. 2013) (unreported case, considered but rejected *Bethea*). Allowed payment of fees by post-dated checks with full disclosure to client that attorney’s fees are a dischargeable debt and there can be only minimal collection. In finding that attorney’s acceptance of post-dated checks was not fraudulent, the court held:

> It is true that collecting post-petition on pre-petition debts goes against the very fiber of the bankruptcy code and its undeniably important automatic stay. However, collecting attorneys’ fees that are contracted pre-petition for work performed post-petition, is entirely different from protecting the estates of newly filed debtors from looting creditors. The Seventh Circuit concluded that Congress must have intentionally left attorneys’ fees out when they enumerated the exceptions to discharge in section 523. However, is it logical that Congress did not intend for attorneys representing destitute chapter 7 debtors to be paid? Some attorneys can afford the luxury of turning away clients who cannot pay in full before filing, and some attorneys cannot. The bankruptcy system is a complicated one in which pro se prosecution is extremely difficult. To deprive struggling debtors of willing counsel in such a time of need is markedly opposite of the intentions of the Bankruptcy Code.


*In re Seare*, 493 B.R. 158 (Bankr. D. Nevada 2013). “A limitation on services violates the duty of competence if the unbundled service is reasonably necessary to achieve the client's reasonably anticipated result.” Here, the attorney’s attempt to remove adversary proceeding defense from the scope of representation was improper because the purpose in filing Chapter 7 was to address a debt involving a nondischargeable fraud claim, an expected complaint.
In re Egwim, 291 B.R. 559 (Banrk. N.D. Ga. 2003). A lawyer must represent the debtor in connection with all adversary proceedings and contested matters filed in the case which may affect the debtor's rights and interests unless and until the lawyer withdraws in accordance with local bankruptcy rules.

In re Slabbinck, 482 B.R. 576 (Bankr. E.D. Mi. 2013). No per se prohibition against unbundling “if the attorney's legal services for an individual debtor are unbundled between pre-petition services and post-petition services, in strict conformance with the MRPC . . . such unbundling of legal services does not by itself warrant any relief under § 329 of the Bankruptcy Code”.

In re Bethea, 352 F.3d. 1125 (7th Cir. 2003)
Question considered: are installment payments collected by lawyers post-petition on prepetition agreement subject to discharge?
**Rejects In re Hines, because this places lawyers in a superior position to other creditors re. Prepetition claims; logic in Hines shatters one agreement into multiple agreements in which each piece of work done is a separate claim.
Reasoning: prepetition retainer agreements are subject to discharge; attorneys can split agreements into pre- and post-petition retainer agreements, if client is fully informed.
Holding: Counsel must repay any sums collected after discharge entered; and any sums collected during pendency of action violated the stay.

Question: Does B.R. 1006 contemplate that fees can be paid in installments, and that attorneys may attempt to collect unpaid installment fees from discharged clients? In this case, the facts are similar to BK Billing, in that the collection efforts are done by the first attorney who purchased the Accounts Receivable (AR) from a placeholder attorney who filed cases while the first attorney was enjoined from practicing law.
Analysis: Reviews language of §329, §1006 and finds no language that creates an exception to discharge language of §727, if not listed as exception in §523; also rejects the Doctrine of Necessity, in which a trustee is allowed to pay prepetition debts to obtain services that are vital to a debtor's reorganization, as inapplicable.
**Suggestions for processes that don't violate the discharge: a) prepay in full in advance; b) break in pre- and post-petition services, and pay pre-petition in full; c) reaffirm the prepetition agreement; seek payment from third party guarantors, not from the debtor.
Holding: Attorney must cease all collection efforts on AR purchases for fees owed under prepetition agreements.

In re Griffin, 313 B.R. 757 (Bankr. N.D. Ill. 2004)
Question: Can post-petition request for fees stemming from prepetition agreement that was funded by AR third party, Redemption Funding, be paid from estate?
Analysis: Rejects In re Hines, which states that post-petition claims for fees are created when work is performed, and reasons that contract-based claims arise at time of signing of contract. All elements necessary to form contract were in play before petition was filed: contract, agreement to pay, billing for services and work under contract. Therefore, claim for fees presented to Court is prepetition claim subject to discharge.
**Reviews disclosure of third-party claim on schedules:
Attorney has arrangement with lender where lender makes post-petition loan to debtor, and proceeds of that loan are paid a) to counsel for prepetition debt created by retainer agreement, and b) to attorney for post-petition services. Court finds that prepetition contract conveys the right to post-petition services. **Finding:** Attorney cannot enter into retainer contract that leaves a conditional balance for potential post-petition services without disclosing conflict of interest and obtaining consent of client. BUT, even if that happened, Debtor schedules did not disclose in Rule 2014 application that Redemption Funding fronted the money for post-petition legal services. Court finds this a material misstatement and analogizes to Rule 2016: “attorney who fails to comply with 329 forfeits the right to receive compensation for services rendered for debtor.”

**Suggestion:** Split representation into two agreements, pre- and post-petition, which are actually entered into in two separate phases, or reaffirm the agreement, with full disclosure.

**Holding:** Claim cannot be paid by Court. Attorney should have disclosed third-party funding on request for compensation. Denies application for compensation in full.

**In re Mansfield,** 394 B.R. 783 (Bankr. E.D. Penn. 2008)

**Question:** Can a flat fee Chap. 7 retainer collect unpaid attorneys fees post-petition.

**Facts:** Flat Fee, $1,000 upfront, with $250 monthly installments with payments to begin after filing.

**Analysis:** Declines to adopt **In re Hines,** because analysis doesn’t comport with nature of a flat fee; defines a claim as arising when services are performed, and, because the fee agreement didn’t differentiate into pre- and post-petition services, all the services are prepetition obligations.

**Holding:** Collecting monthly installments after petition filed violates the automatic stay.


Legal fees which are segregated from prepetition legal fees and incurred for post-petition legal services constitute a post-petition debt and are, therefore, an obligation of the Chapter 7 debtor (as opposed to the estate) which he or she has an obligation to pay out of his or her post-petition earnings or exempt assets.

**In re Sanchez,** 241 F.3d. 1148 (9th Cir. 2001)

This case has good overview on 9th Cir. law on post-petition collection practices, but note that most circuits have come down against **In re Hines.**

**Facts:** Debtors paid 6 monthly installments after their case was filed. Attorney collected $700 post-petition but provided only $450 worth of post-petition services.

**Question:** Did attorney who collected post-petition fees in an amount greater than the amount that was later determined by the court to be reasonable violate the stay by collecting the additional $250.

**Holding:** While there is a discrepancy in the fee charged and what a reasonable fee is under the circumstances, it is not large enough to warrant disgorgement.
**In re Waldo, 417 B.R. 854 (Bankr. E.D. Tenn. 2009)**

**Facts:** seven consolidated cases, all with engagement letters that require $1,250 upfront flat fee or no-look fee, non-refundable, and retainer specifically states that the engagement is for pre-petition services and post-petition services, but that agreement creates “. Clients give attorneys post-dated checks to deposit post-petition.

**Question:** Do no-look fee agreements entered into prepetition that divides the services into pre- and post-petition that allow for the post-petition payment of fees in installments survive discharge?

**Analysis:** Court finds that attorney’s fees are fees that arose prepetition, irrespective of when the services were rendered because all elements to form contract were present pre-petition. Upon signing of agreement, attorneys were obligated to represent debtor in Ch. 7 case in exchange for payment. That some services were rendered post-petition does not change nature of obligation nor nature of the fee. All services fall within the scope of “Routine Case” under 11 U.S.C. Chap. 7. And debtor’s obligation to pay the fees arises on the date the agreements are entered into. If agreements were true “saddle-obligations,” the attorneys wouldn’t collect post-dated checks.

**Holding:** unpaid portions of a flat fee contracted for pre-petition constitutes a pre-petition obligation of a debtor which is dischargeable; attorneys cannot collect post-dated checks prepetition. Order attorneys to disgorge all attorney’s fees received in the seven cases, and return to Debtor’s all post-dated checks in their possession.

**In re Lawson, 437 B.R. 609 (Bank. E. D. Tenn. 2010)**

Follow up from **In re Waldo:** law firm tries to work around holding of **In re Waldo,** by taking checks from third parties prepetition.

**Facts:** Law firm retains clients under split retainer agreement, and take checks from third parties to pay the prepetition fees.

**Analysis:** The clients understood that they were signing an agreement that required them to pay the full fee for both pre- and post-petition services. The checks, even if they were from third parties, were post-dated and created the obligation in both parties to pay for and to provide services. The discharge of the obligation created by the prepetition retainer was not fully disclosed to the clients.

**Holding:** disgorgement of all fees obtained through these retainer agreements.

**This opinion analyzes in-depth the various retainer agreements and says why they still fall afoul of the Bankruptcy Code and the 727 discharge**

**In re Cadwell, 2018 U.S. App. LEXIS 8128 (11th Cir. Fla. 3/30/18)**

After considering several interpretations of § 526(a)(4), the court adopted the following:

Reading No. 3: "A debt relief agency shall not ... advise an assisted person or prospective assisted person to incur more debt [1] in contemplation of such person filing a case under this title or [2] to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title."

Attorney advised debtor to pay legal fees with a credit card and then set up automatic debits for post-filing payments. The court held that lawyer (including a law firm) violates 11 U.S.C. § 526(a)(4) if it advises a client to incur additional debt to pay for bankruptcy-related legal
representation, without respect to whether the advice was given for some independently "invalid purpose".
Chapter 2—Bankruptcy Bermuda Triangle: Unbundling and Factoring in Consumer Bankruptcy Cases

352 F.3d 1125
Albert BETHEA, et al., Plaintiffs Appellants,
v.
ROBERT J. ADAMS & ASSOCIATES; Law Offices of Melvin James Kaplan; and Zalutsky & Pinski, Ltd., Defendants-Appellees.

No. 03-1303.
United States Court of Appeals, Seventh Circuit.
Decided December 17, 2003.

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Timothy M. Kelly (argued), Beerman, Swerdlow, Woloshin, Barezky, Becker, Genin & Londo, Chicago, IL, for Appellees.

Phillip A. Bock (argued), Macey, Chern & Diab, Chicago, IL, for Debtor-Appellant.

Before CUDAHY, EASTERBROOK, and RIPPLE, Circuit Judges.

EASTERBROOK, Circuit Judge.

Three debtors in bankruptcy hired lawyers before filing their petitions. Each agreed to a retainer that would cover the legal services entailed in preparing and prosecuting the proceedings. Unlike most retainers, however, these were to be paid over time — some installments before the petition was filed, others thereafter. The lawyers performed as promised: all three debtors received their discharges, and the cases were closed. When the lawyers continued to collect the unpaid installments, the three debtors (with the assistance of new counsel) commenced adversary proceedings in which they asked the bankruptcy court to hold their former lawyers in contempt for violating the injunctions implementing the discharges. See 11 U.S.C. § 524.

Bankruptcy Judge Barliant concluded that attorneys' fees "reasonable" under 11 U.S.C. § 329(b) are not discharged. 275 B.R. 284 (Bankr.N.D.Ill.2002). Section 329, which deals directly with attorneys' compensation, supersedes the more general reach of 11 U.S.C. § 727, the discharge provision, the judge held, reasoning that any other conclusion would leave no work for § 329(b) to do. Because statutes should not be read to make any section ineffectual, the bankruptcy court thought that § 329(b) must be the only device for controlling debtors' legal fees. The debtors concede that the fees they had promised to pay their ex-attorneys are reasonable, so Judge Barliant dismissed the adversary proceedings. The district judge affirmed, substantially for the bankruptcy judge's reasons. 287 B.R. 906 (N.D.Ill.2003).

Section 727(b) reads: "Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for
relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title." Attorneys' fees are not among the debts excepted from discharge by § 523. The retainer is a pre-petition, liquidated debt; but even if it were an unliquidated "claim" for purposes of § 502, that claim also would be covered. Unless § 329 creates an unenumerated exception to § 727(b), the debts to these attorneys were discharged.

Section 329(a) requires every attorney representing a debtor in bankruptcy to file with the court a statement of all compensation received during the preceding year, or to be received, in connection with the bankruptcy. This statement enables the court to determine whether the lawyer has received a preferential transfer. Debtors may not care who gets what money remains (if the attorney gets more, other creditors get less), and, when clients do not haggle over price, some attorneys will be tempted to divert the funds to themselves by charging excessive fees. Section 329(b) requires bankruptcy judges to use the information supplied under § 329(a) to determine whether "such compensation exceeds the reasonable value of any such services". If it does, then "the court may cancel any such agreement, or order the return of any such payment, to the extent excessive". The bankruptcy and district judges believed that this power is exclusive of discharge under § 727; otherwise, they stated, § 329(b) would play no role in Chapter 7 cases even though 11 U.S.C. § 103(a) declares that it (like the rest of Chapter 3) applies to Chapter 7 proceedings.

Our difficulty with this approach is that § 329 has plenty to do in Chapter 7 cases, even if debts for legal fees are subject to discharge. First, prepaid fees exceeding the "reasonable" value of the legal services must be recouped for the benefit of other creditors. Second, the judge must ensure the reasonableness of any fees incurred during the proceeding itself, once more to protect other creditors. Third, if the debt is reaffirmed during the proceeding, yet again the judge must ensure reasonableness. Finally, if the debtor repudiates the executory portion of the agreement with counsel, and the estate rehires the same lawyer (an approach that gives administrative priority to ongoing legal fees), once again § 329(b) requires the judge to review the fee agreement for reasonableness. Because grouping legal fees with other debts subject to discharge does not gut § 329(b) for Chapter 7 cases, the structure of the Bankruptcy Code does not support treating § 329 as an implicit exception to § 727. We therefore agree with In re Biggar, 110 F.3d 685 (9th Cir.1997), that pre-petition debts for legal fees are subject to discharge under § 727. See also In re Sanchez, 241 F.3d 1148, 1150 (9th Cir.2001). Although Biggar is the only appellate decision squarely in point, almost every bankruptcy judge and district judge who has considered the question has come to the same conclusion — essentially everyone other than the judges in this litigation.

The three lawyers contend that reading § 727 this way would force the most destitute of debtors to forego legal assistance, because counsel neither could be paid in advance (the norm for Chapter 7 cases) nor could collect after the case ends. The bar therefore would shun these debtors, depriving them of the Code's benefits. That argument about what makes for good public policy should be directed to
Chapter 2—Bankruptcy Bermuda Triangle: Unbundling and Factoring in Consumer Bankruptcy Cases

Congress; the judiciary's job is to enforce the law Congress enacted, not write a different one that judges think superior. See *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 460-62, 122 S.Ct. 941, 151 L.Ed.2d 908 (2002). Cf. *United States v. Kras*, 409 U.S. 434, 93 S.Ct. 631, 34 L.Ed.2d 626 (1973) (filing fee that makes it possible to be "too poor to go bankrupt" must be implemented). For what it may be worth, however, we do not share the view that taking § 727(b) at face value necessarily injures deserving debtors. Those who cannot prepay in full can tender a smaller retainer for prepetition work and later hire and pay counsel once the proceeding begins — for a lawyer's aid is helpful in prosecuting the case as well as in filing it. Legal fees incurred after filing in such situations receive administrative priority; that prospect (plus some pre-filing retainer) should be enough to summon legal assistance. And debtors retain the ability to represent themselves, when legal aid cannot be found.

Bankruptcy Judge Barliant considered whether an intermediate position is possible, under which the portion of the retainer reflecting work done during the bankruptcy is immune from discharge, even if the portion of the retainer reflecting pre-filing work is discharged. *In re Hines*, 147 F.3d 1185 (9th Cir.1998), adopted that position, limiting *Biggar* to fees for pre-filing work. The *Hines* majority wrote that it thought the Code as written (and as implemented in *Biggar*) is unsatisfactory as a matter of public policy, and it decided to do a little surgery under what it called a "doctrine of necessity." See 147 F.3d at 1190-91. Like Judge Barliant, who concluded that *Hines* is wrongly decided, we do not conceive revision of the Code as a proper part of the judicial job. The Bankruptcy Code is a complex compromise among debtors and different kinds of creditors; tilting it to help one of these interests is unwarranted. Attorneys compete with other creditors, such as banks, credit card issuers, supermarkets, auto dealers, colleges, spouses, and children; some of these have obtained protection under § 523 and others have not. Judges are not entitled to override the legislative approach with a lawyer-centric public policy that puts members of their own social class higher in the priority list at the expense of other creditors, or of the debtors themselves.

Thus even though the debtors in this appeal have expressed willingness to accept the conclusion of *Hines*, we must determine whether that is a legally open middle ground. (Even when a litigant confesses error on a district court's conclusion, as these litigants effectively have done with respect to Judge Barliant's treatment of *Hines*, an appellate court must decide the issue independently. See *Lawrence v. Chater*, 516 U.S. 163, 170-71, 116 S.Ct. 604, 133 L.Ed.2d 545 (1996); *Rinaldi v. United States*, 434 U.S. 22, 98 S.Ct. 81, 54 L.Ed.2d 207 (1977). Failure to do so might lead to a remand with instructions to proceed in an unlawful manner.) Deciding whether to follow *Hines* is essential to the resolution of the appeal. Because both the bankruptcy judge and the district judge concluded that attorneys' fees are never discharged, the sums owed under the retainer have never been partitioned between pre- and post-filing work. We must either reverse outright (holding that the distinction is not legally material) or remand for apportionment; there is no way to duck.

*Hines* conceded that it was going against the Code's language. What is discharged is a claim to payment. One contract (the retainer) gives rise to one claim, meaning a "right to payment, whether or not such right is ... fixed, contingent, matured [or] unmatured". 11 U.S.C. § 101(5). See *Pennsylvania Department*

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of Public Welfare v. Davenport, 495 U.S. 552, 559, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990). Hines shattered each retained agreement into multiple claims by holding that a "claim" does not accrue until the legal services are performed. Each month (potentially each day or hour) that the lawyer performs services for the estate then becomes a separate claim. That contradicts both the Code and the retainer agreement, which says that the fee is due whether or not the client uses the services. (That's the difference between a retainer and an hourly fee. Judge Tashima's concurrence in Hines, 147 F.3d at 1192-93, which rejected the majority's legislative approach but accepted the outcome, depends on dividing the retainer into hourly units—a step that avoids rewriting the Code by rewriting the contract instead.)

What is more, even the transformation of one retainer into many claims (using either the approach of the Hines majority or that of Judge Tashima) is not enough to support that decision's holding, which is that fees for post-petition work are not discharged. The most a court could do is give administrative priority to post-petition fees for work in the action's prosecution. Yet if the debtor's estate is insufficient to pay administrative claims, even those are discharged. Nothing in the Code permits a categorical exception for any kind of debt other than one listed in § 523 — and legal fees are not on that list. Because this opinion creates a conflict with the ninth circuit's holding in Hines (though it follows the ninth circuit's original holding in Biggar), it was circulated before release to all active judges. See Circuit Rule 40(e). No judge favored a hearing en banc.

Counsel must repay the debtors any sums collected after the discharges were entered. If any sums were collected on account of the retainers during the bankruptcies in violation of the automatic stay, see 11 U.S.C. § 362, these too must be refunded to the estates. Whether additional steps may be warranted is a question for the bankruptcy and district judges to consider in the first instance, and the cases are remanded for that purpose.

VACATED AND REMANDED.

CUDAHY, Circuit Judge, concurring in part and dissenting in part.

I agree with the majority that the painstaking procedure provided in § 329 of the Bankruptcy Code to conform lawyers' charges to reasonable levels is not in "conflict" with the discharge provisions of §§ 727 and 524 or the automatic stay provision of § 362. The relationship of these sections may be awkward, and this awkwardness raises some questions about Congress's understanding and intent with respect to the discharge of attorneys' fees. It does seem implausible that Congress provided a procedure in § 329 to impose reasonableness on attorneys' fees only to simultaneously decree them discharged under § 727. But, as the majority holds, there is no conflict clear enough to defeat discharge, when attorneys' charges are not among the items specifically excepted from discharge by § 523. This conclusion knocks the props out from the main argument made by the courts below to justify an exception from discharge.

There are, however, other incongruities in the application of the Code that lead one to wonder whether Congress really did anticipate that attorneys' fee claims would be discharged. For example, Bankruptcy Rule 1006, implementing 28 U.S.C. § 1930, provides for payment of bankruptcy filing fees in installments within 120 days after the filing of a bankruptcy petition, but Rule 1006(b)(3) prohibits any payment to the debtor's attorney before the filing fee is paid in full. See Fed.R.Bankr.P. 1006(b)(3). Rule 1006 codifies the longstanding practice under the former Bankruptcy
Act and rules. See, e.g., In re Latham, 271 F. 538 (N.D.N.Y.1921). Thus, the rules at least implicitly recognize that attorneys representing debtors in connection with their bankruptcies may be paid, and may agree to be paid, post-petition. Although the Bankruptcy Rules may not contradict substantive provisions of the Code, rules propounded by the Supreme Court are presumed not to do so. See In re Moralez, 618 F.2d 76, 78 (9th Cir.1980) (resolving doubt about prior substantive law in favor of the understanding expressed by the rule); Matter of Decker, 595 F.2d 185, 189 (3d Cir.1979) ("strong presumption" in favor of consistency of rules with Code); but see In re Jastrem, 253 F.3d 438, 441-42 (9th Cir.2001) (resolving inconsistency in favor of Bankruptcy Code and discharging pre-petition fees).

There is also evidence in the history of § 60(d) of the Bankruptcy Act of 1898, as amended (the predecessor of § 329 of the Code), that Congress did not intend that pre-petition attorneys' fees be discharged. The Supreme Court characterized § 60(d) as "recogniz[ing] the right of ... a debtor to have the aid and advice of counsel, and, in contemplation of bankruptcy proceedings which shall strip him of his property, to make provisions for reasonable compensation to his counsel." In re Wood, 210 U.S. 246, 253, 28 S.Ct. 621, 52 L.Ed. 1046 (1908); see also In re Falk, 30 F.2d 607, 609 (2d Cir.1929) ("The object of § 60(d) was to afford the bankrupt representation by counsel, who would not have to take his chances as a general creditor, but might know that a reasonable fee was assured...."). I do not see this, as the majority suggests, as a species of "social-class preference." It seems to me an arrangement that might enable debtors to obtain counsel in bankruptcy when counsel might be sorely needed. The elementary demands of fairness are offended when a necessitous debtor retains a lawyer to help him unburden himself of his debts and then hoists the unsuspecting attorney on his own petard by not only refusing to pay what is due under the retainer but asking that the lawyer be held in contempt.

Bankruptcy Judge Barliant began his opinion in this case with a plea for an appropriate regard for context in the construction of statutes. In that respect, he quoted from our decision in In re Handy Andy Home Improvement Centers, Inc., 144 F.3d 1125, 1128 (7th Cir.1998) (Posner, C.J.), "when context is disregarded, silliness results." So in taking account of the context here, there may be some grounds for viewing the discharge of pre-petition attorneys' fees as "silly," but that is a description we must lay at the feet of Congress, which, I think dispositively, failed to include pre-petition lawyers' fees as an exception to discharge.

I do not, however, agree with the majority that there is anything in the case before us that requires the rejection of In re Hines, 147 F.3d 1185 (9th Cir.1998) (Shadur, J.), and thereby the creation of a split with the Ninth Circuit. In this appeal, the debtors claim only that "Defendants violated the automatic stay ... and the discharge injunction ... of the Bankruptcy Code by collecting debts from Plaintiffs for attorneys' fees earned pre-petition after Plaintiffs' bankruptcy petitions were filed." Appellants' Br. at 3 (emphasis added). The status of payments for post-petition services is not in issue on this appeal, and the majority seems to agree that the parties have not raised this issue here. Under ordinary principles of the adversary system, we do not reach out to decide questions not before us. See, e.g., Adam A. Milani & Michael R. Smith, "Playing God: A Critical Look at Sua Sponte Decisions by Appellate Courts," 69 Tenn. L.Rev. 245, 273 (2002) ("Party identification of the issues is at the core of th[e adversary] system and `[t]he adversary...
process is no more starkly challenged than when a court decides an issue not raised, for it actually decides something other than what the parties asked it to decide." (footnotes and citations omitted). The fact that, in passing, Judge Barliant disagreed with the Ninth Circuit's analysis in *Hines* in support of his refusal to jump on the *Biggar* bandwagon is certainly not a sufficient reason for us to address an issue that is unnecessary to our disposition of this appeal. After all, the bankruptcy judge was rejecting *Hines*'s reaffirmation of *Biggar*'s discharge of pre-petition fees, not its non-discharge of post-petition fees. Moreover, neither party has "confessed error," either explicitly or otherwise, as to Judge Barliant's analysis of *Hines*, because the outcome has not (until now) hinged on *Hines*'s validity. The majority argues that because it might be appropriate to remand for apportionment, we must instruct the lower courts on how to do that or they may "proceed in an unlawful manner." Op. at 1128. But we have decided only the disposition of pre-petition fees — the only issue presented on this appeal. What sort of issues may arise on remand and how the parties will frame them is presently unknown, and it is premature to instruct anyone how to deal with an unlitigated issue. The question before us is what issues are raised by the litigants, not, as in *Lawrence v. Chater* (cited by the majority), whether a lower court would change its opinion in light of a significant change in circumstances, such as a confession of error by one of the parties to the litigation or a failure to consider an important precedent, if given the opportunity to do so on remand.

The issue that the majority seeks to decide prematurely is whether fees for work performed after the filing of the petition are to be discharged, not whether the particular rationales provided by the *Hines* majority or by Judge Tashima's special concurrence are valid. The underlying principle is that only debts owed at the time of filing the petition are subject to discharge under Section 727. See 11 U.S.C. § 301 (the commencement of a voluntary case under Chapter 7 by filing a petition constitutes an order for relief); 11 U.S.C. § 727(b) (operating to discharge "all debts that arose before the date of the order for relief"). As the majority recognizes, fees arising from professional services rendered during bankruptcy are treated entirely differently by the Code. See op. at 1127-28. Nonetheless, the majority seems to be saying that because it might be difficult to allocate fees between pre-petition and post-petition work, both must be discharged. These concerns about problems of allocation are, as I have indicated, also premature. Whether the bankruptcy lawyers' fees for post-petition legal services are dischargeable is an issue that may be raised and dealt with on remand in the bankruptcy court, and, as I have pointed out, we have no idea what positions will be taken by the parties with respect to that issue or what rationales they will advance in support of their positions.

(or whether they will settle the case without further litigation). The validity of *Hines* may become an issue at that time, although that is by no means certain, and there will then be a record upon which to evaluate the holding of that opinion. The issue whether all lawyers' fees in the course of a bankruptcy will be discharged, or only the fees incurred prior to filing the petition, is much too important to decide before it is litigated.
Although, as I have argued, the validity of the Ninth Circuit's holding in \textit{Hines} should not be reached at this time, it should be borne in mind that \textit{Hines} — incidentally, an opinion authored by an able jurist from the Seventh Circuit, sitting by designation — is not only the law of the Ninth Circuit, see \textit{In re Sanchez}, 241 F.3d 1148, 1150 (9th Cir.2001), but has been followed elsewhere, see, e.g., \textit{In re McNickle}, 274 B.R. 477, 480 n. 5 (Bankr.S.D.Ohio 2002). And the principle that fees applicable to post-petition activities are not discharged, even if based on a pre-petition contract, has been broadly recognized. See, e.g., \textit{Siegel v. Federal Home Loan Mortgage Corp.}, 143 F.3d 525, 532 (9th Cir.1998); \textit{In re Sure-Snap Corp.}, 983 F.2d 1015, 1018 (11th Cir.1993); \textit{In re Hadden}, 57 B.R. 187 (Bankr.W.D.Wis. 1986). But, more immediately relevant, the status of \textit{Hines} in this circuit is an issue we may not properly reach in this appeal, and I see no merit to doing so. As Judge Easterbrook observed in another bankruptcy case, "[w]e do not create conflicts among the circuits without strong cause. A conflict here would be gratuitous." \textit{Mayer v. Spanel Int'l Ltd.}, 51 F.3d 670, 675 (7th Cir.1995).

I therefore respectfully dissent to the extent I have indicated.

Notes:

1. In fact, the majority is arguing not that a simple vacatur and remand is appropriate in this case as it was in \textit{Lawrence v. Chater}, but that the parties (despite all indications to the contrary) have actually appealed the validity of \textit{Hines} with respect to the discharge of post-petition fees, and that we must therefore pass judgment on that issue. Moreover, what the majority characterizes as an "effective" "confess[ion of] error" by the litigants is, if anything, merely argumentation on appeal that the lower court (not the parties themselves) has made an error of law. \textit{Lawrence v. Chater} is thus inapposite, and neither it nor \textit{Rinaldi v. United States}, 434 U.S. 22, 98 S.Ct. 81, 54 L.Ed.2d 207 (1977) (also cited by the majority), requires this court to "decide the issue independently." Op. at 1128.

2. It should be kept in mind that the debtors have argued vociferously that "legal fees only become a 'claim' as the legal services are performed," Appellants' Br. at 14, and would be judicially estopped from arguing the opposite on remand if the majority did not insist on prematurely invalidating the holding of \textit{Hines}. And the bankruptcy lawyers have argued \textit{Hines} is wrong only in that it discharges pre-petition fees; they have obviously never argued that post-petition fees should also be discharged. \textit{See Appellee's Br. at 17-18}.

3. Even though the majority disparages the idea of dividing a retainer agreement into multiple "claims" accruing when legal services are performed, "Illinois law entitles a client to discharge his lawyer (without liability) at any time, with or without cause." \textit{Maksym v. Loesch}, 937 F.2d 1237, 1245 (7th Cir.1991), citing \textit{Rhoades v. Norfolk & Western Ry.}, 78 Ill.2d 217, 35 Ill.Dec. 680, 399 N.E.2d 969, 974 (Ill.1979). (For the record, the Illinois Supreme Court followed California's lead in deciding this issue. \textit{See Fracasse v. Brent}, 6 Cal.3d 784, 100 Cal.Rptr. 385, 494 P.2d 9 (1972) (allowing attorney discharged with or without cause to receive a reasonable fee for services rendered). Judge Tashima's rationale for allowing
post-petition fees therefore does not actually involve "rewriting the contract" at all, because, just as in Illinois, California law does not create a right to payment until services have been performed.) Thus, particularly in this case, there is no support for the majority's argument that bifurcating an agreement for legal fees in the way advocated in *Hines* "contradicts both the Code and the retainer agreement, which says that the fee is due whether or not the client uses the services." Op. at 1129. For this reason, it is also arguable whether installment fee agreements entered into by Illinois bankruptcy lawyers would actually give rise to any "right to payment" until they have performed the agreed-upon legal services.

Rather, both Illinois law governing lawyer-client fee agreements and the Code support *Hines*’s holding that post-petition fees are not discharged. Under Illinois law, a bankruptcy lawyer is entitled to the value of services rendered under a theory of *quantum meruit*. This is entirely in keeping with § 329(b) of the Code, which requires bankruptcy courts to make exactly that determination. Although the majority's holding today is arguably correct in finding that the Bankruptcy Code trumps the law of restitution in denying a reasonable fee for *pre-petition* services rendered by "lawyers ... in circumstances in which they can reasonably be expected to be compensated," *Gaskill v. Gordon*, 160 F.3d 361, 363 (7th Cir.1998), neither the Code nor Illinois contract law supports the majority's gratuitous determination that these lawyers are not entitled to their post-petition fees.
IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

IN RE:

ROBERTA ELLARAE WRIGHT,  
Debtor.  

Case No. 17-11936-M  
Chapter 7

IN RE:

IAN GOMES AND STEPHANIE ANN GOMES,  
Debtors.  

Case No. 17-11172-M  
Chapter 7

IN RE:

BRITTANY MARIE DIRKSWAGER, 
Debtor.  

Case No. 17-11410-M  
Chapter 7

IN RE:

RYAN MICHAEL BROWN,  
Debtor.  

Case No. 17-11411-M  
Chapter 7

IN RE:

TOMMY LENARD GUTHRIE and DEBRA DENISE GUTHRIE,  
Debtors.  

Case No. 17-11555-M  
Chapter 7
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<td>DALE DANIEL BURRIS, JR. AND SHEILA MAE BURRIS,</td>
<td>Case No. 17-11933-M Chapter 7</td>
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<td>Debtors.</td>
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<td>IN RE:</td>
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<td>DARIN DWANE MILLER AND KATHY JO MILLER,</td>
<td>Case No. 17-12027-M Chapter 7</td>
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<td>Debtors.</td>
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IN RE:
KENNETH CHARLES BURTON,
Debtor.

Case No. 17-12028-M
Chapter 7

IN RE:
KIRBY DWAYNE SMITH AND
REBECCA LEANN SMITH,
Debtors.

Case No. 17-12029-M
Chapter 7

Memorandum Opinion

“. . ., but at the length truth will out.”1

It is an oft-stated maxim that attorneys are “officers of the court.” What exactly does it mean to be an “officer of the court?” Is it enough for an attorney to obtain a desired result for his or her client, even if they mislead, fail to fully inform, or violate rules of the Court in the process? Is a United States Bankruptcy Court a place where, when it comes to the areas of attorney conduct and non-disclosure, no harm equals no foul? Does ignorance of the law excuse misconduct? All of these questions are raised in the seventeen cases presently before the Court. For each question, the answer is the same: absolutely, unequivocally, no.

Before the Court is the Motion for Review of Debtor’s Transactions with J. Ken Gallon, Attorney (the “Motion”),2 filed in Case No. 17-11936-M, Roberta Ellarae Wright, by Katherine

1 William Shakespeare, The Merchant of Venice act 2, sc. 2.

2 Case No. 17-11936-M, at Docket No. 38.
Vance, on behalf of the United States Trustee ("UST"), and 17 contested matters initiated *sua sponte* by the Court in each of the above captioned cases (the "Captioned Cases"). Because the matters are based on substantially identical facts and raise identical issues regarding the conduct of J. Ken Gallon ("Gallon"), counsel for debtors in each of these cases, they were consolidated for purposes of resolution. The matters discussed herein were first brought to the Court’s attention in the *Wright* case, and the Court will continue to treat it as the lead case. A hearing on the Motion and these contested matters was held on May 10, 2018, at which the Court heard argument and took evidence related to the conduct of Gallon in these cases. The following findings of fact and conclusions of law are made pursuant to Federal Rule of Bankruptcy Procedure 7052, made applicable to this contested matter by Federal Rule of Bankruptcy Procedure 9014.

**Jurisdiction**

The Court has jurisdiction over these bankruptcy cases pursuant to 28 U.S.C.A. § 1334(b). Reference to the Court of these bankruptcy cases is proper pursuant to 28 U.S.C.A. § 157(a).

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3 Although not all of the Captioned Cases were originally assigned to the undersigned Judge, they were transferred to him after the facts described herein came to light, so that counsel’s conduct could be reviewed by the Court in a comprehensive manner.

4 *See* Order Scheduling Hearing and Directing Counsel for the Debtor to Address Issues of Compensation, Case No. 17-11936-M, *at Docket No. 60*. An Order and Notice of Hearing was entered in each of the other Captioned Cases, alerting each debtor to their opportunity to appear and be heard in this matter.

5 The Court will recite the factual differences for each specific case, but notes that those differences are immaterial to the Court’s analysis and resolution of these matters.

6 Unless otherwise noted, all statutory references are to sections of the United States Bankruptcy Code, 11 U.S.C.A. § 101 *et seq*. Unless otherwise noted, all references to a “Rule” or “the Rules” are to the Federal Rules of Bankruptcy Procedure.
Matters concerning the administration of the estate are core proceedings as defined by 28 U.S.C.A. § 157(b)(2)(A).

Findings of Fact

1. The BK Billing Model

Gallon is a consumer debtors’ attorney based in Miami, Oklahoma. BK Billing, LLC (“BK Billing”), a Utah limited liability company, is a finance company that provides factoring services to bankruptcy counsel in Chapter 7 cases. On May 11, 2017, Gallon executed an Accounts Receivable Assignment Agreement (the “AR Agreement”), in which he established a factoring arrangement with BK Billing. The AR Agreement set up a mechanism where Gallon would sell his accounts receivable for “post-petition services” to Chapter 7 consumer debtors based on client contracts that he uploaded to the BK Billing system. Gallon ultimately factored, or sold, 14 client contracts to BK Billing under the AR Agreement (“the BK Billing Cases”). Under the original AR Agreement, Gallon agreed to transfer each account receivable in exchange for 70% of the total contractual value of the account, which amount was to be received by Gallon with 2-3 business days. An amendment executed on July 5, 2017, increased the total amount paid to Gallon upon the submission of an account to 75% of the value of the contract, but lowered the amount immediately available to Gallon to 60%, and set the other 15% aside in an escrow account to be maintained by BK Billing as security for performance of the transferred accounts. The AR Agreement gives BK Billing the “right to

7 Trial Ex. 22.

8 Id. at 1, § 1.

9 Trial Ex. 23 at 1, § 2.1. Except for Case No. 17-11172-M, Gomes, all of the BK Billing Cases were submitted pursuant to the amended AR Agreement. All further references to the AR Agreement will refer to the agreement as amended.
approve of [Gallon’s] form engagement agreement prior to accepting any [accounts].”10 In addition, Gallon is obligated to “cooperate with the collections by BK Billing of the [accounts], including, but not limited to providing evidence reasonably required for any legal action, arbitration, or mediation instituted by BK Billing for collection purposes, and permitting BK Billing to use [Gallon’s] name, address, and telephone number for collection purposes.”11

In addition to the factoring services, BK Billing provided Gallon with various pleadings and templates to effectuate a business model whereby Gallon would enter two separate retention agreements with his clients. The first, executed prior to filing a Chapter 7 bankruptcy case, was for services up to and including filing the petition. The second, executed after the case was filed, was for all remaining services that were rendered to a debtor post-petition.

At a hearing in these matters, Gallon testified that upon meeting with a new client, if he determined that the client was in need of immediate bankruptcy relief but was unable to pay his fee prior to filing the case, Gallon would present them with the “BK Billing Model.”12 Key features of the BK Billing Model include:

10 Trial Ex. 22 at 2, § 4.2.

11 Id. at 3, § 4.4.

12 Gallon did not use this terminology, but the Court will use the term “BK Billing Model” to refer to the two contract bifurcated filing system provided by BK Billing, which included the factoring of Gallon’s attorney fees.
A. The debtors entered into a “Contract for Pre-Petition Legal Services in a Chapter 7 Bankruptcy Case” (the “Pre-Petition Agreement”)\(^\text{13}\) with Gallon.\(^\text{14}\)

B. Under the Pre-Petition Agreement, the debtors were to pay Gallon a specified fee\(^\text{15}\) for various pre-petition bankruptcy services, including “meeting and consulting with [Gallon] as needed,” a “detailed analysis of [] client questionnaire,” and “preparation and filing of a Chapter 7 Voluntary Petition, Statement About Social Security Numbers[]”\(^\text{16}\). The debtors agreed to pay additional fees for a “Pre-filing Credit Counseling Briefing Certificate” and a credit report.

C. The Pre-Petition Agreement gave the debtors the option to pay the Bankruptcy Court filing fee of $335 in full up front, apply to pay it in installments, or request that Gallon pay the fee and seek reimbursement from the debtors at a later time.

D. The Pre-Petition Agreement stated that Gallon’s contractual responsibilities would end “upon completion of the filing of [the] bankruptcy case.” It also stated that “the Law Firm will remain professionally obligated to serve as counsel for Client in the case until the Bankruptcy Court allows the Law Firm to formally withdraw.”\(^\text{17}\)

\(^{13}\) See, e.g., Trial Ex. 14.1 (\textit{Wright}). Substantially similar agreements were entered with each of the debtors in the Captioned Cases.

\(^{14}\) In the contracts with debtors, Gallon represented himself as the “Law Firm.” The Court will use the term “Gallon” to refer to both J. Ken Gallon, as attorney, and any law firm he may represent.

\(^{15}\) This amount varied by debtor. Details for each debtor are discussed in the next section.

\(^{16}\) Trial Ex. 14.1 at 1.

\(^{17}\) \textit{Id.}
E. The Pre-Petition Agreement laid out various options regarding the completion of the debtors’ bankruptcy case through discharge. The debtors could 1) retain Gallon under a second retainer agreement to be executed post-petition, where Gallon would complete the case for an additional specified fee;\textsuperscript{18} 2) seek other counsel to complete the case; or 3) proceed without legal representation, i.e., \textit{pro se}. If the debtors did not choose to retain Gallon for post-petition services within 10 days after filing the bankruptcy petition, they agreed to consent to Gallon’s withdrawal as counsel in the case. The Pre-Petition Agreement also placed the responsibility on the debtors to notify their creditors once the bankruptcy case was filed.

F. After execution of the Pre-Petition Agreement, Gallon filed what is colloquially referred to as a “bare-bones” Chapter 7 petition on behalf of the debtors. That means the documents filed represent the bare minimum necessary to successfully open a bankruptcy case and invoke the automatic stay. In all cases, this consisted of Official Form 101, Voluntary Petition for Individuals Filing for Bankruptcy, required by Rule 1002(a); a Certificate of Counseling, required by Rule 1007(b)(3)(A); a list of creditors, required by Rule 1007(a)(1); and a Verification as to Official Mailing Matrix, required by Rule 1008.\textsuperscript{19} In the seven cases filed prior to August 24, 2017, the initial filing also included Official Form 106Sum, Summary of Your Assets and

\textsuperscript{18} \textit{See supra} note 15. As far as the Court is aware, all of the debtors that executed a Pre-Petition Agreement chose this option.

\textsuperscript{19} The \textit{Sullivan} case included this list of documents plus the Official Form 106Sum, Summary of Your Assets and Liabilities and Certain Statistical Information, required by Bankr. N.D. Okla. Local Rule 1007-1(G).
Liabilities and Certain Statistical Information, required by Bankr. N.D. Okla. Local Rule 1007-1(G); Official Form 106D, Schedule D: Creditors Who Have Claims Secured by Property, required by Rule 1007(b)(1)(A); Official Form 106E/F, Schedule E/F: Creditors Who Have Unsecured Claims, required by Rule 1007(b)(1)(A); and Official Form 106Dec, Declaration About an Individual Debtor’s Schedules, required by Rule 1008.  

G. In eleven of the seventeen Captioned Cases, Gallon filed Bankruptcy Form 103A, Application for Individuals to Pay the Filing Fee in Installments (the “Installment Application”), on behalf of the debtors, requesting that they be allowed to pay the Court filing fee in installments of $83.75 per month for four months, beginning one month from the date the petition was filed. At the time the Installment Application was filed in each case, the Court had no information regarding the financial condition of the debtors, i.e., no schedules of current income or expenditure had been filed.

H. In each of the BK Billing Cases, Gallon and the debtors executed a “Contract for Post-Petition Legal Services in a Chapter 7 Bankruptcy Case” (the “Post-Petition Agreement”). In the Post-Petition Agreement, the debtors agreed to retain Gallon to represent them in the post-petition proceedings of their bankruptcy case in

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20 These cases were Gomes, Dirkswagen, Brown, Inman, Lawrence, Guthrie, and Lawson.

21 Trial Ex. 14.2.
exchange for a specified fee, described as a non-refundable flat fee. Gallon agreed to perform the following services for debtors:

1) Preparation and filing of the Statement of Financial Affairs and Schedules;

2) Preparation for and attendance at the Section 341 Meeting of Creditors;

3) Review and attendance (if necessary) to motions for stay relief;

4) Review of any redemption agreements;

5) Review of any reaffirmation agreements;

6) Follow through with case administration and monitoring;

7) File motions to reopen (if necessary).

I. The Post-Petition Agreement included the following statements:

I acknowledge and agree that as all of these fees are for post-petition services, they are not dischargeable in my Chapter 7 case. In the event of nonpayment of the agreed-upon fees, the Law Firm may commence legal proceedings for collection.

I understand that the Law Firm may assign my post-petition accounts receivable to BK Billing, LLC. I authorize the Law Firm or BK Billing to communicate with me via e-mail, text, and/or telephone. I explicitly give my consent to the Law Firm to share my client file information with BK Billing, including my contact information and social security number. I acknowledge that my payments to BK Billing will be reported to credit bureaus. I acknowledge that on-time payments can help my credit and late payments can hurt my credit. I have been provided an opportunity to ask the Law Firm questions regarding the Law Firm’s accounts receivable assignment agreement with BK Billing. The Law Firm has answered all such questions to my satisfaction.

I agree to submit to the personal jurisdiction of the Oklahoma courts with respect to such action, and Oklahoma law will apply. If such collection procedures shall

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22 See supra note 15.

23 Trial Ex. 14.2 at 1.
become necessary, I agree to pay all reasonable costs of such collection, including reasonable attorney fees.

I understand that I am to notify my creditors of my bankruptcy case once my case is filed.24

J. Attached to the Post-Petition Agreement was a “Recurring Payment Authorization and Consent Form” in which the debtors authorized Gallon or BK Billing, LLC, referred to as an “independent billing company,” to charge their debit card a specified fee per month until a specified amount was paid in full.25 That form included the following statement:

I give my consent that the Law Firm may sell or factor the accounts receivable associated with my contract to BK Billing. I acknowledge my payments would then be made directly to BK Billing on behalf of the Law Firm. I authorize the Law Firm or BK Billing to communicate with me via mail, e-mail, text, and/or telephone. I give my consent for the Law Firm to share my client file information, including my Social Security Number, with BK Billing for the purpose of processing and reporting my payments. I acknowledge that my payments may be reported to the Credit Bureaus. I acknowledge that on-time payments may help my credit and late payments may hurt my credit.26

K. In all of the Captioned Cases, Gallon filed the remaining schedules and statements required by § 521 and Rule 1007(b) sometime after the petition date.

L. Among the documents filed post-petition in each case was a Disclosure of Compensation of Attorney for Debtor (“Disclosure of Compensation”), which

24 Id. at 2–3 (emphasis added). The last sentence was included in each of the Post-Petition Agreements, but it was set out separately in bold and underlined, with instruction for the debtor to initial the clause, only in the Wright case.

25 See supra note 15.

26 Motion, Case No. 17-11936-M, at Docket No. 38 at 9.
indicated that Gallon had agreed to accept a specified fee\textsuperscript{27} “for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case.”\textsuperscript{28} Gallon stated that he had received a specified fee\textsuperscript{29} prior to filing the statement, leaving a specified balance due.\textsuperscript{30} In every case, he checked the box next to the statement “I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.” Gallon also indicated that “by agreement with the debtor(s), the above-disclosed fee does not include the following service: 1) Lien Avoidance; 2) Adversary Proceeding; 3) Judgment Lien Removal; 4) Re-Affirmation (sic) Agreement; 5) Re-Affirmation (sic) Agreement Recession; 6) Amendment to Petition (sic), Schedules and Statements; 7) Objection to Discharge.”\textsuperscript{31}

2. The debtors

The facts in each of the Captioned Cases are as follows:

a. BK Billing Cases

Robert Ellarae Wright, Case No. 17-11936-M

On September 12, 2017, Roberta Ellarae Wright (“Wright”) retained Gallon under a Pre-Petition Agreement, where she agreed to pay $200 for pre-petition services in a Chapter 7

\textsuperscript{27} See supra note 15.

\textsuperscript{28} Bankruptcy Form 2030.

\textsuperscript{29} See supra note 15.

\textsuperscript{30} Id.

\textsuperscript{31} Trial Ex. 14.5.
bankruptcy case, plus $9 for credit counseling and $33 for a credit report.\textsuperscript{32} The Pre-Petition Agreement gave her the option of retaining Gallon to complete her case in post-petition proceedings for $1,350. Wright’s case, Case No. 17-11936-M, was filed on September 28, 2017. On October 5, 2017, Wright executed a Post-Petition Agreement, where she agreed to pay $1,425 as a flat fee for Gallon to represent her in the completion of the case.\textsuperscript{33} No receipt was offered to show the amount received by Gallon. What appears to be an internal information sheet was offered to show that Gallon received $200 from Wright.\textsuperscript{34} Under the AR Agreement, Gallon received $855 from BK Billing upon submission of the Wright account, with an additional $213.75 placed in escrow.\textsuperscript{35} The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $75; leaving a balance due of $1,425.\textsuperscript{36} Wright’s Statement of Financial Affairs (“SOFA”) disclosed that she had paid Gallon $125 (date not indicated), and included the description “Prepare petition schedules & Statements, credit counseling, credit report.” Gallon filed an Installment Application on behalf of Wright.\textsuperscript{38} The final installment of Wright’s filing fee was paid on

\textsuperscript{32} Trial Ex. 14.1.

\textsuperscript{33} Trial Ex. 14.2.

\textsuperscript{34} Trial Ex. 14.3.

\textsuperscript{35} Trial Ex. 14.4. This is based on an invoice amount of $1,425, which BK Billing was to collect from Wright.

\textsuperscript{36} Trial Ex. 14.6.

\textsuperscript{37} Trial Ex. 14.7.

\textsuperscript{38} Case No. 17-11936-M, at Docket No. 4.
December 6, 2017. BK Billing collected $118.75 from Wright on October 15, 2017, a date before the filing fee was paid in full.39

Ian Gomes and Stephanie Ann Gomes, Case No. 17-11172-M

On June 12, 2017, Ian Gomes and Stephanie Ann Gomes (the “Gomeses”) retained Gallon under a Pre-Petition Agreement, where they agreed to pay $100 for pre-petition services in a Chapter 7 bankruptcy case.40 The Pre-Petition Agreement gave them the option of retaining Gallon to complete their case in post-petition proceedings for $1,400. Their case, Case No. 17-11172-M, was filed on June 13, 2017. On that same date, the Gomeses executed a Post-Petition Agreement, where they agreed to pay $1,400 as a flat fee for Gallon to represent them in the completion of their case.41 A receipt shows that Gallon received $500 in cash from Ian Gomes on June 12, 2017, which was described as a “Bankruptcy Retainer.”42 Under the original AR Agreement, Gallon received $980 from BK Billing upon submission of the Gomeses’ account.43 The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.44 The Gomeses’ SOFA disclosed they had paid Gallon $100 on June 12, 2017, and that “[t]he Debtors paid $100 dollars to prepare and to file the Petition, Credit Counseling, Creditors and Verification of Creditors. Debtor[sic] paid $400 was for [sic] the Filing Fee, Credit

39 Trial Ex. 14.4.
40 Trial Ex. 1.1.
41 Trial Ex. 1.2.
42 Trial Ex. 1.3.
43 Trial Ex. 1.4. See supra note 13.
44 Trial Ex. 1.6.
Counseling Course, Debtors Education Course and the Credit Report. The filing fee of $335 was paid on the filing date.

**Ryan Michael Brown, Case No. 17-11411-M**

On July 14, 2017, Ryan Michael Brown (“Brown”) retained Gallon under a Pre-Petition Agreement, where he agreed to pay $158 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $33 for a credit report. The Pre-Petition Agreement gave him the option of retaining Gallon to complete his case in post-petition proceedings for $1,400. Brown’s case, Case No. 17-11411-M, was filed on July 14, 2017. On July 24, 2017, Brown executed a Post-Petition Agreement, where he agreed to pay $1,350 as a flat fee for Gallon to represent him in the completion of the case. A receipt shows that Gallon received $200 in cash from Brown on July 7, 2017, which was described as a “Attorney Fee’s [sic] to file Petition; For CC CR.” Under the AR Agreement, Gallon received $810 from BK Billing upon submission of the Brown account, with an additional $202.50 placed in escrow. The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $150; leaving a balance due of $1,350. Brown’s SOFA disclosed that he had paid Gallon $200 on July 11, 2017. Gallon filed an Installment Application on behalf of Brown. The final installment of Brown’s filing fee was paid on

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45 Trial Ex. 1.7.
46 Trial Ex. 2.1.
47 Trial Ex. 2.2.
48 Trial Ex. 2.3.
49 Trial Ex. 2.4.
50 Case No. 17-11411-M, at Docket No. 2.
November 14, 2017. BK Billing collected $112.50 from Brown on September 15, 2017, September 29, 2017, and November 2, 2017, all dates before the filing fee was paid in full.51

*Brittany Marie Dirkswager, Case No. 17-11410-M*

Sometime in June 2017, Brittany Marie Dirkswager (“Dirkswager”) retained Gallon under a Pre-Petition Agreement, where she agreed to pay $1,400 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $53 for a credit report.52 The Pre-Petition Agreement gave her the option of retaining Gallon to complete her case in post-petition proceedings for $1,400. Dirkswager’s case, Case No. 17-11410-M, was filed on July 14, 2017. On July 19, 2017, Dirkswager executed a Post-Petition Agreement, where she agreed to pay $1,400 as a flat fee for Gallon to represent her in the completion of the case.53 No receipt was offered to show the actual amount received by Gallon. Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Dirkswager account, with an additional $210 placed in escrow.54 The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.55 Dirkswager’s SOFA disclosed that she had paid Gallon $150 on June 22, 2017, and that “[t]he Debtor paid $100 dollars to file the Petition, Credit Counseling Course, Creditors, Verification of Creditors. The Debtor paid $50 for the Credit

51 Trial Ex. 2.4.

52 Trial Ex. 3.1. The Court hesitates to refer to the $1,400 as a “typo” because it was written into a blank by hand, but it does appear to be a mistake.

53 Trial Ex. 3.2.

54 Trial Ex. 3.4.

55 Trial Ex. 3.6.
Counseling Course and Credit Report."56 Gallon filed an Installment Application on behalf of Dirkswager.57 The final installment of Dirkswager’s filing fee was paid on November 28, 2017. BK Billing collected $58.33 from Dirkswager on September 1, 2017, September 26, 2017, October 7, 2017, October 20, 2017, and November 10, 2017, all dates before the filing fee was paid in full.58

Tommy Lenard Guthrie and Debra Denise Guthrie, Case No. 17-11555-M

No Pre-Petition Agreement was offered to show when or the terms under which Tommy Lenard Guthrie and Debra Denise Guthrie (the “Guthries”) retained Gallon. Their Chapter 7 bankruptcy case, Case No. 17-11555-M, was filed on August 4, 2017. On August 9, 2017, the Guthries executed a Post-Petition Agreement, where they agreed to pay $1,400 as a flat fee for Gallon to represent them in the completion of their case.59 A receipt shows that Gallon received $500 by credit card from Debra Guthrie on July 28, 2017, which was described as “for payment of Bankruptc” [sic].60 Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Guthries’ account, with an additional $210 placed in escrow.61 The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.62 The Guthries’ SOFA disclosed that they had paid Gallon

56 Trial Ex. 3.7.
57 Case No. 17-11410-M, at Docket No. 2.
58 Trial Ex. 3.4.
59 Trial Ex. 4.2.
60 Trial Ex. 4.3.
61 Trial Ex. 4.4.
62 Trial Ex. 4.6.
$500 (date not indicated), and included the description “Form 122, prepare petition & creditor
matrix, pull credit report and credit counseling.” The filing fee of $335 was paid on the filing date.

Karen Dawn Inman, Case No. 17-11559-M

On July 5, 2017, Karen Dawn Inman (“Inman”) retained Gallon under a Pre-Petition
Agreement, where she agreed to pay $1,400 for pre-petition services in a Chapter 7 bankruptcy case,
plus $9 for credit counseling and $53 for a credit report. The Pre-Petition Agreement gave her the
option of retaining Gallon to complete her case in post-petition proceedings for $1,400. Inman’s
case, Case No. 17-11559-M, was filed on August 4, 2017. On August 8, 2017, Inman executed a
Post-Petition Agreement, where she agreed to pay $1,400 as a flat fee for Gallon to represent her in
the completion of the case. A receipt shows that Gallon received $100 from Inman on July 6, 2017,
which was described as “CR & CC for BK.” Under the AR Agreement, Gallon received $840
from BK Billing upon submission of the Inman, with an additional $210 placed in escrow. The
Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had
received $100; leaving a balance due of $1,400. Inman’s SOFA disclosed that she had paid Gallon
$150 (date not indicated), and included the description “Credit Report, Credit Counseling [sic] and

63 Trial Ex. 4.7.
64 Trial Ex. 5.1.
65 Trial Ex. 5.2.
66 Trial Ex. 5.3. The method of payment was not indicated.
67 Trial Ex. 5.4.
68 Trial Ex. 5.6.
attorney fees. Gallon filed an Installment Application on behalf of Inman. The final installment of Inman’s filing fee was paid on November 22, 2017. BK Billing collected $116 from Inman on September 1, 2017, October 1, 2017, and November 1, 2017, all dates before the filing fee was paid in full.

**Kiley Gene Lawrence, Case No. 17-11557-M**

On August 1, 2017, Kiley Gene Lawrence (“Lawrence”) retained Gallon under a Pre-Petition Agreement, where she agreed to pay $100 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $53 for a credit report. The Pre-Petition Agreement gave her the option of retaining Gallon to complete her case in post-petition proceedings for $1,400. Lawrence’s case, Case No. 17-11557-M, was filed on August 4, 2017. On August 9, 2017, Lawrence executed a Post-Petition Agreement, where she agreed to pay $1,400 as a flat fee for Gallon to represent her in the completion of the case. A receipt shows that Gallon received $153 in cash from Lawrence on August 1, 2017, which was described as “Attorney Fee’s [sic] – BK.” Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Lawrence account, with

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69 Trial Ex. 5.7.

70 Case No. 17-11559-M, at Docket No. 2.

71 Trial Ex. 5.4.

72 Trial Ex. 6.1. Handwriting obscures the amount of $53 for a credit report on the exhibit submitted to the Court, but its intent in changing the meaning of the printed text is unclear.

73 Trial Ex. 6.2.

74 Trial Ex. 6.3.
an additional $210 placed in escrow.\textsuperscript{75} The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.\textsuperscript{76} Lawrence’s SOFA disclosed that she had paid Gallon $150 (date not indicated), and included the description “payment for credit report, credit counseling & fees.”\textsuperscript{77} Gallon filed an Installment Application on behalf of Lawrence.\textsuperscript{78} The final installment of Lawrence’s filing fee was paid on December 4, 2017. BK Billing collected $120 from Lawrence on September 6, 2017, October 6, 2017, and November 6, 2017, all dates before the filing fee was paid in full.\textsuperscript{79}

\textit{Michael Joe Lawson and Sara Lynne Lawson, Case No. 17-11558-M}

On July 27, 2017, Michael Joe Lawson and Sara Lynne Lawson (the “Lawsons”) retained Gallon under a Pre-Petition Agreement, where they agreed to pay $40 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $53 for a credit report.\textsuperscript{80} The Pre-Petition Agreement gave them the option of retaining Gallon to complete their case in post-petition proceedings for $1,400. Their Chapter 7 bankruptcy case, Case No. 17-11558-M, was filed on August 4, 2017. On August 15, 2017, the Lawsons executed a Post-Petition Agreement, where they agreed to pay $1,460 as a flat fee for Gallon to represent them in the completion of their

\textsuperscript{75} Trial Ex. 6.4.

\textsuperscript{76} Trial Ex. 6.6.

\textsuperscript{77} Trial Ex. 6.7.

\textsuperscript{78} Case No. 17-11557-M, \textit{at Docket No. 2}.

\textsuperscript{79} Trial Ex. 6.4.

\textsuperscript{80} Trial Ex. 7.1.
case. A receipt shows that Gallon received $100 in cash from Sara Lawson on July 27, 2017, which was described as “for BK [unreadable].” Under the AR Agreement, Gallon received $876 from BK Billing upon submission of the Lawson account, with an additional $219 placed in escrow. The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $40; leaving a balance due of $1,460. The Lawsons’ SOFA disclosed that they had paid Gallon $100 (date not indicated), and included the description “prepare petition, e, f, creditor matrix and run credit report and credit counseling.” Gallon filed an Installment Application on behalf of the Lawsons. The final installment of the Lawsons’ filing fee was paid on November 30, 2017. BK Billing collected $121.66 from the Lawsons on September 1, 2017, October 1, 2017, and November 1, 2017, all dates before the filing fee was paid in full.

*Kimberly LeAnn Sullivan, Case No. 17-11690-M*

An undated and unexecuted Pre-Petition Agreement was offered as evidence that Kimberly LeAnn Sullivan (“Sullivan”) retained Gallon, where she agreed to pay $110 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $33 for a credit report. The

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81 Trial Ex. 7.2.

82 Trial Ex. 7.3.

83 Trial Ex. 7.4.

84 Trial Ex. 7.6.

85 Trial Ex. 7.7.

86 Case No. 17-11558-M, *at Docket No. 2*.

87 Trial Ex. 7.4.

88 Trial Ex. 8.1. The document was executed by Gallon, but not by Sullivan.
Pre-Petition Agreement gave her the option of retaining Gallon to complete her case in post-petition proceedings for $1,400. Sullivan’s case, Case No. 17-11690-M, was filed on August 24, 2017. On August 25, 2017, Sullivan executed a Post-Petition Agreement, where she agreed to pay $1,400 as a flat fee for Gallon to represent her in the completion of the case.99 A receipt shows that Gallon received $500 in cash from Sullivan on August 17, 2017, without further notation.90 Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Sullivan account, with an additional $210 placed in escrow.91 The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.92 Sullivan’s SOFA disclosed that she had paid Gallon $500 (date not indicated), and included the description “prepare petition, verify creditors, pull credit report, credit counseling.”93 The filing fee of $335 was paid on the filing date.

David Charles Williams, Case No. 17-11688-M

On August 22, 2017, David Charles Williams (“Williams”) retained Gallon under a Pre-Petition Agreement, where he agreed to pay $200 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $33 for a credit report.94 The Pre-Petition Agreement gave him the option of retaining Gallon to complete his case in post-petition proceedings

89 Trial Ex. 8.2.
90 Trial Ex. 8.3.
91 Trial Ex. 8.4.
92 Trial Ex. 8.6.
93 Trial Ex. 8.7.
94 Trial Ex. 9.1.
for $1,300. Williams’s case, Case No. 17-11688-M, was filed on August 24, 2017. On August 25, 2017, Williams executed a Post-Petition Agreement, where he agreed to pay $1,300 as a flat fee for Gallon to represent him in the completion of the case. A receipt shows that Gallon received $600 in cash from Williams on June 23, 2017, which was described as “Attorney Fee’s [sic] BK.” The receipt also shows an amount due of $1680, and a balance (due) of $1080. Under the AR Agreement, Gallon received $780 from BK Billing upon submission of the Williams account, with an additional $195 placed in escrow. The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $200; leaving a balance due of $1,300. Williams’s SOFA disclosed that he had paid Gallon $600 (date not indicated), and included the description “prepare petition, creditor matrix and verification [sic], obtain credit report, filing fee and credit counseling.” The filing fee of $335 was paid on the filing date.

Daphne Leannette Robitaille, Case No. 17-11689-M

On August 1, 2017, Daphne Leannette Robitaille (“Robitaille”) retained Gallon under a Pre-Petition Agreement, where she agreed to pay $100 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $33 for a credit report. The Pre-Petition Agreement gave her the option of retaining Gallon to complete her case in post-petition proceedings for $1,400. Robitaille’s case, Case No. 17-11689-M, was filed on August 24, 2017. On August 25,

95 Trial Ex. 9.2.
96 Trial Ex. 9.3.
97 Trial Ex. 9.4.
98 Trial Ex. 9.7.
99 Trial Ex. 10.1.
2017, Robitaille executed a Post-Petition Agreement, where she agreed to pay $1,400 as a flat fee for Gallon to represent her in the completion of the case. A receipt shows that Gallon received $150 in cash from Robitaille on August 1, 2017, which was described as “50 CC & CR & 100 [unreadable].” Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Robitaille account, with an additional $210 placed in escrow. The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400. Robitaille’s SOFA disclosed that she had paid Gallon $150 (date not indicated), and included the description “prepare petition, creditor verification [sic], credit report & credit counseling.” Gallon filed an Installment Application on behalf of Robitaille. The final installment of Robitaille’s filing fee was paid on December 18, 2017. BK Billing collected $116.66 from Robitaille on September 11, 2017, October 5, 2017, and November 5, 2017, all dates before the filing fee was paid in full.

100 Trial Ex. 10.2.
101 Trial Ex. 10.3.
102 Trial Ex. 10.4.
103 Trial Ex. 10.6.
104 Trial Ex. 10.7.
105 Case No. 17-11689-M, at Docket No. 3. An amended application was filed at Docket No. 10 to change the due dates for payments. This amended application was later granted by the Court. See Docket No. 16.
106 Trial Ex. 10.4.
On September 22, 2017, Daniel Bruce Bowers and Janie Mae Bowers (the “Bowers”) retained Gallon under a Pre-Petition Agreement, where they agreed to pay $500 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $53 for a credit report.107 The Pre-Petition Agreement gave them the option of retaining Gallon to complete their case in post-petition proceedings for $1,400. Their Chapter 7 bankruptcy case, Case No. 17-11932-M, was filed on September 28, 2017. On September 29, 2017, the Bowers executed a Post-Petition Agreement, where they agreed to pay $575 as a flat fee for Gallon to represent them in the completion of their case.108 A receipt shows that Gallon received $1,000 in cash from Bruce Bowers on September 19, 2017, which was described as “Retainer for BK.”109 Under the AR Agreement, Gallon received $345 from BK Billing upon submission of the Bower account, with an additional $86.25 placed in escrow.110 The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $1,000; leaving a balance due of $500.111 The Bowers’ SOFA disclosed that they had paid Gallon $1,000 (date not indicated), and included the description “prepare petition schedules & statements, filing fee, credit counseling.”112 The filing fee of $335 was paid on the filing date.

107 Trial Ex. 11.1.
108 Trial Ex. 11.2.
109 Trial Ex. 11.3.
110 Trial Ex. 11.4.
111 Trial Ex. 11.6.
112 Trial Ex. 11.7.
An undated and unexecuted Pre-Petition Agreement was offered as evidence that Dale Daniel Burris, Jr. and Sheila Mae Burris (the “Burrises”) retained Gallon, where they agreed to pay $90 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $53 for a credit report.\(^{113}\) The Pre-Petition Agreement gave them the option of retaining Gallon to complete their case in post-petition proceedings for $1,410. Their Chapter 7 bankruptcy case, Case No. 17-11933-M, was filed on September 28, 2017. On September 29, 2017, the Burrises executed a Post-Petition Agreement, where they agreed to pay $1,400 as a flat fee for Gallon to represent them in the completion of their case.\(^{114}\) No receipt was offered to show the actual amount received by Gallon. Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Burris account, with an additional $210 placed in escrow.\(^{115}\) The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,250; had received $0; leaving a balance due of $1,250.\(^{116}\) The Burrises’ SOFA disclosed that they had paid Gallon $150 (date not indicated), and included the description “Prepare petition, schedules & statements, credit report, credit

\(^{113}\) Trial Ex. 12.1. The document was not executed by any party.

\(^{114}\) Trial Ex. 12.2.

\(^{115}\) Trial Ex. 12.4. This is based on an invoice amount of $1,400, which BK Billing was to collect from the Burrises.

\(^{116}\) Trial Ex. 12.6. On October 20, 2017, an amended Disclosure of Compensation was filed, which recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400. See Case No. 17-11933-M, at Docket No. 18.
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counseling. Gallon filed an Installment Application on behalf of the Burrises. The final installment of the Burrises’ filing fee was paid on November 27, 2017. BK Billing collected $58.34 from the Burrises on October 13, 2017, October 21, 2017, and November 4, 2017, all dates before the filing fee was paid in full.

_Brett Wayne Murphy and April Irene Conder, Case No. 17-11930-M_

On September 28, 2017, Brett Wayne Murphy (“Murphy”) and April Irene Conder (“Conder”), retained Gallon under a Pre-Petition Agreement, where they agreed to pay $100 for pre-petition services in a Chapter 7 bankruptcy case, plus $9 for credit counseling and $53 for a credit report. The Pre-Petition Agreement gave them the option of retaining Gallon to complete their case in post-petition proceedings for $1,400. Their Chapter 7 bankruptcy case, Case No. 17-11930-M, was filed on September 28, 2017. On September 29, 2017, Murphy and Conder executed a Post-Petition Agreement, where they agreed to pay $1,400 as a flat fee for Gallon to represent them in the completion of their case. A receipt shows that Gallon received $500 in cash from Murphy and Conder on September 20, 2017. Under the AR Agreement, Gallon received $840 from BK Billing upon submission of the Murphy/Conder account, with an additional $210 placed in escrow.

117 Trial Ex. 12.7.
118 Case No. 17-11933-M, _at Docket No. 3_.
119 Trial Ex. 12.4.
120 Trial Ex. 13.1.
121 Trial Ex. 13.2.
122 Trial Ex. 13.3.
123 Trial Ex. 13.4.
The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.\(^{124}\) Murphy’s and Conder’s SOFA disclosed that they had paid Gallon $500 (date not indicated), and included the description “Prepare petition ceritors [sic] & verification. [sic] Credit report, credit counseling & filing fee.”\(^{125}\) The filing fee of $335 was paid on the filing date.

\textit{b. Non-Factored Cases}\(^{126}\)

\textit{Kenneth Charles Burton, Case No. 17-12028-M}

On October, 12, 2017, Kenneth Charles Burton (“Burton”) filed a petition for relief under Chapter 7 of the Bankruptcy Code, Case No. 17-12028-M. The bare bones petition was filed by Gallon as counsel. A receipt shows that Gallon received $150 in cash from Burton on October 3, 2017.\(^{127}\) No Pre-Petition Agreement was offered to show the terms under which Burton retained Gallon. According to Gallon, no Post-Petition Agreement was executed with Burton because Gallon had ceased doing business with BK Billing and had agreed to complete the Burton case pending further Court review.\(^{128}\) The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $100; leaving a balance due of $1,400.\(^{129}\) Burton’s SOFA

\(^{124}\) Trial Ex. 13.6.

\(^{125}\) Trial Ex. 13.7.

\(^{126}\) The Non-Factored Cases are those initiated by Gallon under the BK Billing Model, but whose accounts were never submitted to BK Billing because of the issues raised at the October 17 Hearing. \textit{See infra} text accompanying note 150.

\(^{127}\) Trial Ex. 15.3.

\(^{128}\) Trial Tr. at 25–26, May 10, 2018, Case No. 11936-M, \textit{at Docket No. 71}.

\(^{129}\) Trial Ex. 15.6.
disclosed that he had paid Gallon $150 (date not indicated), and included the description “prepare peti
tion, schedules, statements, credit counseling, credit report150”130 Gallon filed an Installment Applica
tion on behalf of Burton.131

_Darin Dwane Miller and Kathy Jo Miller, Case No. 17-12027-M_

On October, 12, 2017, Darin Dwane Miller and Kathy Jo Miller (the “Millers”) filed a petition for relief under Chapter 7 of the Bankruptcy Code, Case No. 17-12027-M. The bare bones petition was filed by Gallon as counsel. No receipt was offered to show the amount received by Gallon. No Pre-Petition Agreement was offered to show the terms under which the Millers retained Gallon. According to Gallon, no Post-Petition Agreement was executed with the Millers because Gallon had ceased doing business with BK Billing and had agreed to complete the Miller case pending further Court review.132 The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $130; leaving a balance due of $1,370.133 The Millers’ SOFA disclosed that they had paid Gallon $200 (date not indicated), and included the description “prepare petition schedules & statements, credit counseling, credit report.”134 Gallon

130 Trial Ex. 15.7.

131 Case No. 17-12028-M, at Docket No. 3. An amended application was filed at Docket No. 13 to change the due dates for payments. This amended application was later granted by the Court. See Docket No. 15.

132 Trial Tr. at 25–26, May 10, 2018, Case No. 11936-M, at Docket No. 71.

133 Trial Ex. 16.6.

134 Trial Ex. 16.7.
filed an Installment Application on behalf of the Millers. Although Gallon had no contract or agreement with the Millers, they voluntarily paid Gallon $1,325 post-petition.

*Kirby Dwayne Smith and Rebecca Leann Smith, Case No. 17-12029-M*

On October, 12, 2017, Kirby Dwayne Smith and Rebecca Leann Smith (the “Smiths”) filed a petition for relief under Chapter 7 of the Bankruptcy Code, Case No. 17-12029-M. The bare bones petition was filed by Gallon as counsel. A receipt shows that Gallon received $200 by check from Kirby Smith on October 9, 2017. No Pre-Petition Agreement was offered to show the terms under which the Smiths retained Gallon. According to Gallon, no Post-Petition Agreement was executed with the Smiths because Gallon had ceased doing business with BK Billing and had agreed to complete the Smith case pending further Court review. The Disclosure of Compensation recited that, for legal services, Gallon had agreed to accept $1,500; had received $125; leaving a balance due of $1,375. The Smiths’ SOFA disclosed that they had paid Gallon $200 (date not indicated), and

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135 Case No. 17-12027-M, *at Docket No. 3*. An amended application was filed at Docket No. 14 to change the due dates for payments. This amended application was later granted by the Court. *See Docket No. 15.*

136 According to Gallon, “Mrs. Miller called me up and basically told me that she had received her income tax return and that she wanted me to get paid and I told her I didn’t really know what was going on, but she said that she wanted to pay me. And so I accepted the payment.” *See Trial Tr. at 27 l.l. 12–16, May 10, 2018, Case No. 11936-M, at Docket No. 71. See also Trial Ex. 19 (note regarding Miller case).*

137 Trial Ex. 17.3.

138 Trial Tr. at 25–26, May 10, 2018, Case No. 11936-M, *at Docket No. 71.*

139 Trial Ex. 17.6.
included the description “prepare petition schedules & Statements, credit report, credit counseling, Debtor Education.”

Gallon filed an Installment Application on behalf of the Smiths.

c. Conventional Cases

Between June 13, 2017, the date Gallon filed the first BK Billing Case, and October 17, 2017, the date of the hearing where Gallon first disclosed his relationship with BK Billing to the Court, Gallon filed nineteen cases that did not utilize the services of BK Billing (the “Conventional Cases”). Gallon’s disclosed attorney fee in the Conventional Cases ranged from $900 to $1,250, and averaged $1,160.53. In each of the Conventional Cases, the debtor paid the filing fee on the filing date and did not seek to pay it in installments. In each of the Conventional Cases, Gallon

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140 Trial Ex. 17.7.

141 Case No. 17-12029-M, at Docket No. 3. An amended application was filed at Docket No. 11 to change the due dates for payments. This amended application was later granted by the Court. See Docket No. 13.

142 The Conventional Cases are Case Nos. 17-11177-M; 17-11179-M; 17-11180-M; 17-11181-M; 17-11182-M; 17-11183-M; 17-11407-M; 17-11408-M; 17-11409-M; 17-11561-M; 17-11562-M; 17-11683-M; 17-11684-M; 17-11685-M; 17-11686-M; 17-11831-M; 17-11934-M; 17-12025-M; 17-12026-M. In addition, Gallon filed one case during this period that had the hallmarks of a BK Billing Case, e.g., an Installment Application was filed, attorney fees of $1,500 were disclosed, etc., but it was dismissed because the debtor was ineligible for a discharge due to § 727(a)(8) (debtor had received a discharge within 8 years before the filing date). See Case No. 17-11556-M, Tracie Lynn Tennant.

143 These amounts are taken from the Disclosure of Compensation filed in each of the Conventional Cases. These amounts differ from that disclosed on the SOFA in every case.

144 This number represents the attorney fee collected by Gallon, and does not include any amounts for filing fees or other fees Gallon collected for credit reports, counseling, etc.
attached all required schedules and statements to the petition on the filing date, i.e., none were filed as bare-bones cases.\textsuperscript{145}

3. \textit{Court proceedings}

Completely unaware of the bifurcated contractual relationships Gallon had entered into with his clients, the Court set the Disclosure of Compensation in the \textit{Wright} case for hearing, noting that the Court had previously ruled that some of the excluded services were required to be performed by counsel for debtors in every Chapter 7 case.\textsuperscript{146} In addition, the Court noticed an unusual spate of Installment Applications filed by Gallon in the previous few months without sufficient information for Court review, and set the Installment Agreement in the \textit{Wright} case for hearing to inquire about this practice. It was at this hearing (the “October 17 Hearing”) that the Court was first informed of Gallon’s use of the BK Billing Model and his factoring arrangement with BK Billing. The UST stated that she had only become aware of the arrangement the day before when preparing for the hearing with Gallon. At the hearing, the Court bluntly asked Gallon to explain “Why wouldn’t this be disclosed?” His answer:

\begin{quote}
MR. GALLON: Well, it might -- the reason I did not disclose it, Your Honor, in my mind, is that once -- I mean, what, what is happening here is there, is a bifurcation process.
So the client hires you to perform, to, to file the petition and the creditors and the verification. Then once that’s done, you have a second meeting, which is the
\end{quote}

\textsuperscript{145} The only required pleading Gallon failed to consistently attach to the petition in the Conventional Cases was the Payment Advice Certification, which was sporadically submitted as a later pleading.

\textsuperscript{146} \textit{See In re Minardi}, 399 B.R. 841, 849–850 (Bankr. N.D. Okla. 2009). After the Disclosure of Compensation was set for hearing, but prior to the October 17 Hearing, Gallon amended the Disclosure of Compensation in the \textit{Wright} case to exclude only 1) Adversary Proceeding; 2) Amendment(s) to Schedules to add creditors; and 3) Objection to Discharge from the services he agreed to perform for debtors. \textit{See} Trial Ex. 14.6.
Two days after the October 17 Hearing, Gallon filed an amended Disclosure of Compensation in the Wright case (the “Amended Disclosure”), which added the following statement:

Counsel may receive financing from a third-party via a financing or factoring facility. Although in undersigned counsel’s view such financing or factoring facility should not be considered an agreement to share compensation, the terms of such agreement will include the granting by undersigned counsel of an interest in the undersigned counsel’s accounts and the creditor may have rights to receive payment from the client. Any such financing or factoring facility agreement will clearly provide that client must first give consent to the party relationship and under no circumstances will any of the terms of the financing or factoring facility agreement require counsel to disclose any information that is either confidential or may be considered a privileged communication with the client. The actual agreement will be made available upon request by a party-in-interest.

Gallon has since filed the same Amended Disclosure in all of the BK Billing Cases.

The Court continued the hearing to allow the UST to gather more information regarding Gallon’s relationship with BK Billing and decide on a course of action. At the continued hearing, the Court heard from the UST and Gallon, and discussed the UST’s Motion filed in the Wright case. The Motion proposed an agreement between the UST and Gallon, whereby Gallon would: 1) disgorge his fee in the Wright case “in part;” 2) continue to represent debtors in any of the open BK Billing Cases; 3) continue representing debtors in the Non-Factored Cases; and 4) cease doing

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147  See Trial Tr. at 7 ll. 4–18, October 17, 2017, Case No. 17-11936-M, at Docket No. 29.

148  Trial Ex. 14.6.

149  Case No. 17-11936-M, at Docket No. 38.

150  These are the Burton, Miller, and Smith cases.
business with BK Billing going forward. A proposed agreed order along those lines was later submitted to (not filed with) the Court that indicated Gallon would disgorge $855 received post-petition (presumably from BK Billing) and cancel any post-petition contract that allowed BK Billing to further collect from Wright. The Court found the proposed agreement wholly unsatisfactory, and held a telephonic hearing on January 31, 2018, at which it requested more information from Gallon regarding the Captioned Cases. The Court subsequently issued an Order Scheduling Hearing and Directing Counsel for the Debtor to Address Issues of Compensation. The Order outlined the concerns of the Court and advised Gallon of the various types of sanctions or remedies the Court was contemplating in these cases. Among the possible sanctions was disgorgement of all fees paid by debtors in any of the Captioned Cases and the indemnification by Gallon of his clients against any further collection action brought by BK Billing.

On May 10, 2018, the Court held a hearing (the “May 10 Hearing”) on these matters. Gallon’s arguments and defenses were presented in a pre-hearing brief. His arguments can be summarized as follows:

1. Use of the BK Billing Model made Gallon financially worse off than if he had used a conventional, pre-petition billing method.

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151 Case No. 17-11936-M, at Docket No. 60. An order giving the debtors an opportunity to appear and be heard at the hearing was also entered in each of the other 16 Captioned Cases.

152 Id. at 7.


154 Id. at 3.
2. Gallon relied on BK Billing, based on the vigor and sophistication used to induce him to adopt the BK Billing Model. BK Billing appeared to be a highly professional organization, presented a polished sales pitch, and was a high-level sponsor of the National Association of Consumer Bankruptcy Attorneys annual meeting. Gallon was given the impression that its model was widely and successfully used.\textsuperscript{155}

3. Gallon did not disclose the BK Billing Model because 1) he relied on BK Billing to advise him of the need to change his usual procedures; 2) he was not aware that BK Billing provided a specific form of disclosure to be filed with the Court; and 3) “it just did not occur to him that such disclosure was required.”\textsuperscript{156}

4. Gallon did not understand that participating in the BK Billing program might involve violation of bankruptcy law.\textsuperscript{157}

5. A significant motivation for Gallon to offer the BK Billing Model “was to allow clients to obtain relief from their debt problems more quickly.”\textsuperscript{158}

6. Gallon’s long-time bankruptcy legal assistant was distracted and ultimately quit during the period he was utilizing the BK Billing Model. He states that many of the mistakes in the disclosures and statements were due to that distracted assistant, his

\textsuperscript{155} \textit{Id.} at 5.

\textsuperscript{156} \textit{Id.} at 6.

\textsuperscript{157} \textit{Id.}

\textsuperscript{158} \textit{Id.}
own inept efforts at learning the software, and finally the learning curve of training a new assistant.\textsuperscript{159}

7. Each of the debtors in the Captioned Cases received a discharge without complaint or complication. Gallon suggests that this is a vindication of any charge that his pre-petition investigation and analysis of the debtors’ cases, without preparing schedules and statements, was inadequate.\textsuperscript{160}

When questioned about the reason for the bifurcation and performance of services post-petition, Gallon admitted that the practice was not for the benefit of debtors, but was done solely to facilitate the BK Billing Model of collection, by making all fees attributed to post-petition work non-dischargeable.\textsuperscript{161} Gallon valued his time at $250 per hour, based on the amount he charges in Chapter 13 cases. He acknowledged that he did not accurately account for services provided pre-petition to debtors, and often spent more time working on their cases pre-petition than the debtors paid for before the case was filed. For example, if a debtor paid only $100 prior to the case being filed, Gallon acknowledged that he spent more than 4/10 of an hour preparing the case for filing.\textsuperscript{162} Under the BK Billing Model, Gallon then shifted the remainder of his fee to be collected post-petition, even though some of the services being compensated had already been provided pre-petition.

\textsuperscript{159} Id.

\textsuperscript{160} Id. at 6–7.

\textsuperscript{161} Trial Tr. at 58 \textit{ll.} 9–24, May 10, 2018, Case No. 11936-M, \textit{at Docket No. 71}.

\textsuperscript{162} Id. at 60.
Gallon testified that he immediately stopped using the services of BK Billing as soon as he became aware of the concerns of the Court and the UST. The UST stipulated that Gallon cooperated fully in amending disclosures and providing documents and information during their investigation of these matters. At the May 10 Hearing, Gallon reiterated his understanding that the factoring of his fee to BK Billing did not involve any sharing of fees since they were simply a collection agency and not providing any services to the debtors.

Conclusions of Law

1. Counsel’s duty of disclosure pursuant to § 329

Section 329 of the Bankruptcy Code lies at the heart of these cases. Under that section, if a debtor pays or makes an agreement to pay an attorney for services related to a bankruptcy case, that attorney is required to file a statement with the Court that discloses: 1) any compensation paid to the attorney, if the payment was made after one year before the date of the filing of the petition; 2) any compensation agreed to be paid to the attorney, if such agreement was made after one year before the date of the filing of the petition; and 3) the source of such compensation paid or agreed to be paid. For Chapter 7 debtors’ counsel, § 329 is implemented by Bankruptcy Rule 2016(b).

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163 Id. at 9–10.

164 Id. at 64.

165 The language of the statute requires disclosure of compensation paid or agreed to be paid “for services rendered or to be rendered in contemplation of or in connection with the case by such attorney.” § 329(a). There is no issue in this case that the services rendered by Gallon to the various debtors were not related to their bankruptcy cases.

166 (a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services
In addition to the duties specified in § 329, the Rule adds the requirement that counsel disclose “whether the attorney has shared or agreed to share the compensation with any other entity,” including “the particulars of any such sharing or agreement to share by the attorney[.]”\footnote{168} These disclosures are required to be filed within 14 days after the case is filed, and supplemented within 14 days after any payment or agreement not previously disclosed.\footnote{169}

Counsel’s duties of disclosure apply whether or not the attorney applies for compensation from the estate.\footnote{170} The disclosure requirements of § 329 are “mandatory not permissive.”\footnote{171} The rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

\textsection{329(a)}.

\begin{footnotesize}
\begin{itemize}
\item (b) Disclosure of compensation paid or promised to attorney for debtor

Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by \textsection{329} of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney’s law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed.

\textsection{2016(b)}.

\footnote{168} Id.

\footnote{169} Id.


\footnote{171} \textit{See Turner v. Davis, Gillenwater & Lynch (In re Inv. Bankers, Inc.)}, 4 F.3d 1556, 1565 (10th Cir. 1993) (\textit{citing In re Bennett}, 133 B.R. 374, 378 (Bankr. N.D. Tex. 1991)).
\end{itemize}
\end{footnotesize}
statute is “designed to prevent bankruptcy attorneys from extracting more than their fair share from prospective debtors willing to do whatever is necessary to obtain their counsel of choice and avoid unfavorable bankruptcy proceedings.”172 “Counsel’s fee revelations must be direct and comprehensive. Coy or incomplete disclosures which leave the court to ferret out pertinent information from other sources are not sufficient.”173 “Absent complete disclosure, the court is unable to make an informed judgment regarding the nature and amount of compensation paid or promised by the debtor for legal services in contemplation of bankruptcy.”174

Rule 2017 directs the court to review any payments or transfers, or agreements for either, made directly or indirectly by debtors to an attorney, either before or after the filing of the

172 Id. (citing In re NBI, Inc., 129 B.R. 212, 222 (Bankr. D. Colo. 1991)).


bankruptcy case, to determine if those payments or transfers are excessive.\textsuperscript{175} According to the advisory committee’s note appended to the Rule’s original publication,

\begin{quote}
This rule . . . is premised on the need for and appropriateness of judicial scrutiny of arrangements between a debtor and his attorney to protect the creditors of the estate and the debtor against overreaching by an officer of the court who is in a peculiarly advantageous position to impose on both the creditors and his client.\textsuperscript{176}
\end{quote}

If the payment or agreement is found to exceed the reasonable value of the services provided by the attorney, the Court may cancel the agreement or disgorge any such payment to its source.\textsuperscript{177}

\textsuperscript{175} See \textit{In re Brown}, 371 B.R. at 497. Rule 2017 reads:

\begin{quote}
(a) Payment or transfer to attorney before order for relief

On motion by any party in interest or on the court’s own initiative, the court after notice and a hearing may determine whether any payment of money or any transfer of property by the debtor, made directly or indirectly and in contemplation of the filing of a petition under the Code by or against the debtor or before entry of the order for relief in an involuntary case, to an attorney for services rendered or to be rendered is excessive.

(b) Payment or transfer to attorney after order for relief

On motion by the debtor, the United States trustee, or on the court’s own initiative, the court after notice and a hearing may determine whether any payment of money or any transfer of property, or any agreement therefor, by the debtor to an attorney after entry of an order for relief in a case under the Code is excessive, whether the payment or transfer is made or is to be made directly or indirectly, if the payment, transfer, or agreement therefor is for services in any way related to the case.
\end{quote}

Rule 2017.

\textsuperscript{176} Rule 2017 advisory committee’s note (\textit{citing} 2 Collier on Bankruptcy ¶329.02 (15th ed. 1980); MacLachlan, Bankruptcy 318 (1956)).

\textsuperscript{177} § 329 (b) reads:

\begin{quote}
(b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to–
\end{quote}
The consequences of an attorney’s failure to comply with the disclosure requirements of § 329 can be severe, including forfeiting the right to receive any compensation for services rendered to the debtor.178 “Disgorgement of fees as a result of inadequate disclosure by counsel is a matter left to the sound discretion of the bankruptcy court.”179 “The imposition of a disgorgement order should be commensurate with the egregiousness of the conduct and will depend on the particular facts of each case.”180 “The Court may sanction failure to disclose ‘regardless of actual harm to the estate.’”181 This Court has previously adopted a strict position regarding failure of debtors’ counsel to disclose compensation arrangements to the Court:

This Court takes the requirement of full disclosure under § 329 seriously, for to do less is to judicially repeal the statute . . . Were the Court to require less than full disclosure, the purpose behind § 329(a) would be defeated. Counsel could avoid disclosure of any or all of the fees paid to them by making a covert decision that the undisclosed fee was so unrelated to the bankruptcy case that its disclosure was not required, and eliminating the possibility of Court review in the process. The Court’s

(1) the estate, if the property transferred—

(A) would have been property of the estate; or

(B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or

(2) the entity that made such payment.

178 In re Inv. Bankers, 4 F.3d at 1565; In re Smitty’s Truck Stop, Inc., 210 B.R. 844, 848–49 (10th Cir. BAP 1997).


180 In re Brown, 371 B.R. at 499 (citing In re Hackney, 347 B.R. 432, 443 (Bankr. M.D. Fla. 2006)) (internal citations and quotations omitted).

181 In re Smitty’s Truck Stop, 210 B.R. at 849 (citing In re Maui 14K, Ltd., 133 B.R. 657, 660 (Bankr. D. Haw. 1991)).
ability to make a meaningful review of attorney’s fees would be hindered if not destroyed. Such a result can be neither condoned nor allowed.182

Nothing presented to the Court in these matters suggests that any lesser standard should prevail. Nor does the Court find that a “pure heart,” without a subjective intent to violate the Code or Rules, provides counsel any defense to the failure to file the proper disclosures under § 329.183 “Negligent or inadvertent omissions ‘do not vitiate the failure to disclose.’”184

The Court finds Gallon’s original Disclosure of Compensation in each of these cases to be grossly misleading and indicative of a wanton disregard—to the point of negligence—for the level of candor required under § 329. Some of Gallon’s errors defy comprehension. For example, in the Wright case, Gallon 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, from BK Billing.185 The statement is flat-out deceptive, whether or not that is what Gallon 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 of the BK Billing Cases.


183 In re Stewart, 583 B.R. at 782.

184 In re Smitty’s Truck Stop, 210 B.R. at 848 (quoting Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.), 63 F.3d 877, 881 (9th Cir. 1995)) (internal citations omitted).

185 Trial Ex. 14-4, 14-6.
Other errors demonstrate the general level of sloppiness evident in much of Gallon’s record keeping. For example, in the *Wright* case, Gallon disclosed that “prior to the filing of this statement I have received $75,” even though his Pre-Petition Agreement indicated Ms. Wright had agreed to pay $200 plus an additional $42 in fees. An internal office memo indicated that she had actually paid $200. Although Gallon blamed such mistakes on the loss of his long-time assistant and the difficulty in training a new one, Gallon has duties of competence to his clients that transcend bankruptcy law.\(^{186}\) He should not accept clients if he does not have the basic skills to file their cases in a complete and competent manner. This Court does not accept laying the blame at the foot of an employee as an excuse.

Of equal concern is that Gallon indicated in each Disclosure of Compensation that he had not shared his fee with any other person. Both in his written brief and testimony, Gallon 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 BK Billing was simply a collection agency. The Court is not particularly concerned here with the legal or ethical violations involved with any possible sharing arrangement.\(^{187}\) What concerns the Court is Gallon’s rather brazen position, with no citation to authority, that collection of a fee from his client that is split between himself and BK Billing does

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\(^{186}\) *Rules of Prof’l Conduct, Rule 1.1, Okla. Stat. tit. 5, ch. 1, app. 3-A* (“A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.”).

\(^{187}\) *See, e.g.*, § 504(a) (“Except as provided in subsection (b) of this section, a person receiving compensation or reimbursement under section 503(b)(2) or 503(b)(4) of this title may not share or agree to share—(1) any such compensation or reimbursement with another person[.]”) This statute suggests that while sharing of fees is prohibited in some circumstances, not every receipt of fees related to a bankruptcy case is affected. *But see Rules of Prof’l Conduct, Rule 5.4(a), Okla. Stat. tit. 5, ch. 1, app. 3-A* (“A lawyer or law firm shall not share legal fees with a nonlawyer[.]”) (listing several exceptions that do not apply here).
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.\(^{188}\)

Gallon filed an Amended Disclosure in each of the cases in an effort to remedy the deficiencies in the original. His efforts fell woefully short. His statement that “counsel may receive financing from a third-party” does not adequately disclose that in each of the affected cases he *did in fact* receive such financing, and on what terms. He goes on to state his view that the arrangement does not involve sharing of fees, but gives no particulars of the arrangement. Offering to make the agreement available upon request does not satisfy Rule 2016(b)’s requirement of disclosing “the particulars of any such sharing or agreement to share.”\(^{189}\)

2. **Counsel’s duty of candor to the tribunal**

In addition to the statutory duties provided in the Bankruptcy Code, Gallon has other duties to his clients and the Court based on his role as an officer of the court. An attorney becomes an officer of the court upon taking an oath and meeting other requirements imposed by state law.\(^{190}\) In Oklahoma, that oath requires counsel to show complete candor toward the tribunal.\(^{191}\)

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\(^{188}\) *In re Stewart*, 583 B.R. at 782. See also *In re Waldo*, 417 B.R. 854, 893 (Bank. E.D. Tenn. 2009).

\(^{189}\) Rule 2016(b).

\(^{190}\) Rules of Prof’l Conduct, Preamble cmt. 1, Okla. Stat. tit. 5, ch. 1, app. 3-A (“A lawyer, as a member of the legal profession, is a representative of clients, *an officer of the legal system* and a public citizen having special responsibility for the quality of justice.”) (emphasis added).

\(^{191}\) The oath required to practice law in Oklahoma reads as follows:

I do solemnly swear that I will support, protect and defend the Constitution of the
Rule of Professional Conduct 3.3 reinforces the requirement of candor. Such candor is vital to the integrity of the bankruptcy process itself.

The Court is troubled by Gallon’s practice of charging a higher fee to his clients that use the BK Billing Model than to his conventional clients. Gallon charged his average conventional client $1,250 when the fee was fully paid prior to filing a debtor’s petition. Under the BK Billing Model, a debtor was charged a total of $1,500 for attorney fees. From the debtor’s perspective, that is a $250 premium, or 20% above the fee charged in a conventional case, for the convenience of paying the fee over 12 months. From Gallon’s perspective, the math is even worse. For example in the Wright case, Gallon invoiced Wright’s account to BK Billing for $1,425. He actually received $855 from BK Billing. That means Wright agreed to pay a 66% markup over the amount Gallon actually

United States, and the Constitution of the State of Oklahoma; that I will do no falsehood, or consent that any be done in court, and if I know of any I will give knowledge thereof to the judges of the court, or some one of them, that it may be reformed; I will not wittingly, willingly or knowingly promote, sue, or procure to be sued, any false or unlawful suit, or give aid or consent to the same; I will delay no person for lucre or malice, but will act in the office of attorney in all courts according to my best learning and discretion with all good fidelity as well to the court as to my client, so help me God.

Okla. Stat. tit. 5, ch. 1, § 2. See also id., app. 5, § 1.

192 Rule 3.3. Candor Toward The Tribunal:

(a) A lawyer shall not knowingly:

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

received for providing her services.\textsuperscript{193} Additionally, if Gallon was willing to accept roughly $1,069, or 75\% of $1,425, in a typical BK Billing Case, assuming he received the escrowed payments, the Court could rightly conclude that he consistently overcharges his conventional clients for the value of his services. Gallon’s only defense of the practice of charging higher fees to BK Billing clients was that it was encouraged by BK Billing as part of their training package.

It is clear to the Court that a prominent feature of the BK Billing Model is the designation of the bulk of services as “post-petition” in order to render them beyond the Chapter 7 discharge and therefore collectable by BK Billing. There are (at least) two problems with this approach. First, by waiting until after the petition is filed to perform most of the actual services, such as filing out schedules and statements, counsel risks overlooking essential information regarding the debtors’ financial condition, which may have been missed in the cursory interview conducted pre-petition. Counsel may discover too late that he or she should have chosen a different chapter, or not filed the case at all. Second, the amount of Gallon’s fees designated pre- or post-petition was motivated by how much money the debtor was able to pay up front, and not related in any way to when Gallon’s services were actually performed. Valuing his time at $250 per hour, Gallon admitted that in several cases he spent much more time pre-petition than he was paid for, but then designated the remaining fee as “post-petition,” thus turning an otherwise dischargeable pre-petition claim into a non-discharged claim.\textsuperscript{194} Such a scheme works a fraud both on the debtor and the Court.

\textsuperscript{193} Even if Gallon had received the additional escrow payment, Wright would have paid a 33\% markup over the amount Gallon received.

\textsuperscript{194} Trial Tr. at 60, May 10, 2018, Case No. 11936-M, \textit{at Docket No. 71}. 
Of additional concern to the Court is that Gallon indicated that the source of the compensation to be paid to him was the debtor, even though Bankruptcy Form 2030 presented him with another option. Courts have consistently held that payment of funds from a third-party payor to pay a debtor’s legal fees does not alter counsel’s obligation of proper disclosure.\footnote{In re Stewart, 583 B.R. at 781.} In each of the BK Billing Cases except \textit{Gomes}, Gallon received a direct deposit equal to 60\% of the invoiced account value from BK Billing, with an agreement he would be paid an additional 15\% if the accounts were sufficiently remitted by the debtors.\footnote{Under the original AR Agreement, Gallon received 70\% of the invoiced Gomes account, with no escrowed payment.} Clearly, “the “source of such compensation” is directly required to be disclosed under § 329. Gallon tries to deflect responsibility for this failure by stating that he relied on BK Billing to train and advise him on the use of their model. Such reliance on BK Billing in the discharge of his professional duties and judgment is a breach of the Oklahoma Rules of Professional Conduct.\footnote{See, e.g., Rules of Prof’l Conduct, Rule 5.4(c), Okla. Stat. tit. 5, ch. 1, app. 3-A (“A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.”) (emphasis added); Id. Rule 1.8(f) (“A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship[.]”) (emphasis added); Rule 1.7(a) (“A concurrent conflict of interest exists if: . . .(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to . . . a third person or by a personal interest of the lawyer.”) (emphasis added).} Despite not being “trained” or provided a form by BK Billing, Gallon certainly understood that he was only indirectly being compensated by his clients, but that the actual funds he received came directly from BK Billing. He should have known that the information provided to the Court in the Disclosure of Compensation filed in these cases was grossly

\footnote{In re Stewart, 583 B.R. at 781.}

\footnote{Under the original AR Agreement, Gallon received 70\% of the invoiced Gomes account, with no escrowed payment.}

\footnote{See, e.g., Rules of Prof’l Conduct, Rule 5.4(c), Okla. Stat. tit. 5, ch. 1, app. 3-A (“A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.”) (emphasis added); Id. Rule 1.8(f) (“A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship[.]”) (emphasis added); Rule 1.7(a) (“A concurrent conflict of interest exists if: . . .(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to . . . a third person or by a personal interest of the lawyer.”) (emphasis added).}
misleading, if not outright false. His declaration that it simply “did not occur to him that such
disclosure was required” is both disheartening and astonishing. This Court has published no less
than three opinions directly related to the failure of debtors’ counsel to properly disclose all financial
dealings with their clients.\textsuperscript{198} As an officer of the Court, Gallon is expected to be aware of such
rulings.

Gallon tries to rationalize his failures by citing the blind faith he put in BK Billing as a
company. He suggests that he was induced to adopt the BK Billing Model based on the company’s
slick sales pitch and high-profile sponsorship of a leading bankruptcy conference. While the Court
does not doubt that BK Billing rolled out a persuasive marketing campaign, the Court believes that
any reasonable attorney would have at least questioned the “too good to be true” aspect of the model.
Instead, Gallon blindly adopted the BK Billing Model, without conducting even a minimal inquiry
into the legal or ethical issues that such a system might raise. The Court finds that such abdication
of his professional judgment is unreasonable.

This Court has previously noted the bankruptcy system is a fragile one, built on the principles
of full and candid disclosure.\textsuperscript{199} Its operation and survival rely on the integrity and professionalism
of its practitioners. Only through serendipity were these matters brought to the Court’s attention.
“This is not an area where the Court will engage in or tolerate a game of ‘catch me if you can,’ or
allow ‘I guess I did not know better’ to be a palatable excuse.”\textsuperscript{200} The Court finds Gallon’s

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\textsuperscript{198} \textit{In re Woodward}, 229 B.R. at 468; \textit{In re Lewis}, 309 B.R. at 597; \textit{In re Brown}, 371 B.R.
at 486.

\textsuperscript{199} \textit{In re Lewis}, 309 B.R. at 602.

\textsuperscript{200} \textit{Id.} at 603.
disclosures regarding the nature and source of his compensation in these cases to be grossly inadequate to the point of being misleading. The Court is aware that it has discretion when determining the degree of sanctions for non-disclosure.\textsuperscript{201} The Court finds Gallon’s entire fee in each of these cases to be unreasonable. His failures are sufficiently severe and pervasive to warrant disgorgement. The Court would be justified in disgorging all fees received by Gallon or collected by BK Billing, but finds that such an order would be administratively unworkable, since some of the funds paid by the debtors pre-petition were allocated to court fees and other miscellaneous services. The Court will limit disgorgement to the value of fees actually collected by BK Billing from each of the debtors in the Captioned Cases after their petitions were filed.\textsuperscript{202} Such funds shall be remitted by Gallon to the debtor that made the payment. The Post-Petition Agreements in each case are found to be void, and neither Gallon nor BK Billing may enforce any claim against the debtors under those contracts.\textsuperscript{203} The Court is aware this is a harsh sanction, but anything less would minimize the serious nature of Gallon’s conduct.

2. Debtors’ violations of Rule 1006

Section 1930 of title 28 of the United States Code sets out the schedule of fees to be collected by the clerk when a bankruptcy case is filed. The statute explicitly allows a debtor in a voluntary

\textsuperscript{201} In re Brown, 371 B.R. at 499; In re Stewart, 583 B.R. at 783.

\textsuperscript{202} To be abundantly clear, these fees are ordered disgorged from Gallon, and not from BK Billing, over which the Court has not exercised jurisdiction. In addition, the Court will not disturb the voluntary payment of $1,325 made directly to Gallon from the Millers in Case No. 17-12027-M.

\textsuperscript{203} The Court offers no opinion on how this ruling affects the contractual duties between Gallon and BK Billing.
case to pay the required fee in installments. 204 Rule 1006 implements this statute, but adds that a debtor that utilizes the installment provision may make no further payments “to an attorney or any other person who renders services to the debtor in connection with the case” until the filing fee is paid in full. 205

In eleven of the seventeen Captioned Cases, Gallon filed an Installment Application. In each of those cases, the application included a statement executed by both the debtors and Gallon that the debtors understood they must pay their entire filing fee before they make any more payments or transfer any more property to an attorney or anyone else for services in connection with their bankruptcy case. 206 In eight of those cases, due to the scheme orchestrated by Gallon, debtors unwittingly made payments to BK Billing toward Gallon’s attorney fee before their entire filing fee was paid to the Court, in direct violation of Rule 1006. The remaining three cases were not submitted to BK Billing for factoring, therefore no violation occurred.

Gallon, as an attorney admitted to practice before this Court, is charged with knowing and understanding the Federal Rules of Bankruptcy Procedure, as well as the applicable provisions of the Bankruptcy Code. His signature on the Installment Application was a violation of both his ethical and statutory duties. Rule 9011(b)(3) outlines counsel’s ethical duty of candor in signing an application submitted to the Court:

(b) Representations to the court

204 28 U.S.C. § 1930(a) (hanging paragraph).

205 Rule 1006(b)(3)(“All installments of the filing fee must be paid in full before the debtor or chapter 13 trustee may make further payments to an attorney or any other person who renders services to the debtor in connection with the case.”).

206 See, e.g., Case No. 17-11936-M, at Docket No. 4.
By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,—

* * *

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) was enacted “to correct perceived abuses of the bankruptcy system.” Among its reforms were §§ 526–528, which target debt relief agencies, “i.e., professionals who provide bankruptcy assistance to consumer debtors.” As a debt relief agency, Gallon is bound by duties of candor therein. The relevant subsection of § 526 reads as follows:

(a) A debt relief agency shall not—

* * *

(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue or misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading.

Considering he set these events in motion by factoring his fee to BK Billing, Gallon knew or should have known that BK Billing would begin collection activity prior to the debtors’ court fees being paid in full. He is also charged with knowing that such payment to BK Billing was a violation of

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207 Rule 9011(b)(3) (emphasis added).
209 Id. at 232.
210 Id. (holding that consumer debtors’ attorneys qualify as “debt relief agencies,” as defined in § 101(12A), and are therefore subject to §§526–528).
the debtors’ duties under Rule 1006. His signature on the Installment Agreements is a violation of
his duty of candor under both Rule 9011(b)(3) and § 526(a)(2). Gallon compounded the violation
of § 526(a)(2) by advising his clients to sign the Installment Agreements and causing them to make
misleading statements regarding their payment of his fees.

The Court does not take these violations lightly. The bankruptcy system requires complete
candor from both debtors and their engaged professionals.212 Standing alone, the Court would find
cause to sanction Gallon under Rule 9011(c) or § 526(c)(5) for filing and endorsing the debtors’
 misleading statements found in the Installment Agreements. The Court notes that in all eleven cases,
all required Court filing fees were eventually fully paid, either by the debtors or Gallon, and each of
the debtors received their discharge. Therefore, despite the authority to do so, the Court will not
 impose additional sanctions.

3. Counsel’s duties under BAPCPA

As soon as Gallon became aware of his missteps in these cases, he worked diligently to assist
the UST to investigate this matter and cut ties with BK Billing. As such, he offered no defense of
the BK Billing Model of bifurcating services into pre- and post-petition categories or its factoring
practice, which required debtors to incur debt to pay their attorney’s fee. Several courts across the
country have faced variations on this theme. Some have offered advice and recommendations in
order to craft an acceptable scheme whereby attorneys may offer bifurcated services.213 Others have

 opportunity for a completely unencumbered new beginning to the ‘honest but unfortunate
debtor.’”) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)). See also Rule 9011.

213 Bethea v. Robert J. Adams & Assocs., 352 F.3d 1125, 1128 (7th Cir. 2003) (proposes
bifurcation of services model; pre-BAPCPA case); Walton v. Clark & Washington, P.C., 469
B.R. 383 (Bankr. M.D. Fla. 2012) (endorses specific bifurcation of services model; provides
noted that various provisions added to the Code by BAPCPA appear to thwart such schemes.\textsuperscript{214} This Court has reviewed the cases carefully and believes that BAPCPA presents serious impediments to the legality of this kind of bifurcated services scheme, such as the BK Billing Model.\textsuperscript{215} The


\textsuperscript{215} Relevant subsections of § 526 read as follows:
(a) A debt relief agency shall not–
(1) fail to perform any service that such agency informed an assisted person or prospective assisted person it would provide in connection with a case or proceeding under this title;
(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue or misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;
(3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to–
(A) the services that such agency will provide to such person; or
(B) the benefits and risks that may result if such person becomes a debtor in a case under this title;
(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.
(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.
(c)(1) Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this
difficulty here is that no one appears in these cases to defend the model or offer an alternative section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys’ fees and costs if such agency is found, after notice and a hearing, to have—

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency’s intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

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(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may—

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.


Section 528 provides in part:

(a) A debt relief agency shall—

(1) not later than 5 business days after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to such assisted person’s petition under this title being filed, execute a written contract with such assisted person that explains clearly and conspicuously—

(A) the services such agency will provide to such assisted person; and

(B) the fees or charges for such services, and the terms of payment;

(2) provide the assisted person with a copy of the fully executed and completed contract;

§ 528(a)(1–2).
argument to the Court. That seems like shaky ground to rule or comment on the validity of the model. Because the Court has disposed of these matters under section 329, it is not necessary to review them further on alternative grounds. Therefore the Court will wait until issues of bifurcation of services and fee factoring are before it in an actual case or controversy before it weighs in on §§526 and 528. The Court raises these issues in the hope that counsel considering use of a similar scheme will carefully review the legal and ethical provisions of BAPCPA and state ethics rules before they file a petition in this district.

**Conclusion**

Gallon must disgorge the value of all fees actually collected by BK Billing from the debtors after their petitions were filed in each of the Captioned Cases. Such funds shall be remitted by Gallon to the debtor that made the payment. The Post-Petition Agreements in each case are found to be void, and neither Gallon nor BK Billing may enforce any claim against the debtors under those contracts. A separate order consistent with this Memorandum Opinion is entered concurrently herewith in each of the Captioned Cases.

DATED this 4th day of September, 2018.

BY THE COURT:

TERRENCE L. MICHAEL, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT
IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 17-10810

D.C. Docket No. 6:16-cv-00662-PGB-KRS

LOYD P. CADWELL,
Individually and on behalf of All Others Similarly Situated,

Plaintiff - Appellant,

versus

KAUFMAN, ENGLETT & LYND, PLLC,

Defendant - Appellee.

Appeal from the United States District Court
for the Middle District of Florida

(March 30, 2018)

Before ED CARNES, Chief Judge, NEWSOM, and SILER,* Circuit Judges.

NEWSOM, Circuit Judge:

* Honorable Eugene E. Siler, Jr., United States Circuit Judge for the Sixth Circuit, sitting by designation.
This case arises under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which, among other things, amended federal law to impose new requirements and prohibitions on professionals who assist with the preparation of bankruptcy petitions. The provision specifically at issue here, 11 U.S.C. § 526(a)(4), provides in relevant part that a “debt relief agency”—including a law firm that provides bankruptcy-related services—“shall not … advise” a debtor “to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.” In Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. 229 (2010), the Supreme Court unanimously concluded that Section 526(a)(4)’s first prohibition—on advice to incur additional debt “in contemplation of” a bankruptcy filing—requires proof that the advice was given for an invalid purpose designed to manipulate the bankruptcy process. This case presents the question whether the statute’s second prohibition—on advice to incur debt to pay for a lawyer’s bankruptcy-related representation—likewise entails an invalid-purpose requirement. We hold that it does not and that, as relevant here, an attorney violates Section 526(a)(4) if he instructs a client to pay his bankruptcy-related legal fees using a credit card.
Loyd Cadwell consulted with the law firm of Kaufman, Englett & Lynd (“KEL”) about the possibility of filing a Chapter 7 bankruptcy petition. Following the initial meeting, Cadwell entered into an agreement that obligated him to pay $1700 in attorneys’ fees “for representation in [his] Chapter 7 Bankruptcy case.” The agreement contained an addendum establishing a schedule that required immediate payment of a $250 retainer, a second $250 installment shortly thereafter, and then, after that, four monthly installments of $300 apiece. According to Cadwell’s complaint, “KEL instructed [him] to pay the initial retainer and all subsequent payments by credit card.” As directed, Cadwell paid the initial retainer and the next three installments using two different credit cards.

After terminating his relationship with KEL, Cadwell filed this action under 11 U.S.C. § 526(a)(4), which, as already explained, states that a law firm “shall not … advise” a client “to incur more debt in contemplation of such person filing a case under this title or to pay an attorney” for bankruptcy-related legal services. KEL moved to dismiss Cadwell’s complaint, arguing (1) that he hadn’t stated a claim on which relief could be granted and (2) that even if he had, Section 526(a)(4) is unconstitutional because it improperly restricts KEL’s attorney-client

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1 Because Cadwell’s appeal follows the district court’s dismissal of his complaint for failure to state a claim, we accept as true the facts alleged in the complaint and draw all reasonable inferences in Cadwell’s favor. See, e.g., Hill v. White, 321 F.3d 1334, 1335 (11th Cir. 2003).
communications. The district court granted KEL’s motion. “[W]ithout more,” the
court held, “the mere advice to use credit cards to pay for legal fees does not
violate” Section 526(a)(4). Rather, based on its reading of the Supreme Court’s
decision in Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. 229
(2010), the district court concluded that Section 526(a)(4) only “prohibits a debt
relief agency from advising a debtor to incur additional debt for an invalid
purpose.” Because Cadwell had “alleg[ed] no facts that would” support an
inference “that KEL acted with an improper purpose or with an intent to
manipulate the bankruptcy system,” the district court held that he had failed to
state a viable claim under the statute. Having done so, the district court found it
unnecessary to address KEL’s First Amendment challenge.

On appeal, Cadwell contends that the district court erred in faulting him for
failing to allege that KEL acted with an “invalid” (or “improper”) purpose. At
least as it pertains to a lawyer’s advice to his client to incur debt to pay legal fees,
Cadwell insists, Section 526(a)(4)’s text admits of no such requirement. KEL
responds that the district court correctly interpreted the statute to impose an
invalid-purpose element, but that even if Cadwell had stated a claim, the statute
violates the First Amendment. Our review is *de novo.* See Batchelor-Robjohns v.
United States, 788 F.3d 1280, 1284 (11th Cir. 2015).
II

As its name suggests, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was enacted “to correct perceived abuses of the bankruptcy system.” *Milavetz*, 559 U.S. at 231–32. The Act added to the Bankruptcy Code a number of provisions directed at the conduct of bankruptcy professionals. *Id.* Among those provisions is 11 U.S.C. § 526(a), which “establishes several rules of professional conduct for persons qualifying as debt relief agencies,” including lawyers. *Id.* at 233. At issue here is subsection (a)(4), which provides as follows:

A debt relief agency shall not … advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.


The parties here agree that KEL—as a law firm that provides bankruptcy-related advice—qualifies as a “debt relief agency” within the meaning of Section 526(a)(4). *See* Br. of Appellant at 3, 7; Br. of Appellee at 5; *see also Milavetz*, 559 U.S. at 239. The parties also agree that for purposes of this appeal, Cadwell is an “assisted person or prospective assisted person” under the statute. *See* Br. of Appellant at 7; Br. of Appellee at 5. Finally, and importantly, the parties agree that the statute contains two distinct prohibitions—one about incurring debt in anticipation of bankruptcy filings generally, and the other about incurring debt to
pay for bankruptcy-related legal services more specifically. From there, the parties’ positions diverge.

A

The parties’ central disagreement is over the proper way to parse Section 526(a)(4)’s two prohibitions. For example, where does each prohibition begin and end, and more to the point, does the phrase “in contemplation of”—which the Supreme Court in Milavetz construed to require proof that the advice to incur debt was given for an invalid purpose—apply to both prohibitions, or only the first? Unfortunately, the statute contains no punctuation that might help us determine where to place the “hinge” that divides the two prohibitions—which, as it turns out, really matters. We are presented here with three different ways of reading Section 526(a)(4)—one (sort of) suggested by the Supreme Court in Milavetz, another proposed by KEL and adopted by the district court, and yet another advocated by Cadwell. Each locates the hinge in a different place in the text, resulting in three very different meanings. We consider each in turn.

1

Reading No. 1: “A debt relief agency shall not … advise an assisted person or prospective assisted person [1] to incur more debt in contemplation of such person filing a case under this title or [2] to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.”
One way to parse the statute was suggested (obliquely) by the Supreme Court’s opinion in *Milavetz*. There, at the outset of the pertinent portion of its analysis, the Court observed that Section 526(a)(4) “prohibits a debt relief agency from ‘advising an assisted person’ *either* ‘to incur more debt in contemplation of’ filing for bankruptcy ‘or to pay an attorney or bankruptcy petition preparer fee or charge for services’ performed in preparation for filing.” 559 U.S. at 239 (emphasis added and alterations omitted). Under that reading, in which the hinge—the word “either” in the Court’s paraphrase—comes before the words “to incur more debt,” the statute would separately prohibit advice (1) “to incur more debt in contemplation of” filing for bankruptcy and (2) “to pay an attorney” for bankruptcy-related representation.

That’s not an unnatural reading of the statute, at least as a grammatical matter. Under it, both prohibitions would begin (neatly) with infinitives—“to incur” and “to pay.” But the interpretation does have a pretty big wart—namely, that it would flatly prohibit *all* advice “to pay an attorney” for bankruptcy-related representation. That makes little sense, it seems to us, particularly in light of other provisions of the Bankruptcy Code that clearly contemplate that attorneys will get paid for bankruptcy-related services. *See, e.g.*, 11 U.S.C. § 329 (requiring
attorneys to “file with the court a statement of the compensation paid or agreed to be paid” during the year preceding the petition).\(^2\)

Perhaps not surprisingly, no one here has urged us to adopt this reading of Section 526(a)(4). And we don’t think that we are bound by Milavetz’s passing suggestion that the statute’s second prohibition might be understood to forbid advice “to pay an attorney,” because the Court was concerned there only with the first prohibition. See 559 U.S. at 239 (“Only the first of these prohibitions is at issue.”). We thus reject any interpretation of Section 526(a)(4) pursuant to which the statute’s second prohibition erects a categorical bar on advice to pay bankruptcy attorneys.

2

**Reading No. 2:** “A debt relief agency shall not … advise an assisted person or prospective assisted person to incur more debt in contemplation of [1] such person filing a case under this title or [2] to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.”

There is a second way to read Section 526(a)(4), proposed by KEL and adopted by the district court. In essence, KEL asserts that the statute prohibits a lawyer from advising his client to incur debt to pay for bankruptcy-related legal services *only* if that advice was given for an “invalid purpose.” The district court

\(^2\) See also Lamie v. United States Trustee, 540 U.S. 526, 537 (2004) (“It appears to be routine for debtors to pay reasonable fees for legal services before filing for bankruptcy ….”).
agreed, reasoning that KEL’s invalid-purpose interpretation was compelled by Milavetz. We disagree.

The issue in Milavetz was whether the first prohibition in Section 526(a)(4)—precluding advice to incur more debt “in contemplation of” a bankruptcy filing—unconstitutionally restricted a law firm’s attorney-client communications. In service of its speech-based argument, the firm there contended that Section 526(a)(4)’s first prohibition broadly forbade “not only affirmative advice but also any discussion of the advantages, disadvantages, or legality of incurring more debt.” 559 U.S. at 240. The Supreme Court rejected the firm’s expansive interpretation; instead, focusing on the phrase “in contemplation of,” the Court concluded that the first prohibition more narrowly prevents an attorney “only from advising a debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose.” Id. at 243. In so holding, the Court explained that the phrase “in contemplation of” is a term of art historically associated with abusive conduct—basically, advice to “load up” on debt with the expectation of obtaining its discharge in bankruptcy. Id. at 244. Thus, the Court held, the “controlling question” under Section 526(a)(4)’s first prohibition is “whether the impelling reason for advising an assisted person to incur more debt was the prospect of filing for bankruptcy.” Id. at 243 (quotation marks and alterations omitted).
We reject the view that *Milavetz*’s invalid-purpose gloss applies here. For starters, *Milavetz* certainly doesn’t “directly control[]” this case, as KEL asserts. Br. of Appellee at 11. As already explained, *Milavetz* addressed only Section 526(a)(4)’s first prohibition; it said nothing about the second. 559 U.S. at 239 (“Only the first of these prohibitions is at issue.”). Nor, we conclude, does *Milavetz*’s reasoning sensibly apply to the statute’s second prohibition. Again, the *Milavetz* Court’s conclusion that the statute’s first clause prohibits only advice to incur additional debt for an invalid purpose rested on the phrase “in contemplation of.” Thus, KEL’s *Milavetz*-based argument—pursuant to which the invalid-purpose gloss applies to the second prohibition, as well as the first—would require that we place the hinge after the phrase “in contemplation of.” On that construction, the statute would prohibit advice “to incur more debt in contemplation of [1] such person filing a case under this title or [2] to pay an attorney” for bankruptcy-related legal representation.

That interpretation founders for two reasons. Initially, and most obviously, it makes syntactical hash of Section 526(a)(4)’s second prohibition: A lawyer shall not advise his client “to incur more debt in contemplation of … to pay an attorney”? Nonsense. *See United States v. Hayes*, 555 U.S. 415, 422 (2009) (rejecting a particular reading of a statute because it was, among other things, “awkward as a matter of syntax”). Moreover, reading the phrase “in contemplation
of” to apply to both prohibitions renders the second prohibition essentially meaningless. Under KEL’s interpretation, advice to incur additional debt would violate Section 526(a)(4) if either (1) the “impelling reason” for the advice is the expectation of bankruptcy discharge, i.e., an invalid purpose, see Milavetz, 559 U.S. at 243, or (2) the impelling reason for the advice is exactly the same, and is thus invalid for the same reason, and the debt happens to be incurred to pay an attorney. Under that reading, the second prohibition becomes a mere subset of the first—it has no independent bite. We disfavor interpretations of statutes that render words or clauses superfluous. See, e.g., Bloate v. United States, 559 U.S. 196, 209 (2010). We therefore reject KEL’s contention that the phrase “in contemplation of”—and thus, Milavetz’s invalid-purpose test—applies to Section 526(a)(4)’s second prohibition.

3

Reading No. 3: “A debt relief agency shall not … advise an assisted person or prospective assisted person to incur more debt [1] in contemplation of such person filing a case under this title or [2] to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.”

That leaves us with a third possible—and in our view, the correct—interpretation of Section 526(a)(4). Under this reading, the hinge comes after the phrase “to incur more debt,” such that the statute prohibits advice “to incur more debt” either (1) “in contemplation of” a bankruptcy filing or (2) “to pay an
attorney” for bankruptcy-related legal services. Unlike the first two interpretations, this one doesn’t produce goofy results, defy the usual rules of syntax, or render a phrase meaningless.

Properly interpreted, then, Section 526(a)(4)’s second prohibition forbids lawyers from advising their clients “to incur more debt … to pay an attorney … a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.” 11 U.S.C. § 526(a)(4). Importantly, this second prohibition—unlike the first, which is modified by the “in contemplation of” phrase of art that drove the result in Milavetz—entails no invalid-purpose requirement. And that, we think, makes perfect sense, because the two prohibitions address different subjects. The first is framed in general terms—it forbids advice “to incur more debt in contemplation of” a bankruptcy filing. That prohibition, read for all it might be worth, could cover both abusive advice (e.g., advice to “load up” on debt just to get it discharged) and salutary advice that would likely inure to the benefit of both debtor and creditor (say, to refinance a mortgage to a better interest rate). As the Supreme Court recognized in Milavetz, the “in contemplation of” clause acts as a divining rod of sorts to separate the abusive advice from the salutary. 559 U.S. at 239–43, 248 n.6.

The second prohibition, by contrast, is aimed at one specific kind of misconduct—in essence, a bankruptcy lawyer saying to his client, “You should
That sort of advice is inherently abusive in at least two respects. First, it puts the attorney’s financial interest—getting paid in full—ahead of the debtor-client’s. If a creditor discovers the timing and reason for the fee-related debt, it could challenge the debt’s dischargeability, thereby compromising the debtor’s fresh start. See Milavetz, 559 U.S. at 245. Second, it puts the lawyer’s own interests ahead of the creditors’ in that, while ensuring the lawyer’s full payment, it leaves a diminished estate on which creditors can draw. See id. Section 526(a)(4)’s second prohibition, then, has no need for any further invalid-purpose gloss, because the advice it targets is, in effect, suspect per se.

*   *   *

We therefore hold that the district court erred in concluding that Cadwell was required to allege that KEL’s advice was given for some additional, invalid purpose. Rather, the statute required only that he allege that he was “advise[d] … to incur more debt … to pay an attorney” for bankruptcy-related legal services.

B

Having determined Section 526(a)(4)’s proper interpretation, we now turn to the question whether Cadwell’s allegations state a claim under the statute’s second prohibition. It seems clear to us that they do.
Cadwell alleged in his complaint that “KEL instructed [him] to pay the initial retainer and all subsequent payments by credit card.” Good enough. First, Cadwell’s assertion that KEL “instructed” him to make the payment satisfies the statute’s “advise” requirement. See Milavetz, 559 U.S. at 246 (explaining that Section 526(a)(4)’s limit on “advis[ing]” a person to incur more debt “requires professionals … to avoid instructing or encouraging assisted persons to take on more debt in that circumstance”) (emphasis added). Second, Cadwell alleged that he was instructed to make a payment by credit card, an action that necessarily required him to “incur more debt.” See, e.g., Webster’s Second New International Dictionary 1261 (1959) (defining “incur” to mean “[t]o meet or fall in with, as something inconvenient or harmful; to become liable or subject to; to bring down upon oneself; as to incur debt …”). Finally, there is no dispute for purposes of this appeal that the credit card charges were for KEL’s representation of Cadwell in a bankruptcy-related legal proceeding.3

We therefore have no trouble concluding (as even KEL’s attorney ultimately conceded at oral argument4) that Cadwell’s allegations state a claim under the

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3 Because a violation of Section 526(a)(4) is complete when a lawyer gives the advice to incur a debt to pay for bankruptcy-related representation, it doesn’t matter that Cadwell might have completed a “Payment Authorization” form indicating that he intended to pay (at least in part) by debit card. In any event, ambiguities in the complaint are construed in Cadwell’s favor, see, e.g., Hill, 321 F.3d at 1335, and exhibits attached to the complaint demonstrate that Cadwell did in fact make four of his payments via credit card.

4 See Tr. of Oral Argument at 15:45 (Q: “Do you agree that if the statute is properly read to say that the debt relief agency shall not advise an assisted person to incur more debt to pay his
statute as we have interpreted it.\(^5\)

### III

KEL finally contends that even if Cadwell has stated a claim under Section 526(a)(4), that provision is unconstitutional because it improperly restricts KEL’s attorney-client communications. KEL’s primary argument in that connection is that “[p]rohibiting advice to clients to pay a fee” violates the First Amendment. Br. of Appellee at 24. But as already explained, Cadwell hasn’t asserted—and we don’t hold—that the statute flatly prevents a lawyer from advising a client to pay legal fees. We therefore reject any First Amendment argument based on that overbroad reading of the statute.

KEL separately—and more narrowly—contends that “a statutory prohibition on KEL from providing sound legal advice as to how a client may obtain representation from an attorney, pay costs, and navigate the complex world of bankruptcy law is unconstitutional.” Br. of Appellee at 24. The Supreme Court considered and dismissed a similar argument in *Milavetz*. Specifically, the Court

\(^5\) Cadwell’s complaint also purports to assert a claim on behalf of a class. As to the class, Cadwell alleged that “KEL collected Chapter 7 retainer fees from the prospective debtor(s) through the charging of a credit/charge card which served to cause the prospective debtor(s) to incur more debt prior to the potential filing of the Chapter 7.” The district court didn’t address whether the class allegations stated a claim under the statute, and the parties haven’t addressed those allegations on appeal. We therefore won’t address them either.
“reject[ed] … [the] suggestion that § 526(a)(4) broadly prohibits debt relief agencies from discussing covered subjects instead of merely proscribing affirmative advice to undertake a particular action.” 559 U.S. at 246 (emphasis added and alterations omitted). Rather, the Court explained, the statute “by its terms prevents debt relief agencies only from ‘advising’ assisted persons ‘to incur’ more debt,” meaning that attorneys “remain free to talk fully and candidly about the incurrence of debt in contemplation of filing a bankruptcy case.” Id. Just so here. Section 526(a)(4) doesn’t prevent firms like KEL from discussing with debtors potential options and their legal consequences. It merely prohibits them from giving their clients “affirmative advice” to incur more debt in order to pay for bankruptcy-related representation.6

IV

We therefore hold (1) that a debt-relief agency (including a law firm) violates 11 U.S.C. § 526(a)(4) if it advises a client to incur additional debt to pay for bankruptcy-related legal representation, without respect to whether the advice was given for some independently “invalid purpose”; (2) that Cadwell’s allegation

6 Because KEL didn’t offer in its brief any other arguments as to why Section 526(a)(4)—as properly interpreted—might violate the First Amendment, we needn’t further consider whether the statute, as correctly interpreted, withstands First Amendment scrutiny. Cf. Milavetz, 559 U.S. at 248 (“Because our reading of the statute supplies a sufficient ground for reversing the Court of Appeals’ decision, and because [the firm] challenges the constitutionality of the statute, as narrowed, only on vagueness grounds, we need not further consider whether the statute so construed withstands First Amendment scrutiny.”).
that KEL instructed him to pay his bankruptcy-related legal bills by credit card
states a viable claim under Section 526(a)(4); and (3) that none of the
constitutional arguments that KEL has presented to us warrants invalidating the
statute on First Amendment grounds.

    REVERSED AND REMANDED.
Chapter 2—Bankruptcy Bermuda Triangle: Unbundling and Factoring in Consumer Bankruptcy Cases

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Final Report of the ABI National Ethics Task Force

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Introduction

In 2011, then-American Bankruptcy Institute President Geoffrey L. Berman established the ABI’s National Ethics Task Force1 to address a problem familiar to all bankruptcy professionals and judges: state ethics rules do not always “fit” with the realities of bankruptcy practice. State ethics rules may also not be a perfect fit in the context of other types of practice, either—for example, states may not yet know how to handle the increasingly interconnected digital and virtual world—but it is clear that the Model Rules do not fit neatly with the realities of a bankruptcy practice that involves numerous parties with changing allegiances, often departing from the classic two-party adversarial proceeding.2

Shortly after President Berman appointed the Task Force’s members, the Task Force met to discuss the best way to approach its assignment. At its first meeting, the Task Force promulgated its mission statement:

The ABI National Ethics Task Force will consider ethics issues in bankruptcy practice and will make recommendations for uniform standards, where appropriate.

In essence, the Task Force was charged with answering the question of whether there is a need for national ethics rules, standards, and general practice guidance in the bankruptcy context.3

As the Task Force considered the various topics and issues that could potentially be addressed, a few “jumped out.”4 These included the conflicts-related issues that result from the shifting allegiances that can arise during the life of a bankruptcy case, the complexity of disclosure of “connections” when seeking approval of employment, the fleshing out of the duties of counsel for a debtor in possession, and the role of conflicts counsel in business reorganization cases. Other issues implicated in the context of bankruptcy practice, while not specifically at odds with state ethics rules—for example, the concept of attorney competency and the pressing question of how to balance the need for a capable and skilled bar with the need to provide consumers in financial distress access to the bankruptcy system—were addressed in order to provide needed guidance to bankruptcy attorneys.

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1 Past-President Berman and current President James Markus—with the help of the ABI’s Anthony H. N. Schnelling Endowment Fund—have provided significant support for the Task Force’s work.

2 Cf. In re Nguyen, 447 B.R. 268, 277 (9th Cir. Bankr. 2011) (“The ABA Standards, which were developed primarily for nonfederal, nonbankruptcy courts by unelected and nonjudicial parties, are ill-adapted to federal bankruptcy proceedings. The ABA Standards were not drafted to address the distinctive context of bankruptcy where, as here, administrative matters rather than litigation may be the focus of an attorney's work.”) (referring to the American Bar Association Standards for Imposing Lawyer Sanctions and citing In re Brooks-Hamilton, 400 B.R. 238 (9th Cir. Bankr. 2009) (citation omitted)).

3 The ABI has established a separate Civility Task Force, chaired by James Patrick Shea of Shea & Carlyon.

4 The Task Force also adopted a set of bylaws.
The Task Force began its work by forming several committees, each focused by topic. Each committee developed initial memoranda on issues that fell within the purview of its subject area. The committees’ topics included (1) conflicts of interest, (2) disclosure, retention, and fee issues, (3) consumer issues, (4) committee solicitation issues, and (5) discipline, sanctions, competence, and multi-jurisdictional practice issues. Each committee member attended regular committee meetings, in addition to teleconferences and quarterly meetings of the entire Task Force. The Reporters also held quarterly retreats at which the Reports were researched and drafted. Each Task Force member had the opportunity to comment on the Reporters’ draft Reports, and each draft Report was ultimately voted on and approved by the entire Task Force. Although, in its work, the Task Force reviewed several 50-state surveys of particular state ethics rules, it used the American Bar Association’s MODEL RULES OF PROFESSIONAL CONDUCT in addressing the issues discussed in this Final Report.

The Task Force also found several worthy topics—including the issue of retainers and employment, standards for practice competency for creditors’ counsel, and the issue of ghostwriting a debtor’s petition and schedules as a way of addressing bankruptcy access—that the constraints of this Task Force prevented it from fully developing. It is our expectation that these important issues will be taken up in the near future by another ABI working group or committee.

All of the Reporters’ White Papers and Proposals are compiled within this Final Report. They are as follows:

2. Duties of Counsel for a DIP as Fiduciary and Responsibilities to the Estate.
4. The Use of Conflicts Counsel in Business Reorganization Cases.
6. Competency for Debtors’ Counsel in Business and Consumer Cases.

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5 The Reporters were ably assisted by Research Assistants Bridget McMahon, University of Maine School of Law, Class of 2014, and by David Rothenberg and Nicole Scott, William S. Boyd School of Law, UNLV, Class of 2014. The Reporters would also like to thank Heidi Gage for her excellent research and administrative assistance.

6 The Task Force gratefully acknowledges the research support provided by the reference librarians of the Wiener-Rogers Law Library at the William S. Boyd School of Law.

7 The Task Force recognizes that the Model Rules do not have the force of law; however, so many states have adopted the Model Rules in part or in whole that the Task Force determined that the discussion of the Model Rules, rather than state ethics rules, would be more useful to most ABI members.

8 One of the Task Force’s Reports—the Report on Proposed Amendments to Rule 2014—has been transmitted to the Advisory Committee on Bankruptcy Rules, which will be reviewing the Report before its Fall meeting.
The Task Force recognizes that much more needs to be done in terms of ethics issues facing the bankruptcy bar and bankruptcy bench—and discussions have already begun with ABI’s leadership as to how best to proceed with further review and discussion of ethics issues—but it is pleased to present to you this Final Report and it looks forward to the discussion that will follow.

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April 21, 2013
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Introduction

Sections 327 and 1103 of the Bankruptcy Code set forth specific standards that proposed professionals must meet in order to be retained as an estate or committee professional. Each of these provisions requires the professional in question to meet certain standards relating to their independence from parties other than their client in a case. As noted by several courts, “the purpose of Rule 2014(a) is to provide the court and the United States trustee with information to determine whether the professional's employment is in the best interest of the estate. . . . Rule 2014 disclosures are to be strictly construed and failure to disclose relevant connections is an independent basis for the bankruptcy court to disallow fees or to disqualify the professional from the case.”

In order for courts, the Office of the U.S. Trustee and other parties in interest to evaluate employment applications, Federal Rule of Bankruptcy Procedure 2014 requires professionals to disclose to the court those facts related to actual or potential conflicts of interests they may have. FRBP 2014 currently provides:

(a) Application for an order of employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing

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1 The Reporters are grateful to Chip Bowles for all of his hard work on this project.
4 See, e.g., In re Crivello, 134 F.3d 831, 836 (7th Cir. 1998).
7 Of course, there are state ethics rules that are implicated as well, including issues related to conflicts of interest and candor to the tribunal. We are focusing here on the bankruptcy issues. For a discussion of the application of Rule 2014, see generally, U.S. v. Gellene, 182 F.3d 578, 582 (7th Cir. 1999); Halbert v. Yousif, 225 B.R. 336, 346 (E.D. Mich. 1998). See also In re Plaza Hotel Corp., 111 B.R. 882, 883 (Bankr. E.D. Cal. 1990), aff’d without op., 123 B.R. 466 (9th Cir. BAP 1990); In re Gluth Bros. Constr., 459 B.R. 351, 364 (Bankr. N.D. Ill. 2011); In re Bellevue Place Assocs., 171 B.R. 615, 626 (Bankr. N.D. Ill. 1994) (holding that purpose of 2014 “is to avoid even appearance of a conflict regardless of the integrity of the professional seeking to be employed”).
the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

(b) Services rendered by member or associate of firm of attorneys or accountants. If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation or individual may act as attorney or accountant so employed, without further order of the court.

Currently, FRBP 2014 does not limit the extent of disclosure of a professional's connections\(^8\) with: (i) the debtor; (ii) any creditors of the debtor; (iii) other parties in interest; (iv) attorneys of the debtor, creditors, and parties in interest; (v) accountants for the debtor, creditors, and parties in interest; and (vi) the United States Trustee and persons employed by the U.S. Trustee's office (collectively, “2014 Parties”). Indeed, most courts that have addressed this issue have held that professionals have little, if any, discretion in determining whether a connection is “relevant” to their employment application.\(^9\)

\(^8\) See In re Gluth Bros. Constr., 459 B.R. 351, 364 (Bankr. N.D. Ill. 2011), where the court stated: The term “connections” used in Rule 2014(a) is considerably broader than the terms “disinterested” and “interest adverse to the estate” used in Section 327(a). Thus an attorney must disclose a connection even if he does not believe it would disqualify him under Section 327(a). As the Seventh Circuit Court of Appeals has stated, professionals “cannot pick and choose which connections are irrelevant or trivial.” U.S. v. Gellene, 182 F.3d 578, 588 (7th Cir. 1999) (internal citation omitted). Instead, no “matter how trivial a connection appears to the professional seeking employment, it must be disclosed.” In re Enviroyde Indus., 150 B.R. 1008, 1021 (Bankr. N.D. Ill. 1993) (Schwartz, J.). Counsel who “fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation.” Gellene, 182 F.3d at 588 (quoting In re Crivello, 134 F.3d 831, 836 (7th Cir. 1998)). Thus “denial of fees or disqualification may be justified [33] even when the professional is in fact disinterested.” In re Raymond Professional Group, Inc., 421 B.R. 891, 906 (Bankr. N.D. Ill. 2009) (quoting In re Midway Indus. Contractors, 272 B.R. 651, 662 (Bankr. N.D. Ill. 2001)).

\(^9\) See generally In re Crivello, 134 F.3d 831 (7th Cir. 1998); In re Park-Helena Corp., 63 F.3d 877 (9th Cir. 1995); Rome v. Braunstein, 19 F.3d 54 (1st Cir. 1994); see also In re Rusty Jones, Inc., 134 B.R. 321, 346 (Bankr. D. Ill. 1991) (noting the fact the professional owned a hot dog stand over 20 years before the bankruptcy with an indirect owner of the debtor was a \textit{de minimis} connection).
The broad but undefined term “connection” has led to confusion\(^{10}\) over the appropriate level of inclusiveness in disclosures.\(^{11}\) The uncertainty surrounding the meaning of “connection” has also led to attempts by professionals to argue that some important “connections are immaterial.”\(^{12}\) The following proposed new FRBP 2014 is an effort to provide clarity to professionals concerning what relevant connections must be disclosed, as well as to provide improved information for courts and other parties to use in determining a professional’s eligibility for employment.

**Current Rule 2014**

Current Rule 2014 reads as follows:

(a) Application for and Order of Employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to §327, §1103, or §1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

(b) Services Rendered by Member or Associate of Firm of Attorneys or Accountants. If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an

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\(^{10}\) In re Rusty Jones, Inc., at 346, 134 B.R. 321 (Bankr. D. Ill. 1991) (discussing whether ownership of a hot dog stand with a 2014 party 20 years before bankruptcy was filed was a connection required to be disclosed).

\(^{11}\) In re EWC, 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992) (“duty of professionals is to disclose all connections with the debtor, debtor in possession, insiders, creditors and parties in interest . . . they cannot pick and choose which connections are irrelevant or trivial . . . No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it.”).

\(^{12}\) See In re eToys Inc., 331 B.R. 176, 197 (Bankr. D. Del. 2005) (committee counsel, which was ultimately sanctioned $750,000, argued failure to disclose business arrangement between committee counsel and the president of the debtor was not disqualifying as committee counsel was not required to be disinterested under 11 U.S.C. § 1103).
accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation, or individual may act as attorney or accountant so employed, without further order of the court.

Proposed Amended Rule 2014

In comparison, the proposed amended Rule 2014 provides:

(a) APPLICATION FOR AND ORDER OF EMPLOYMENT. An application for an order approving the employment of a professional under § 327, § 1103, or § 1114 of the Code shall be made in writing and shall be made by the trustee, debtor in possession, or committee.\(^\text{13}\) The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States Trustee. The application shall contain:

1. specific facts demonstrating the necessity for the employment;
2. the identity of the professional to be employed, the reasons for the selection of the professional, and the list of the professional’s employees, members, owners, and partners most likely to work on the matter;
3. a description of the professional services to be rendered;
4. a description of any proposed arrangement for compensation, including a statement of whether the professional is seeking approval of compensation standards under 11 U.S.C. § 328(a);
5. a statement that, to the best of the applicant's knowledge, the professional is eligible under the Code for employment for the purposes set forth in the application;
6. a description of the investigation undertaken and the procedures used by the applicant to determine that the professional is eligible for the proposed employment, including specifically the actions that the professional undertook to identify those connections that are material under the circumstances, including personal, business, and professional connections, that would be relevant to the court in determining whether the professional was free of any disqualifying current or potential bias;
7. if the professional is to be employed in multiple affiliated cases, a description of relevant inter-company relationships, including any potential conflicts among the affiliated debtors and any proposed allocation of compensation of the professional to be paid by each affiliate; and
8. for professionals seeking approval of employment by a committee,
   (a) a statement of the process by which the professional sought employment by that committee, including interactions with other professionals; and

\(^{13}\) As for court-appointed experts, we expect that a court will set its own disclosure procedures for them.
PROPOSED AMENDMENTS TO RULE 2014

(b) a disclosure of any direct and indirect contacts and communications with a person eligible for the committee or who sought to be appointed to the committee.

(b) STATEMENT OF PROFESSIONAL. The application shall be accompanied by a verified statement by an authorized representative of the professional, made according to the best of that person’s knowledge, information, and belief, and formed after an inquiry reasonable under the circumstances, that shall:

1. state that the professional is eligible under the Code for employment for the purposes set forth in the application;
2. describe the investigation undertaken and the procedures used by the professional in order to make its determination of eligibility for the employment set forth in the application;
3. describe any interest that the professional, or any employee, member, owner, or partner of the professional, holds or that the professional represents that is adverse to the estate;
4. describe any relationship that the professional, or any employee, member, owner, or partner of the professional, has shared or has agreed to share any compensation with any person, other than an employee, member, owner, or partner of the professional, and if so, describe the terms of any such arrangement;
5. disclose the source and describe the amount of any retainer to be paid, and if such retainer is to be paid from a creditor's collateral, whether such use is within the scope of authorized use of that collateral;
6. describe any guarantee of payment, enhancements of payment, or any collateral securing the payment of compensation and state the relationship of the guarantor with the debtor or committee and the professional;
7. disclose any payments for prepetition work received by the professional within 90 days of the petition’s filing, and all facts that may be relevant to a preference analysis under 11 U.S.C. § 547;
8. disclose any conflicts waiver requested or obtained and the scope of that waiver, including any waiver limitations on actions the professional may or may not take during the case; and
9. describe the Relevant Connections, as defined in subsection (c) below, including any applicable materiality thresholds used, with the following persons, parties, or entities:
   (A) the debtor;
   (B) creditors of the estate;
   (C) known or anticipated post-petition creditors of the estate;
   (D) equity security holders of the debtor or of affiliates of the debtor;
   (E) officers and directors of the debtor;
   (F) parties that are insiders of the debtors or that were insiders of the debtor within 2 years before the date of the filing of the petition;
   (G) any investment banker for any outstanding security of the debtor;
   (H) the United States trustee;
(I) customers of the debtor or vendors to the debtor whose transactions with the debtor as of the petition date constitute a material portion of the debtor’s business;

(J) parties to executory contracts and unexpired leases;

(K) utility service providers;

(L) governmental units and officials and employees thereof;

(M) members of any committee appointed under 11 U.S.C § 1102 or otherwise subject to disclosure under Rule 2019;

(N) any identified potential asset purchasers; and

(O) any professional employed by any of the above persons, parties or entities.

All disclosures made under this Rule shall be made in a format that describes the Relevant Connections in sufficient detail so the court and parties in interest may recognize potential biases and conflicts. For the Relevant Connections listed in subparagraph (b)(10), such disclosures should also be indicated in a grid substantially conforming to the New Proposed Official Form for Rule 2014 Disclosures, and that grid should cross-reference the relevant paragraphs in the narrative disclosure itself.

(c) RELEVANT CONNECTION. For purposes of this Rule, and unless otherwise defined by the court, “Relevant Connection” means,

(1) any connection with a person or entity listed in subsection (b) that:

(A) on or within two years of the filing of the petition, generated a material amount of income and/or transfers;

(B) involved or was related to property of the estate with a material value;

(C) involved a material business venture with the person or entity; or

(D) involved working for the person or entity as a professional and generating a material amount of fees in the two years prior to the filing of the petition;

(2) any connection with the court to which the employment application is being submitted;

(3) any connection with the United States Trustee or any person employed in the office of the United States Trustee; or

(4) any other connection constituting a personal, professional, or business relationship that could reasonably be determined to be significant in its evaluation of whether a professional is qualified to be employed.

With respect to each Relevant Connection, the applicant shall disclose personal and professional relationships and other connections relevant to determining the existence of bias or influence on professional judgment. Any materiality threshold used by the applicant for each Relevant Connection shall be set forth in the application. If the court directs use of a different threshold, the professional shall amend its disclosures to conform to such threshold. The list of Relevant Connections is intended to be comprehensive and encompass connections relevant to the court’s consideration of the application. Any additional relevant connections necessary to prevent the application and the professional’s verified statement from being materially misleading shall be included.
(d) SERVICE AND TRANSMITTAL OF APPLICATION. The applicant shall serve a copy of the application on:
   (A) the United States trustee;
   (B) the debtor and the debtor’s attorney;
   (C) any committee elected under § 705 or appointed under § 1102, or, if the case is a chapter 9 case or a chapter 11 case and no committee of unsecured creditors has been appointed, on the creditors included on the list filed under Rule 1007(d); and
   (D) any other entity as the court may direct.

(e) SERVICES RENDERED BY MEMBER OR ASSOCIATE OF FIRM OF EMPLOYED PROFESSIONAL. If the court approves the employment of an individual, partnership, corporation, or other business entity, then any employee, member, owner, or partner of the professional working with the professional so employed may act as a professional so employed, without further order of the court, provided that the employee, member, owner, or partner of the professional has not been screened off from the employment due to a conflict of interest. If a partnership is employed, a further order approving employment is not required if the partnership agreement has been amended solely because of the addition or withdrawal of a partner.

(f) SUPPLEMENTAL STATEMENT OF PROFESSIONAL.
   (1) The professional has a continuing duty to file a supplemental statement regarding any new Relevant Connections for as long as the professional is employed.
   (2) The professional shall regularly undertake a reasonable investigation to determine whether any additional Relevant Connections have developed and whether previously disclosed Relevant Connections should be updated, and in any event, shall undertake an investigation at the following times:
      (A) before filing any adversary proceeding or before filing a response to any such adversary proceeding involving such professional;
      (B) within 28 days after any amendment to bankruptcy schedules is filed;
      (C) when a bidder for estate assets or purchase of estate assets outside the ordinary course of business is publicly identified; and
      (D) before filing any interim or final fee application.
   (3) Such supplemental statements shall be served on each entity listed in Rule 2014(c), and, unless the case is a chapter 9 case, on the United States Trustee.

(g) The court may set a threshold for materiality of Relevant Connections.
Comment on Proposed Amended Rule 2014

The appropriate threshold will vary depending on the size and type of case, and the applicable Relevant Connection. For a strip mall “mom & pop” debtor, a minimum threshold on size of creditor claims used to determine which names to check for conflicts would likely not be appropriate. A Delta Airlines or Enron case, on the other hand, would likely warrant a considerably higher threshold. Likewise, all equity owners would need to be disclosed for a small debtor, but for a publicly-traded debtor, a securities law threshold for identified equity owners would be an appropriate threshold. There will be significant variance in threshold levels given the range of case sizes. It is likely that Delaware and New York City courts would allow higher thresholds that would be considered unacceptable in other jurisdictions. If the thresholds used are set forth—and parties in interest and the court have the opportunity to question them—at the beginning of the case, the Rule is flexible enough to be used across the board in all parts of the country.
### New Proposed Official Form for Rule 2014 Disclosures

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<th>Name and position of professional with Relevant Connection</th>
<th>Debtor</th>
<th>Creditor</th>
<th>Known or anticipated Pre-petition creditors</th>
<th>Equity security holders</th>
<th>Insiders</th>
<th>Investment bankers</th>
<th>U.S. Trustee</th>
<th>Customers/vendors</th>
<th>Parties to executory contracts or unexpired leases</th>
<th>Utility service providers</th>
<th>Governmental units and employees thereof</th>
<th>Committee members</th>
<th>Potential asset buyers</th>
<th>Any professional of any entity listed</th>
<th>Description of Relevant Connection</th>
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1 Cross-reference with paragraph in Application itself.
2 Cross-reference with paragraph in Application itself.

This form is new and implements Revised Rule 2014, which relates to the disclosure of relevant connections for retention purposes. The individual completing the form must sign and date it. By doing so, he or she declares under penalty of perjury that the information provided is true and correct to the best of that individual’s knowledge, information, and reasonable belief. The signature is also a certification that the standards of Rule 9011(b) are satisfied.

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Duties of Counsel for a DIP as Fiduciary and Responsibilities to the Estate

Introduction

The issue of the relationship between the DIP’s fiduciary duties and the advice of counsel for the DIP has caused many courts to conclude that the DIP’s attorneys are actually counsel for the “estate.” Perhaps those courts have relied on the concept of “counsel for the estate” as a way of expressing their frustration with cases in which counsel for DIPs have ratified the bad decisions of the individuals speaking for the DIPs. Although “counsel for the estate” is a convenient concept, a better way to address the matter of rogue DIPs and their counsel is to explain in methodical detail just what the DIP’s fiduciary duties are and how counsel for a DIP can guide and advise a DIP to carry out its fiduciary duties.

In general, both the law about how fiduciaries should behave and the ethics rules governing how lawyers for fiduciaries should behave are well-settled. In the bankruptcy context, however, the issues are not as clear due to the complex and shifting nature of the relationship between and among the DIP, the estate, and the other parties in interest. At least one of the underlying purposes of the Bankruptcy Code is to maximize the value of the estate. The residual owners of the estate—typically, the unsecured creditors—care deeply about the choices that the DIP makes during its reorganization, as do the individuals running the DIP. Each of these parties, however, may not have the same views about what might constitute acceptable decisions during the case. If one thinks of the DIP as being a fiduciary for multiple beneficiaries with possibly differing interests, then the need for more clarity in terms of the DIP’s fiduciary duties and the duties of DIP counsel is evident.

1 Susan Freeman took the laboring oar with a wonderful first draft of this topic, and we thank her. We also thank David Rothenberg and Nicole Scott, second-year law students at the William S. Boyd School of Law, UNLV, for their hard work in assisting us.

2 See cases cited in n. 15, infra.

3 The ethics rule regarding lawyers who represent entities is also well-settled. For a starting point, see, e.g., MODEL RULES OF PROFESSIONAL CONDUCT (“MODEL RULES”) R. 1.13.


5 At least when there are enough funds to trickle down to the general unsecured creditors.
Fiduciary Duties in General

Fiduciary duties have a subject and an object: fiduciary duties do not exist in a vacuum. If someone owes a fiduciary duty, he must owe it to the beneficiary of that duty. Fiduciary duties are sometimes described as the obligation to act solely in the beneficiaries’ interest. That generalization overlooks the right of a fiduciary to be self-interested in some respects. For example, a fiduciary may contract for its own compensation; it need not serve free of charge.

There are two core fiduciary duties: the duty of loyalty and the duty of care. In situations involving multiple beneficiaries, courts have also imposed a duty of impartiality.

Duty of loyalty. The principle underlying the duty of loyalty is that “the agent [must] subordinate [his own] interests to those of the principal and place the principal's interests first as to matters connected with the agency relationship.” A fiduciary acting in a matter involving personal interests and conflicts (such as compensation) may not obtain an improper personal benefit. The key here is the modifier “improper.” The fiduciary may meet its duty of loyalty and still obtain some proper personal benefits by acting fairly, with full disclosure, and by obtaining approval or ratification of the action by disinterested persons.

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7 See Brook Valley VII, Joint Venture v. Schropp (In re Brook Valley VII, Joint Venture), 496 F.3d 892, 900 (8th Cir. 2007) (“The fiduciary obligation consists of two duties: the duty of care and duty of loyalty.”); In re Microwave Prods. of Am., 102 B.R. 666, 672 (Bankr. W.D. Tenn. 1989) (noting DIP has fiduciary duties, such as duty to avoid conflicts, duty to avoid self-dealing, and the duty to avoid “negligent behavior”); John H. Langbein, Mandatory Rules in the Law of Trusts, 98 N.W. U. L. Rev. 1105, 1122 (2004) (recognizing core fiduciary duties of loyalty, impartiality, and prudence of conduct). In certain areas, such as the duties of non-profit boards, some courts have fine-tuned these two duties. See, e.g., Summers v. Cherokee Children & Family Servs., Inc., 112 S.W.3d 486, 504 (Tenn. Ct. App. 2003) (“In particular, the duty of loyalty requires that a director or officer faithfully pursue the interest of the organization, and its nonprofit purpose, rather than his or her own financial or other interests, or those of another person or organization.”)
8 See Restatement (Third) of Agency § 8.01 cmt. b (2006); id. at § 8.01 (“An agent has a fiduciary duty to act loyally for the principal’s benefit in all matters connected with the agency relationship.”); see also In re Bank of New York Mellon Corp. FOREX Transactions Litigation, 2013 WL 440628, *16 n. 165 (S.D.N.Y. 2013) (describing a trustee’s duty of loyalty as acting in the interests of his beneficiaries).
9 A common example of this rule is the approval of corporate transactions with a board member by a vote of other disinterested board members. The corporate codes of most states protect conflict of interest transactions from being voided if: (1) they are fair, or (2) they are approved by a “disinterested” majority of the directors, or (3) they are ratified by the shareholders. See 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.02(a) (1994) (indicating circumstances where duty of fair dealing is fulfilled); 3 William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations § 915.10 (perm. ed. rev. vol. 2002) (discussing effects of state statutory provisions on transactions or contracts between interested direction and corporation); Del. Code Ann. tit. 8, § 144 (2001); cf. In re Brook Valley, 496 F.3d at 901 (noting fiduciary must prove transaction was fair when challenged for breach of duty of loyalty).
DUTIES OF COUNSEL FOR A DIP AS FIDUCIARY AND RESPONSIBILITIES TO THE ESTATE

Duty of care. The fiduciary’s duty of care requires that the fiduciary act with “such care and skill as a man of ordinary prudence would exercise in dealing with his own property.”

Duty of impartiality. When the fiduciary has multiple beneficiaries, courts also impose an additional duty of impartiality. In the field of trust law, the trust instrument guides and explains the state law trustee’s fiduciary obligations with respect to conflicting beneficiaries’ interests. The Bankruptcy Code and Rules provide much of the same guidance as a trust instrument in setting forth parameters for the exercise of fiduciary duties in Chapter 11 cases. When the DIP is exercising rights that are within the provisions (and intent) of the Code and Rules, typically the Code and Rules provide a safe harbor for the DIP’s decisions. For example, parties may openly negotiate over how assets and future earnings will be allocated under a reorganization plan, with Code-specified priorities for creditor distributions and required terms for any forced plan provisions, and the DIP/debtor is permitted to participate actively in plan negotiations without violating its fiduciary obligations.

In short, the state law of fiduciary duties provides a good description of the contours of fiduciary duties in general, and the Bankruptcy Code and Rules (and courts’ interpretation of the Code and Rules) provide an enhanced description of the DIP’s duties. The challenge is to determine what a DIP’s counsel should do to assist the DIP in the understanding of its fiduciary duties, and how a DIP’s counsel should behave when the DIP is in danger of violating those duties.

Relationship of Fiduciary Duties in General to Fiduciary Duties of the DIP

As observed in Part I above, many courts have stated that DIP counsel is “counsel for the estate,” with separate fiduciary duties to the “estate” to independently (as in “separate from the

10 See United States v. Aldrich (In re Rigden), 795 F.2d 727, 730 (9th Cir. 1986) (“A bankruptcy or reorganization trustee has a duty to exercise that measure of care and diligence that an ordinary prudent person would exercise under similar circumstances.”); RESTATEMENT (SECOND) OF AGENCY § 379(1) (1958). In a corporate context of management fiduciary duties, the duty of care for corporate directors is substantially the same. They are to act “in a reasonably prudent manner, in the interest of the company,” after obtaining adequate information and in good faith. MODEL BUS. CORP. ACT § 8.30(a) (2008).

11 RESTATEMENT (THIRD) OF TRUSTS § 183 (1992) (“When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.”).

12 Id. § 183, cmt. a (1992) (“By the terms of the trust the trustee may have discretion to favor one or more beneficiaries over others. The court will not control the exercise of such discretion, except to prevent the trustee from abusing it.”).

13 See Fulton State Bank v. Schipper (In re Schipper), 933 F.2d 513, 515 (7th Cir. 1991) (holding DIP’s fiduciary duty to creditors met by good faith compliance with Code and Rule provisions).

DIP”) determine what is in the estate’s best interest.15 Other courts have analyzed DIP counsel’s duties as a lawyer for a fiduciary client.16 Courts appear to use “fiduciary” terminology for its strong moral tone of fidelity and trustworthiness and to increase lawyer vigilance and sensitivity. But “fiduciary” is not just a synonym for careful attention to the effect of client decisions. Rather, it is a word with a specific legal meaning. Courts referring to the DIP’s lawyer as having fiduciary duties to the estate describe duties consisting of those held by a lawyer to a fiduciary client and by a lawyer to the court.17

15 E.g., Everett v. Perez (In re Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) (“Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually. Counsel has an independent responsibility to determine whether a proposed course of action is likely to benefit the estate or will merely cause delay or produce some other procedural advantage to the debtor. While he must always take his directions from his client, where counsel for the estate develops material doubts about whether a proposed course of action in fact serves the estate’s interests, he must seek to persuade his client to take a different course or, failing that, resign. Under no circumstances, however, may the lawyer for a bankruptcy estate pursue a course of action, unless he has determined in good faith and as an exercise of his professional judgment that the course complies with the Bankruptcy Code and serves the best interests of the estate”); In re Count Liberty, LLC, 370 B.R. 259, 280 (Bankr. C.D. Cal. 2007) (asserting “majority view” that DIP counsel is fiduciary of bankruptcy estate); see Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (In re JLM, Inc.), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) (holding counsel’s duties are to estate in bankruptcy); see also In re Delta Petroleum (P.R.), Ltd., 193 B.R. 99, 111 (D. P.R. 1996) (citing Model Rules R. 1.15(a) (1983) and holding bankruptcy attorney is counsel for estate, not trustee); In re Rivers, 167 B.R. at 301 (“When the interests of the [debtor] conflict with those of the [estate], it is the estate and the court to which the attorney owes his highest allegiance.”).


17 E.g., ICM Notes, Ltd. v. Andrews & Kurth, LLP, 278 B.R. 117, 124-26 (S.D. Tex. 2002) (noting that some courts have determined that DIP counsel owes fiduciary duties to the bankruptcy estate as a whole, and explaining that an examination of these fiduciary duties reveals that they arise either from the role of counsel as an officer of the court or the derivative nature of fiduciary obligations owed by counsel to its client, the DIP; “The cases cited by ICM Notes do not support a finding that counsel for the debtor owes particular fiduciary duties to the estate or its creditors. The language in these cases referencing a duty to the estate or the creditors is often included without analysis or elaboration by the court and is cited in conjunction with the traditional bankruptcy concepts of a breach of counsel’s fiduciary duty to the client debtor-in-possession or counsel’s failure to provide services which benefit the estate … [or] are grounded in principles relating to the retention and compensation of bankruptcy professionals, including conflict of interest rules.”), aff’d, 324 F.3d 768 (5th Cir. 2003); Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (In re JLM, Inc.), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) (directing a “noisy withdrawal” and stating that “debtor’s attorney, while not a trustee, nevertheless is charged with the duty of counseling the debtor in possession to comply with its duties and obligations under the law. When a debtor in possession is in breach of its fiduciary obligations, counsel must advise the client “to follow a lawful course.”) (internal citations omitted); In re Food Mgmt. Group, LLC, 380 B.R. 677, 708 (Bankr. S.D.N.Y. 2008) (counsel’s duty “may not rise to the level of a policeman for the debtor’s postpetition conduct,” but he or she must advise the DIP of its responsibilities under the Code and assist its management in discharging those responsibilities).
Rather than using “counsel for the estate” as a proxy for “attorney representing a fiduciary client who also owes duties as an officer of the court,” we propose to be more specific and precise about the duties that DIP’s counsel owe—and to whom—by applying state rules of professional responsibility and the Bankruptcy Code and Bankruptcy Rules. Otherwise, the DIP’s attorney runs the risk of facing a rule that simply proves too much. We cannot have a rule that links DIP’s counsel’s duties to claims of individual creditors who may assert that the DIP has violated fiduciary duties, nor can we have a rule that bootstraps representing the DIP to somehow representing the property interests constituting the bankruptcy estate. After all, the DIP’s attorney can only speak for the client who directs her and should be able to counsel her client on a privileged basis. The DIP’s attorney is not directed by creditors or by the res of estate property and cannot provide them with confidential and/or privileged advice.

18 While counsel have duties of honor and candor and truthfulness to courts, that does not make them fiduciaries to other parties in litigation before the court. Every lawyer is obliged by Rule 9011 not to file unsupported pleadings or pursue frivolous litigation. These duties to the court apply in every case, yet in most if not virtually all cases, counsel for one party is not a fiduciary for the adverse party. See In re Brennan, 187 B.R. 135, 151 (Bankr. D.N.J. 1995) (“The ultimate conflict of interest problem in chapter 11 cases is the tension between the concept of a debtor in possession as fiduciary and the reality that the debtor usually seeks to further its own interest at the expense of its creditors. The objections based on alleged conflicts of professionals in such situations often reflect confusion about the real problem, which is creditor mistrust of the debtor, and therefore of his, her or its professionals. However, unless such mistrust is sufficiently serious to warrant appointment of a trustee, requiring related debtors to change professionals, or to have different professionals, often fails to create the independent perspective which is intended by such requests.”); see also In re SIDCO, Inc., 162, B.R. 299, 300 (Bankr. E.D. Cal. 1993), aff’d 173 B.R. 194 (E.D. Cal. 1994) (notion that DIP counsel must represent interests, not only of client but also other parties whose interests may be adverse to those of client, is “flight into the absurd”); In re Best Western Heritage Inn P’ship, 70 B.R. 736, 740 (Bankr. E.D. Tenn. 1987) (“difficult to believe that Congress intended to require a disinterested attorney for a debtor-in-possession as a somewhat ineffective safeguard for the rights of creditors and investors other than management.”).

19 Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 457-60 (D. Utah 1998); ICM Notes, Ltd. v. Andrews & Kurth, L.L.P., 278 B.R. 117, 126 (Bankr. S.D. Tex. 2002) (in a bankruptcy case, the debtor, secured creditors, unsecured creditors and other parties in interest have different and competing interests and are represented by counsel; if DIP counsel owed a fiduciary duty to a particular creditor, it would prevent counsel from representing his own client and would be contrary to the mandate that DIP counsel be disinterested); 9 NORTON BANKRUPTCY LAW & PRACTICE, supra note 34 § 172:6, at 172-35 (discussing duties of debtor-in-possession and his/her counsel); see ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 94-380 (1994) (lawyer with fiduciary client only has client relationship with that fiduciary, and owes to beneficiaries only those duties owed to third parties in general); See CenTra, Inc. v. Estrin, 538 F.3d 402, 413 (6th Cir. 2008) (“[A] lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other.”) (quoting MODEL RULES OF PROFESSIONAL CONDUCT R. 1.7 cmt. [28] (2009)); see also In re Jaeger, 213 B.R. 578, 587 (Bankr. C.D. Cal. 1997) (stating attorney representing adverse clients can be disqualified if adverse to clients’ interests); MODEL RULES R. 1.7 cmt. [29] (2009).

20 See In re Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) (“Although the line separating advice or assistance in performing duties from the actual performance of those duties is not always bright, the line exists, and a professional has no business making decisions that are the responsibility of the fiduciary.”); see also Model Rules R. 1.14 (2009); In re ABC Auto. Prods. Corp., 210 B.R. 437, 443 (Bankr. E.D. Pa. 1997) (“[T]he bankruptcy process is compromised when its attorney does not present the actual views of his clients but rather what he believes they should be.”). Model Rules R. 1.6 (“attorney must make reasonable effort to
The critical lesson from court statements about DIP lawyers’ fiduciary duties is the fundamental importance of counseling and guiding DIP clients on the exercise of their fiduciary duties, while meeting the attorney’s professional obligations to the court. In visual terms, the relationship looks like this:

Of course, this dual relationship—lawyer to client and lawyer to court—is one that every litigator has. What makes the DIP counsel’s situation so tricky is the relationship of its client to the amorphous “estate.” And, as discussed in part IV, below, the relationship is even trickier than it might first appear.
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Duties of the DIP’s Attorneys

In fact, the drawing above does not tell the whole story. The DIP is also a bankruptcy debtor, and unlike a state-law defined trustee, is not required to be disinterested. It files a plan as a “proponent” or “debtor,” with disclosure requirements but no obligation to discount the interests of equity in order to maximize creditor recoveries as long as Bankruptcy Code “cram-down” requirements are met (assuming a non-consensual plan). As the court said in *Water’s Edge Limited Partnership*:

A chapter 11 debtor in possession wears two hats. As observed by Judge Saris, it is a fiduciary of the bankruptcy estate, and as such owes fiduciary obligations to the unsecured creditors, the prime beneficiaries of the estate. Subject to certain limitations not material here, the Code provides that “a debtor in possession shall have all the rights ... and powers, and shall perform all the functions and duties ... of a trustee serving in a case under this chapter.” 11 U.S.C.S. § 1107(a) (Law.Co-op.1987). The general powers and obligations of a debtor in possession are accordingly based upon sections of the Code which refer to the “trustee.”

A chapter 11 debtor’s obligations are quite different as to the plan dividend it proposes. In describing the role of a debtor in possession as plan proponent the Code contains no reference to the debtor as a trustee. Instead, the Code calls the debtor in possession “debtor” or plan “proponent.” See 11 U.S.C.S. §§ 1121, 1127, 1129, 1142, 1144 (Law.Co-op.1987 & Supp.2000).

There is a basic reason for the Code’s failure to describe a chapter 11 debtor in possession as a “trustee” when referring to its role in proposing and confirming a plan of reorganization. A consensual plan (one accepted by all impaired classes of claims or interests) is typically the result of hard bargaining between the debtor and a creditors’ committee. To be confirmed, the plan must give creditors at least what they would get in a liquidation under chapter 7. See 11 U.S.C.S. § 1129(a)(7) (Law.Co-op. Supp.2000). If they have plan proposal rights, creditors can propose a plan of their own which converts their debt to equity. See 11 U.S.C.S. § 1129(b)(2)(C)(ii) (Law.Co-op.1987). As equity holders, they can then sell the business and obtain its going concern value. In the plan negotiations, therefore, liquidation value is the floor for any dividend and going concern value is the ceiling. The


24 11 U.S.C. §§ 521, 1106, 1121, 1127, 1129, 1142, 1144 (2006) (referring to DIP as “plan proponent” or “debtor” and not as “trustee”); 1129(b) (cram-down provisions); see *In re Water’s Edge Ltd. P’ship*, 251 B.R. at 7 (suggesting that Code’s drafters chose terminology intentionally and discussing cram-down rights).
difference can be considerable. And of course value under any standard is a slippery concept.

So there is plenty of room for bargaining. Beyond the minimal disclosure requirements of section 1125, the Code imposes no fiduciary obligations upon a debtor in possession in this negotiation process. The debtor is not required, for example, to disclose the maximum dividend it is willing to pay. Moreover, not all plans are consensual. A debtor may, as here, confirm a plan over the objection of a class of creditors if the plan gains the acceptance of at least one class of impaired claims and satisfies the other requirements for a so-called “cramdown” plan. See 11 U.S.C.S. § 1129(b) (Law.Co-op.1987). The self-serving nature of these negotiating and cramdown rights has been noted. . . .

A debtor in possession is therefore permitted to place its own interests above those of the unsecured creditors with respect to what it proposes to pay under its plan. This is of course inconsistent with the concept that the debtor in possession is a fiduciary of the unsecured creditors owing them a duty of loyalty. The conclusion seems inescapable. As to its proposed plan dividend, a debtor in possession is not a fiduciary of the unsecured creditors owing them a duty of loyalty. Its bargaining and cramdown rights necessarily exclude such a fiduciary obligation.25

In a sense, then, the DIP is more of a quasi-trustee than it is the pure equivalent of a state law trustee; it has certain obligations that rise to the level of fiduciary duties, and it has obligations that relate to its status as a debtor in bankruptcy, in which its duty is to act within the confines of the Bankruptcy Code.

Generally, in Chapter 11, a single law firm will represent the client in its capacities as both debtor and DIP.27 Representing the DIP/debtor client entails counseling the “debtor part” of the


26 As observed,

[A] DIP is not the same as a trustee. As the Supreme Court has recognized, there is a difference between a “strict trusteeship,” such as a bankruptcy trusteehip, and “one of those quasi-trusteeships in which self-interest and representative interests are combined.” A DIP is a quintessential example of such a quasi-trusteeship. The DIP is, first of all, the debtor with additional, rights, duties and powers. Not only are these comprised solely of the rights, duties and powers of a trustee, but the DIP also has the duties of the debtor, the rights of a party in interest and—most significantly, at the outset of a chapter 11 case—the exclusive right to file a plan. Consequently, there should at least be a distinction between the rights, duties and powers the DIP enjoys as a debtor, and those it enjoys as a trustee. For those it enjoys as a trustee, it has a fiduciary duty to the estate. For those it enjoys as debtor, it does not.

Alec P. Ostrow, We Don’t Need the Case Law to Turn the DIP’s Attorney into a Court Informant, 27-MAY AM. BANKR. INST. J. 14, 44, April 2008 (footnotes omitted).

27 The debtor’s equity owner may be separately represented when the debtor is closely held or publicly held and there is an equity committee. In cases in which the equity owner of a closely held company or partnership is also a debtor, a number of courts have required separate representation. See In re Straughn, 428 B.R. 618, 623-24 (Bankr. W.D. Pa. 2010) and cases cited therein. In larger cases of affiliated debtors, requiring

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client on exercising its rights and responsibilities as defined under the Bankruptcy Code. Advising the “DIP part” of the client entails understanding and facilitating the exercise of the DIP’s fiduciary duties of loyalty, care, and impartiality. It also requires the lawyer’s refusal to participate in the client’s proposed violation of its statutory and fiduciary duties. Therefore, a complete depiction of the relationships among the estate, the DIP, the debtor, DIP counsel, and the court looks like this:

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28 Advising the DIP (as with any client) involves the provision of competent legal advice and likely involves a discussion of the DIP’s business considerations in addition to any purely legal advice. The Task Force recognizes the difficulty of drawing a line of demarcation between legal advice and business advice. Although such a discussion is beyond the scope of this Report, the Task Force finds useful the guidance in MODEL RULE 2.1 (“In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.”).

29 For a thorough discussion of the DIP’s fiduciary duties, as well as a discussion of the issue about what “not participating in the client in a proposed violation of its duties” means, see Susan M. Freeman, Are DIP and Committee Counsel Fiduciaries for Their Clients’ Constituents or the Bankruptcy Estate? What is a Fiduciary, Anyway?, 17 AM. BANKR. INST. L. REV. 291, 333-36 (Winter 2009) [hereinafter Freeman, DIP Counsel as Fiduciary]; C.R. Bowles & Nancy B. Rapoport, Debtor Counsel’s Fiduciary Duty: Is There a Duty to Rat in Chapter 11?, 29 AM. BANKR. INST. JOURNAL 16 (2010); C.R. Bowles & Nancy B. Rapoport, Has the DIP’s Attorney Become the Ultimate Creditors’ Lawyer in Bankruptcy Reorganization Proceedings?, 5 AM. BANKR. INST. L. REV. 47 (1997). The attorney for the DIP/debtor must clearly explain to the equity owners and management that the lawyer represents the entity, not the individual owners, and that the entity has fiduciary duties. In re Kendavis Industries International, Inc., 91 B.R. 742, 752 (Bankr. N.D. Tex. 1988).
To recap the complexity, then: As the lawyer for a fiduciary, DIP counsel must take proactive steps to ensure that the DIP client understands its responsibilities, informing the client of the need for preventative or corrective measures.\(^{30}\) The DIP's counsel may not proceed with actions that violate legal requirements.\(^{31}\) Where the client’s proposed action is a borderline judgment call, courts stress the importance of disclosure to enable all parties in interest to weigh in on the acceptability of the action.\(^{32}\) The DIP’s counsel does not owe duties to individual creditors, except to the extent that the lawyer assumes particular responsibilities, such as holding bankruptcy estate

\(^{30}\) *In re* Count Liberty, L.L.C., 370 B.R. 259, 281–82 (Bankr. C.D. Cal. 2007) (remarking that DIP counsel must proactively render candid advice and must not ignore matters that may adversely affect the estate); *In re* Nilges, 301 B.R. 321, 325 (Bankr. N.D. Iowa 2003) (“As a professional, an attorney must instruct the debtor on appropriate conduct and must develop client control.” (quoting *In re* Berg, 268 B.R. 250, 262 (Bankr. D. Mont. 2001); *In re* Whitney Place Partners, 147 B.R. 619, 620–21 (Bankr. N.D. Ga. 1992); *In re* Consupak, Inc., 87 B.R. 529, 551 (Bankr. N.D. Ill. 1988) (finding violation of ethical obligations where lawyer failed to offer legal advice, client was unaware of adverse legal consequences, and advice would have been in client’s best interest). See *Model Rules* R. 2.1 (2009) (stating that lawyer shall exercise independent professional judgment and render candid advice); id. R. 2.1 cmt. [5] (2009) (“In general, a lawyer is not expected to give advice until asked by the client. However, when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to a client, duty to a client under Rule 1.4 may require that the lawyer act if the client’s course of action is related to the representation . . . . A lawyer ordinarily has no duty to initiate investigation of a client’s affairs or to give advice that the client has indicated is unwanted, but a lawyer may initiate advice to a client when doing so appears to be in the client’s interest.”) (emphasis added); but see also id. R. 2.2 (“In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.”)

\(^{31}\) United Student Aid Funds v. Espinosa, 130 S. Ct. 1367 (2010); Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1219 (9th Cir. 1994); *In re* Jones, 339 B.R. 903, 904 (Bankr. E.D. Mich. 2006) (indicating attorney cannot file chapter 13 case simply because client so instructs when feasibility is not reasonably arguable); *In re* The Phoenix Group Corp., 305 B.R. 447, 450–52 (Bankr. N.D. Tex. 2003) (discussing situation where DIP counsel determined that DIP as fiduciary should not pursue action and moved to withdraw, citing demand to pursue strategies firm believed were legally and/or ethically improper).

\(^{32}\) See *In re* Rancourt, 207 B.R. 338, 358 (Bankr. D.N.H. 1997) (indicating that the natural desire of individual DIP to negotiate plan providing maximum value for equity does not represent conflict for DIP counsel “provided that full disclosure is made as to any divergence of interests in that regard that may be appropriate for the creditors and the Court itself to consider in context”); see also *Browning Mfg.* v. *Mims* (*In re* Coastal Plains, Inc.), 179 F.3d 197, 208 (5th Cir. 1999) (stressing importance of disclosure generally).
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funds. Courts confronted with creditors’ claims for damages from an alleged breach of fiduciary
duty by a DIP counsel have denied such claims.

The DIP’s attorney must, of course, comply with her professional responsibility duties to the
DIP/debtor client and to the court, notwithstanding the absence of direct liability to creditors.
Duties to the court include maintaining candor, providing the appropriate disclosures, complying
with the court’s rules and procedures, and not asserting frivolous positions. Lawyers may not
knowingly make a false statement of material fact or law to a court, or fail to disclose a material fact
when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client. And
although all lawyers must avoid conflicts of interest, the Bankruptcy Code and Rules impose
heightened duties on the DIP’s attorney not to hold or represent any interest adverse to the estate
and to be disinterested. The duty to avoid a conflict of interest is particularly relevant when the
DIP’s lawyer acts in a manner that appears to favor the interests of insider individuals over those of
the DIP fiduciary.

does not owe fiduciary duties to any individual creditor and is not subject to creditor cause of action for
breach of fiduciary duty); In re Texasoil Enters., 296 B.R. at 435 (noting that, although DIP counsel may not
owe duty directly to creditors, DIP counsel does have obligation to ensure that debtor properly maintains
estate). One court proposed that a DIP's lawyer owes duties to non-clients, under RESTATEMENT (THIRD)
OF THE LAW GOVERNING LAWYERS § 51(4) (2000) (“LGL RESTATEMENT”). In re Food Mgmt. Group, LLC,
380 B.R. 677, 708-10 (Bankr. S.D.N.Y. 2008). That section, though, does not apply to clients for whom
fiduciary responsibilities are part of a larger role, such as management of a business, and the identified duties
are not “fiduciary” duties. See Freeman, DIP Counsel as Fiduciary, supra n. 29.

34 See In re Texasoil Enters., Inc., 296 B.R. at 435 (“[C]ounsel to a debtor in possession may not owe a
duty directly to creditors . . . .”); ICM Notes, Ltd. v. Andrews & Kurth, L.L.P., 278 B.R. 117, 123 (Bankr. S.D.
Tex. 2002) (concluding that DIP counsel’s general fiduciary duty to bankruptcy estate should not be extended
to include a duty to a specific creditor, which would support a claim for breach); In re Dieringer, 132 B.R. 34,
37 (Bankr. N.D. Cal. 1991) (“[D]ebtor's attorney is not liable to creditors for mishandling a bankruptcy
except to the extent that his conduct was fraudulent or otherwise intentionally wrongful.”).


36 Id. § 120 (2000) (describing duties owed to court); see In re The Phoenix Group Corp., 305 B.R. 447,
452–53 (Bankr. N.D. Tex. 2003) (finding that attorney properly refused to file documents requested by client
that would violate client’s and lawyer's ethical duties).

37 MODEL RULES R. 3.3 (candor and disclosure), R. 1.1 (competence—demonstrated here by complying
with the court's rules and procedures), and R. 3.1 (not asserting frivolous positions).

38 See MODEL RULES R. 3.3 (2009); see also In re Count Liberty, LLC, 370 B.R. 259, 283–84 (Bankr. C.D.
Cal. 2007) (lawyer represented that estate funds were in blocked bank account without confirming with bank).


40 See Bezanson v. Thomas (In re R&R Assocs. of Hampton), 402 F.3d 257, 272 (1st Cir. 2005) (finding
that lawyer helped partners transfer partnership estate assets to themselves, breaching duty of loyalty to
partnership client DIP); Fellheimer, Eichen & Braverman, PC v. Charter Techs., Inc., 57 F.3d 1215, 1228-29
(3d Cir. 1995) (determining that lawyer abandoned fiduciary obligation to debtor corporation by advocating
for its president). As noted infra in n. 42, the DIP, as debtor, may pursue the rights of insiders, but only within
the parameters of applicable law.

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An attorney for the DIP, like the DIP itself, cannot engage in improper self-dealing or have unacceptable conflicts of interest. But, like the DIP, its attorney has personal interests and conflicts, including, most notably, the interest in being compensated for work performed and receiving that compensation on an administrative expense basis, ahead of other creditors. The lawyer may pursue a personal interest in obtaining a retainer, negotiate a DIP loan carve-out for professional fees, propound other methods for safeguarding fees (including getting collateral as security for the fees), and insist on fee payment as an administrative expense despite its effect on plan confirmation. The Bankruptcy Code and Rules provide the parameters for proper pursuit of such personal interests, with a mandate of full disclosure and court review and approval.

The DIP’s attorney, likewise, must meet her obligations of full disclosure and actions within the confines of bankruptcy law, with court approval, when required, when advising and acting for the fiduciary DIP client.

When a lawyer’s representation will violate the applicable rules of professional conduct or other law, the lawyer must withdraw. Withdrawal requires court permission, and there is always a risk that a court will order continued representation. In other circumstances, such as when the client insists on taking action that the lawyer considers repugnant or insists on taking action with which the lawyer fundamentally disagrees, withdrawal is optional.

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41 See In re Martin, 817 F.2d 175, 180 (1st Cir. 1987) (acknowledging that any attorney retained for DIP “becomes a creditor of the estate just as soon as any compensable time is spent on account”); see 11 U.S.C. § 1129(a)(9)(A) (2006) (stating that debtor must pay administrative fees included in 11 U.S.C. § 507(a)(2) in order to have plan confirmed); see also In re Capitol Hill Group, 313 B.R. 344, 347 (D. D.C. 2004) (recognizing problem when debtor, in process of confirming plan, asked counsel to accept less than full amount agreed to, despite previously agreeing to pay entire amount); In re Dale’s Serv., Inc., No. 07-01255-JDP, 2008 Bankr. LEXIS 1652, at *10 (Bankr. D. Idaho May 27, 2008) (acknowledging attorney may object to confirmation of plan that did compensate attorney for services); Jay Lawrence Westbrook, Fees and Inherent Conflicts of Interest, 1 AM. BANKR. INST. L. REV. 287, 287 (1993) (stating there are “unavoidable conflicts that are inherent in the representation of DIPs”).

42 Thus, the attorney can represent the “debtor part” of the DIP/debtor client and successfully avoid any conflict between the interest of the DIP as fiduciary by, e.g., openly negotiating with adverse counsel for the creditors’ committee and secured creditors for a smaller “new value” plan contribution by equity owners, assuming that the facts of the case support such a negotiation within the boundaries of the Code. But if a transaction benefiting DIP insiders is hidden from adverse parties in interest and the court, and if it falls outside the parameters of the Code and Rules, the DIP’s attorney may be charged with having taken on the representation of an additional party in interest adverse to the DIP—a conflict of interest. In such a situation, then, the lawyer would be perceived as serving two masters (the insider and the fiduciary entity). That “serving two masters” situation occurs outside of bankruptcy, too, if a lawyer is secretly advising a corporate president to embezzle. See In re Kendavi Indus. Int’l, Inc., 91 B.R. 742, 762 (Bankr. N.D. Tex. 1988); see also Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 464 (D. Utah 1998) (DIP counsel must exercise independent judgment in advising DIP client of its fiduciary duties to the estate and not favor the interests of management to the exclusion of creditors).

43 MODEL RULES R. 1.16 (2009).
44 MODEL RULES R. 1.16(c) (2009).
45 MODEL RULES R. 1.16(b)(4) (2009).
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A DIP’s persistence in a course of action that the lawyer considers to breach fiduciary duties can trigger withdrawal. At that point, the DIP’s lawyer must also determine whether there is an obligation to bring the DIP’s breaches of fiduciary duty to the attention of the court in some way. Several courts have stated that disclosure is required.46 Some courts have also stated that a breach of “any fiduciary duty” requires disclosure, but the facts of these cases concern such serious crimes or frauds as embezzlement, and the decisions generally do not explain how such disclosure is to be accomplished.47

The DIP’s attorney, like any other attorney, must comply with her applicable rules of professional responsibility when undertaking a “noisy withdrawal” (bringing misconduct to the attention of the court and creditor body by withdrawing “for professional reasons,” accompanied by a filing stating that the lawyer withdraws particular documents for such reasons), while maintaining specific client confidences to the extent mandated by those rules.48

46 See In re Ward, 894 F.2d 771, 776 (5th Cir. 1990) (noting that, had attorney for debtor known of existence of unscheduled judgment against estate, “as an officer of the court, [the attorney] would certainly have had a duty to inform the court”); In re JLM, Inc., 210 B.R. at 26 (holding that attorney for DIP must inform “the court in some manner of derogation by the debtor in possession”); United States v. Thomas, 342 B.R. 758, 761-62 (S.D. Tex. 2005) (indicating that once lawyer discovers omission in schedules, he has duty to court and opposing counsel to notify, amend, and formally correct effect of omission); In re Gregory, 214 B.R. 570, 576 (S.D. Tex. 1997) (noting duty to disclose client defalcation); In re N. Star Mgmt., LP, 305 B.R. 312, 320 (Bankr. D.N.D. 2003) (describing requirement of trustee to act affirmatively to investigate and halt misappropriation of funds, and report to court or U.S. Trustee), rev’d on other grounds, 308 B.R. 906 (B.A.P. 8th Cir. 2004) (finding professional took appropriate steps but was undermined by wrongdoer); In re Granite Sheet Metal Works, Inc., 159 B.R. 840, 848 (Bankr. S.D. Ill. 1993) (determining that it was DIP counsel’s duty to bring to court’s attention that DIP was breaching fiduciary duties by refusing to investigate insider transfers); In re Swansea Consol. Res., Inc., 155 B.R. 28, 38 n. 14 (Bankr. D.R.I. 1993) (noting as officer of court, attorney had “absolutely no choice but to disclose the fact of the missing $64,000 [of DIP funds]”); In re United Utensils Corp., 141 B.R. 306, 309 (Bankr. W.D. Pa. 1992) (noting that former DIP counsel hired by trustee was obliged to disclose to trustee his information about estate assets; “If the debtor is not fulfilling its fiduciary obligations to the estate, it is the responsibility and duty of Debtor’s counsel to bring such matters to the attention of the court” (quoting In re Wilde Horse Enters., 136 B.R. 830, 847 (Bankr. C.D. Cal. 1991)); id. at 847 (indicating that upon suspicion of dishonesty or neglect of fiduciary duty to estate, attorney must ask probing questions and demand fully and reasonably corroborated responses, and if still unsatisfied or ethically uncomfortable, immediately bring unresolved concerns to court’s attention by way of motion to be relieved as counsel or in some other way); see also MODEL RULES R. 1.6 cmt. [4] (2009) (noting lawyer will sometimes be required to disclose confidential information); ABA Comm. on Ethics and Prof’l Responsibility, FORMAL Op. 92-366 (1992) (discussing duty of “noisy withdrawal” from representation).

47 See cases cited supra n. 46.

48 See MODEL RULE R. 1.6 cmt. [8] (2009) (explaining attorney may disclose information relating to representation to remedy fraud); id. R. 1.16 cmt. [3] (2009); id. R. 4.1 cmt. [3] (2009) (“Sometimes it may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like.”); id. R. 2.1 cmt. 10 (discussing how lawyer may not assist client in conduct discovered to be criminal or fraudulent, but must instead withdraw from representation and how there may be instances where “withdrawal alone might be insufficient” and “[i]t may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like”); ABA Comm. on Ethics and Prof’l Responsibility, FORMAL Op. 92-366 Withdrawal When a Lawyer’s Services will Otherwise be Used to
Although the DIP's attorney has no liability to individual creditors for breach of any fiduciary duties owed by the DIP to the bankruptcy estate,49 the attorney may still be sanctioned by the court, especially through reductions of fee awards, for misrepresentations or non-disclosures about criminal behavior by the DIP client, such as concealing estate assets.50 Outside of bankruptcy, a lawyer who knowingly participates in the client’s breach of fiduciary duties may be liable to third parties on such grounds as conspiracy to breach or aiding and abetting the breach of a client’s fiduciary duty, or for personally handling funds of a fiduciary contrary to the interest of the beneficiary.51 In the trust context, the mere knowledge of a breach of fiduciary duty is generally not enough for liability without the attorney’s active involvement.52

Perpetrate a Fraud (1992) (determining that, although “noisy” withdrawal could result in the impermissible disclosure of information otherwise protected as a client confidence, nothing “prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw, or disaffirm any opinion, document, affirmation, or the like”); see also In re Matthews, 154 B.R. 673, 680–81 (Bankr. W.D. Tex. 1993) (explaining duty to alert U.S. Trustee, court, or another interested party that schedules are incomplete or inaccurate; failure to withdraw contributed to debtor’s dishonesty by not setting up early alarm that something was amiss); In re Satrley, 131 B.R. 509, 519 (Bankr. D. Me. 1991) (indicating attorney’s prerogative to inform trustee that schedules are incomplete if concerned about client’s candor, thus prompting trustee investigation); In re Wilde Horse, 136 B.R. at 847 (posing that upon suspicion of debtor’s dishonesty or neglect of fiduciary duty to the estate, attorney has duty to ask probing questions, demand full and reasonably corroborated responses, and if “still unsatisfied or ethically uncomfortable, immediately bring the unresolved concerns to court’s attention by way of counsel or in some other way”); see also C.R. Bowles, Jr., Noisy Withdrawals: Urban Bankruptcy Legend or Invaluable Ethical Tool?, 20 AM. BANKR. INST. L. J. 26, 26–27 (Oct. 2001).

49 See ICM Notes, Ltd. v. Andrews & Kurth, L.L.P., 278 B.R. 117, 123-24 (Bankr. S.D. Tex. 2002) (discussing how, although DIP counsel may owe general fiduciary duties to bankruptcy estate, “this duty cannot be extended to justify the imposition of a fiduciary duty running from counsel for the debtor-in-possession directly to a particular creditor that would support a separate civil action for breach”), aff’d without change, 324 F.3d 768 (5th Cir. 2003); see also In re Count Liberty, LLC, 370 B.R. 259, 280 n. 54 (Bankr. C.D. Cal. 2007) (“Fiduciary duties of a debtor in possession’s counsel to the estate do not extend to any particular creditor in a chapter 11 case.”); In re Texasoil Enters., Inc., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (acknowledging that DIP counsel does not directly owe fiduciary duties to creditors).

50 See, e.g., In re Count Liberty, LLC., 370 B.R. 259, 281 (Bankr. C.D. Cal. 2007) (issuing civil contempt sanctions to DIP’s attorney for not appropriately counseling DIP when DIP transferred money out of account against court orders and finding that DIP’s attorney did not fulfill fiduciary duty to carry out responsibilities of estate); In re Sky Valley, 135 B.R. 925, 933, 936 (Bankr. N.D. Ga. 1992) (sanctioning DIP counsel for obtaining court approval of a broker’s employment without disclosing the broker’s connections and lack of disinterestedness, failing to disclose the role of an insider secretly being compensated through the broker’s employment, and failing to instruct the broker on disposition of sale proceeds); In re Wilde Horse Enters., 136 B.R. 830, 840, 846 (Bankr. C.D. Cal. 1991) (denying fees to attorney for improper conduct as officer of court for not reporting illegal sale of DIP’s property and for improperly certifying application); MODEL RULES R. 1.16, 3.3, 1.6 cmt. [18] (2009).

51 See Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 461 (Bankr. D. Utah 1998) (rejecting any fiduciary duty owed by the DIP to creditors or shareholders, reasoning that “[i]f counsel owes the same fiduciary duty to creditors and shareholders and other parties in interest as does the debtor-in-possession, any breach of debtor’s duties theoretically exposes counsel to liability to these nonclient beneficiaries, even if counsel’s conduct was not fraudulent or criminal.”); see also In re Dieringer, 132 B.R. 34, 37 (Bankr. N.D. Cal. 1991) (DIP counsel served as disbursing agent under confirmed plan; continued to assure creditors they...
DUTIES OF COUNSEL FOR A DIP AS FIDUCIARY AND RESPONSIBILITIES TO THE ESTATE

Best Practices Recommendations

A. An attorney for a debtor-in-possession must be proactive in counseling her client with respect to its compliance with its fiduciary duties to the bankruptcy estate.

B. An attorney for a debtor-in-possession must recognize and understand which hat (DIP or debtor) the client is wearing at a given time. The same lawyer may, and generally does, advise the DIP in its capacity as the debtor, including preparing and advocating for a reorganization plan that may include cram-down treatment of creditors. When doing so, the attorney must not advocate for personal debtor interests that violate the DIP's fiduciary duties.

C. An attorney for a debtor-in-possession must, at all times, comply with the applicable rules of professional responsibility. She must also meet the applicable requirements of the Bankruptcy Code and Rules for disclosure, non-adversity and disinterestedness, and reasonableness of fees and expenses.

D. An attorney must ensure that her client knows and understands its basic fiduciary duties to the estate. These consist of:

1. Loyalty: All actions taken must be fair and reasonable. The DIP and its management and owners must not obtain an improper personal benefit, even when pursuing their “debtor” interests. This standard is met by compliance with applicable provisions of the Code and Rules, full and accurate disclosures, and ratification or approval by the court when required by law.

2. Care: All actions must be taken in good faith, with the care of a prudent person.

Would eventually be paid while allowing debtors to make withdrawals and incur liabilities; lawyer held liable to creditors for misrepresentations for damages suffered by his forbearance from action); see Klepak v. Dole, 490 U.S. 1089 (1989) (holding lawyer liable to pension plan for aiding trustee in breach of duties); Morales v. Field, 160 Cal. Rptr. 239, 243 (Cal. Ct. App. 1979) (acknowledging that lawyer for fiduciary is liable to beneficiary for active participation in breach of trust); but see In re Dieringer, 132 B.R. 34, 36 (Bankr. N.D. Cal. 1991) (holding no breach of fiduciary duty because lawyer had fiduciary duty to bankruptcy estate, not to plaintiffs, because plaintiffs were not beneficiaries of trust).

52 See Newburger, Loeb & Co., v. Gross, 563 F.2d 1057, 1074, 1080 (2d Cir. 1977) (lawyer found liable for inducing and participating in his clients’ breach of fiduciary duty by affirmatively permitting transfer of funds to take place); see also Albright v. Burns, 503 A.2d 386 388–91 (N.J. Super. Ct. App. Div. 1986) (finding lawyer “participation” when lawyer received funds from trust and disbursed funds to fiduciary, knowing fiduciary intended to use them illegally); see also Robert W. Tuttle, The Fiduciary's Fiduciary: Legal Ethics in Fiduciary Representation, 1994 U. ILL. L. REV. 889, 945 (“[E]ven if the lawyer has notice of the breach, she only assumes liability if she ‘participates’ in the breach.”); RESTATEMENT (SECOND) OF TORTS §§ 874, 876 (1965) (asserting attorney will be subject to liability if he knowingly gives “substantial assistance or encouragement” to personal representative’s breach of fiduciary duty); Katerina P. Lewinbuk, Let’s Sue All the Lawyers: The Rise of Claims Against Lawyers for Aiding and Abetting a Client’s Breach of Fiduciary Duty, 40 ARIZ. ST. L.J. 135, 152–53 (2008).
3. Impartiality: All estate constituents must be treated fairly and within the structure of the Code, without unfairly favoring particular creditors to the detriment of others.

E. The DIP’s attorney cannot knowingly facilitate a DIP’s violation of fiduciary duties. If the DIP client breaches any of its fiduciary duties, the DIP’s attorney must explain the law and consequences and urge compliance. If the DIP still refuses to correct the violation after such counseling and the action rises to the level of violating applicable rules of professional conduct or other law, the DIP’s attorney must seek court permission to withdraw from the representation and must make disclosures in the manner and to the extent allowed by the applicable rules of professional responsibility.

F. An attorney must be aware of the exceptions to the “no individual liability to creditors” rule. The DIP’s attorney has no liability to individual creditors for the DIP’s violation of its fiduciary duties, unless the lawyer’s actions are fraudulent or intentionally wrongful. Nonetheless, the DIP’s attorney may be held liable for knowingly and actively participating in (and, in some jurisdictions, aiding and abetting), the DIP’s breach of its fiduciary duties. The DIP’s attorney may also be sanctioned in a variety of ways, including fee disallowance or referral to the appropriate disciplinary authorities, for violations of the Code, the Rules, or the applicable rules of professional responsibility.
A Framework for Pre-Approval of Terms for Retention and Compensation Under 11 U.S.C. § 328

Introduction

Section 327 of the Bankruptcy Code sets forth the standards for the employment of professional persons by trustees and debtors-in-possession. Section 327(a) indicates that a trustee or debtor-in-possession, with the court's approval, may employ various professional persons to represent and assist in carrying out the duties prescribed under the Bankruptcy Code. For the purposes of section 327(a), the definition of “professional person” is generally limited to attorneys, accountants, appraisers, auctioneers, financial advisors, and others who play a central role in the case.

Section 327(a) establishes that a professional person can be retained only if such person does not “hold or represent an adverse interest to the estate” and is a “disinterested person.” The professional’s duty to meet those requirements continues throughout the case. The retention process is designed to ensure public confidence in the bankruptcy system, prevent abuses, and achieve a degree of efficiency in the administration of a Chapter 11 case. The requirements of 11 U.S.C. § 327 “serve the important policy of ensuring that all professionals … tender undivided...
loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.” Court approval of a professional person’s employment is contingent upon the court’s finding that the applicant has met a two-pronged test. Under section 327(a), the professional (1) must be disinterested; and (2) must not hold or represent an interest adverse to the estate. Other parts of section 327 govern special counsel for the estate and the effect of a professional’s representation of a creditor on his or her eligibility for employment. The retention provisions embodied in the Bankruptcy Code “create an ongoing duty on the part of professionals hired by the estate to avoid conflicts of interest.”

There are other provisions in the Bankruptcy Code beyond section 327 that address the issue of the employment, and specifically the compensation of professionals. As one commentator has explained,

The other statutory provision requiring court approval of employment is section 1103, which covers the employment of professionals working for committees. 11 U.S.C. § 1103 permits a committee that has been appointed under section 1102 to employ professionals for the benefit of the committee, provided that the professional may not concurrently “represent any other entity having an adverse interest in connection with the case.”

Some professionals have focused their attention on section 328, which allows for a variety of creative compensation structures (“on any reasonable terms and conditions of

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6 Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994).
7 The question of whether a professional meets these tests is one for the court to adjudicate after full disclosure of the facts in accordance with FED. R. BANKR. P. 2014. In re Filene’s Basement, Inc., 239 B.R. 850 (Bankr. D. Mass. 1999); In re Leslie Fay Cos., Inc., 175 B.R. 525 (Bankr. S.D.N.Y. 1994).
8 11 U.S.C. § 327(e).
9 11 U.S.C. § 327(c).
11 Section 1103(a) provides: “At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court’s approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.” There’s a bit of a gap between sections 327 and 1103: “It’s a little trickier for getting court approval for those professionals whom committees want to employ. Section 1103(a) gives Committees the authority to seek court approval for the employment of professionals, but section 327 speaks only of employing professionals for the trustee (and, via section 1107, for the debtor in possession). That’s a drafting glitch that omits employment approval for committee professionals.” Nancy B. Rapoport, The Case for Value Billing in Chapter 11, 7 J. BUS. L. & TECH. LAW 117, 124 (2012) [hereinafter Value Billing]. Most courts solve this problem by using section 328(a) as the appointing authority for committee professionals; the other way is to use section 1103 itself as the authority. See id. at 122-23.
12 11 U.S.C. § 328(a) provides:

The trustee, or a committee appointed under section 1102 of this title, with the court’s approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a
employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis”). But—at least for professionals employed by the trustee or debtor in possession—section 328 is more properly read as elaborating the latitude that a court has in approving compensation arrangements, rather than as separate authority for appointment. Under section 328, the court may only “allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions”—a much more difficult standard for the court to meet. In other words, compensation arrangements made pursuant to section 328 protect the professional’s compensation structure far more aggressively than those made pursuant to section 327.13

Section 330(a)(3) provides the roadmap for reviewing compensation:

In determining the amount of reasonable compensation to be awarded to an examiner, trustee under Chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

(A) the time spent on such services;
(B) the rates charged for such services;
(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.14

Traditionally, a court’s review of compensation for professionals appointed under section 327 focuses on the “lodestar” method (hours multiplied by hourly rate)15 as part of its determination

13 Value Billing, supra n. 11, at 122-23 (footnotes omitted).
15 In Matter of Pilgrim’s Pride Corp., 690 F.3d 650, 655 (5th Cir. 2012), the Fifth Circuit defined the lodestar amount as “the number of hours reasonably expended multiplied by the prevailing hourly rate in the community for similar work.” Id. (quoting In re Lawler, 807 F.2d 1207, 1211 (5th Cir.1987)).
of the reasonableness of that compensation. Because the lodestar method does not, in itself, contemplate success fees or fee enhancements based on particular benchmarks, professionals, such as financial advisors and investment bankers, have sought the approval of non-lodestar types of compensation under section 328.\textsuperscript{16} Compensation formats approved pursuant to section 328 can only be reconsidered “if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.”\textsuperscript{17} Under section 328, the compensation method used to calculate professional fees receive up-front approval.\textsuperscript{18} Such pre-determination differs from the ordinary retrospective fee review and analysis performed when employment is approved under section 327.

On the theory that a discussion of “best practices” for compensation approved under section 328 would be useful for courts and those professionals seeking such approval, the Task Force suggests a particular framework for professionals seeking approval of their compensation methods under that section.\textsuperscript{19}

\textsuperscript{16} Trustees, debtors-in-possession, and official committees sometimes use section 328 to obtain pre-approval of the terms through which the fees of certain professionals, such as special counsel, financial advisors or investment bankers, will be allowed and paid on an interim basis or at the conclusion of the engagement. “Absent approval of compensation under § 328, the court awards a professional employed under § 327 “reasonable compensation for actual, necessary services rendered by [the professional] . . . , based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title,” as well as “reimbursement for actual, necessary expenses.” Nischwitz v. Miskovic (In re Airspect Air Inc.), 385 F.3d 915, 920 (6th Cir. 2004).

\textsuperscript{17} In Pilgrim’s Pride, the Fifth Circuit held that bankruptcy courts could award fee enhancements under certain circumstances, notwithstanding the Supreme Court’s ruling in another, non-bankruptcy, case limiting the ability of courts to award fee enhancements. \textit{Id.} at 667. The professional in \textit{Pilgrim’s Pride} sought a fee enhancement at the end of a very successful case. \textit{Id.} at 653. That fee enhancement was later affirmed. In Matter of Pilgrim’s Pride Corp., 690 F.3d 650, 667 (5th Cir. 2012) (affirming the bankruptcy court’s order of a $1 million fee enhancement).

\textsuperscript{18} In most instances in which a professional seeks approval of a section 328 compensation formula, the United States Trustee will seek to preserve a “back-end” review and objection for its office and for the bankruptcy court despite the pre-approval that is binding on all other parties in interest (unless developments incapable of being anticipated ultimately show the improvidence of approving the form of compensation).

\textsuperscript{19} The Task Force is aware that some law firms are moving in the direction of alternative fee arrangements, such as flat-rate billing and success fee benchmarks. This Report is not intended to review the variety of creative compensation arrangements for which professionals can seek approval under section 328. Some of these alternative compensation arrangements are even referenced in the United States Trustee Program’s Updated Proposed Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed Under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases (“Proposed Guidelines”), available at http://www.justice.gov/ust/EO/rules_regulations/guidelines/docs/proposed/AppendixB_Fee_Guidelines_Exhibits_Comments.pdf. See, e.g., Proposed Guidelines at 20.
A FRAMEWORK FOR PRE-APPROVAL FOR TERMS FOR RETENTION AND COMPENSATION UNDER 11 U.S.C. § 328

Framework for Pre-Approval of Terms for Retention and Compensation Under 11 U.S.C. § 328

1. Be clear about the Bankruptcy Code provision under which approval is being sought.

2. A bankruptcy court has wide discretion to decide whether a proposed arrangement is or is not reasonable or appropriate.

In reaching this decision, the court will carefully examine the circumstances of the particular case. To receive approval under section 328, the moving party must unambiguously specify that it is seeking such pre-approval. Unless the moving party meets all of section 328’s conditions, as described in its employment application (and the court approves the professional’s method of compensation), the court must review the professional’s fee application under section 330 (the lodestar review).

The Fifth Circuit Court of Appeals has provided a clear articulation of the differences between fee review and approval under sections 328 and 330:

Sections 328 and 330 of the Bankruptcy Code govern attorneys’ fees in representing bankruptcy estates. Under 11 U.S.C. § 330, attorneys’ fees are reviewed for their reasonableness after representation has concluded. In contrast, section 328 of the Bankruptcy Code allows an attorney seeking to represent a bankruptcy estate to obtain prior court approval of her compensation plan. As this Court has noted, “able professionals were often unwilling to work for bankruptcy estates where their compensation would be subject to the uncertainties of what a judge thought the work was worth after it had been done. That uncertainty continues under the present § 330 . . . .”20

Therefore, unless a professional wishes to have his or her fees reviewed under section 330’s reasonableness standard, the professional should specify—both in the employment application itself and in the draft order approving such employment—that he or she is seeking approval of the compensation structure under section 328.21

20 Daniels v. Barron (In re Barron), 325 F.3d 690, 692-93 (5th Cir. 2003) (quoting In re National Gypsum Co., 123 F.3d 861, 862 (5th Cir. 1997)).
21 In the Ninth Circuit, the applicant “must invoke . . . section [328] explicitly in the retention application’ in order to ensure that that section will govern the review of the professional’s fees. Circle K. Corp. v. Houlihan, Lokey, Howard & Zukin Inc. (In re Circle K Corp.), 279 F. 3d 669, 674 (9th Cir. 2002). The Sixth Circuit Court of Appeals has adopted a more lenient standard for evaluating whether a compensation structure has been pre-approved under section 328. In the case of Nischwitz v. Miskovic (In re Airspect Air Inc.), 385 F.3d 915 (6th Cir. 2004), the Sixth Circuit eschewed the standards of both the Third and Ninth Circuits, holding instead that the analysis rests on the totality of the circumstances, “looking at both the application and the bankruptcy court’s order.” Id. 922. The Sixth Circuit indicated that relevant factors for courts to consider in their analysis include (1) the existence of a request for preapproval; (2) the reasonableness of the requested compensation; and (3) and an express reference to § 328. Id.
3. The party seeking approval of a professional’s employment has the burden of proof in its employment application.

The party seeking approval of a professional’s compensation arrangement under section 328 should be mindful that he has the burden of proof and must “ensure that the court notes explicitly the terms and conditions if the applicant expects them to be established at that early point.”22 Therefore, professionals seeking retention and approval of a fee structure under either section 327 or 328 must be prepared to put forth specific evidence establishing the reasonableness of the employment agreement. Both the United States Trustee and the bankruptcy court will scrutinize the employment agreement to ensure that it meets the test for approval under the Bankruptcy Code.

Financial advisors and investment bankers should, in particular, take note of the opinion issued by the Bankruptcy Court for the Southern District of Texas in the Chapter 11 case of Energy Partners when preparing for their employment application hearings. In Energy Partners, the Court denied applications filed by both the equity holders’ and note-holders’ committees to engage separate investment banking firms in order to perform a valuation analysis of the debtor. The Court was highly critical of the proposed fee agreements and the lack of evidence offered by the applicants, beginning its analysis by noting that it does not “take § 328(a) applications lightly” and, in performing its duties as a gatekeeper, the Court “must have a sufficiently strong record when deciding whether to approve a professional under § 328(a).”23 The Court relied on decisions from the District of Delaware and District of Massachusetts in setting forth a non-exhaustive list of five factors to consider when determining whether to approve employment terms under section 328(a). Such factors include:

(1) whether terms of an engagement agreement reflect normal business terms in the marketplace; (2) the relationship between the Debtor and the professionals, i.e., whether the parties involved are sophisticated business entities with equal bargaining power who engaged in an arms-length negotiation; (3) whether the retention, as proposed, is in the best interests of the estate; (4) whether there is creditor opposition to the retention and retainer provisions; and (5) whether, given the size, circumstances and posture of the case, the amount of the retainer is itself reasonable, including whether the retainer provides the appropriate level of “risk minimization,” especially in light of the existence of any other “risk-minimizing” devices, such as an administrative order and/or a carve-out.24

In the High Voltage Energy Corp. case, cited in Energy Partners, the court used blunt and straightforward language in denying the retention application and highlighting the debtor’s failure to present sufficient evidence to warrant the engagement:

The Court has been given no information about the specific scope and complexity of the assignment or specialized skills needed for it. The Court has been given no information about the prevailing fees in the industry for comparable engagements, either in bankruptcy

cases or other insolvency or workout situations. The Court has been given no information about how Evercore was selected. The Court has been given no information about the number and qualifications of the professionals employed by Evercore who are assisting the Debtors. The Court has been given no information about the compensation being paid to the professionals employed by Evercore who are assisting the Debtors. The Court has been given no information about the number of hours these employees have devoted to and intend to devote to assisting the Debtors in restructuring their financial affairs. The Court has merely been provided with vague descriptions of the tasks Evercore intends to perform. Accordingly, the Court simply is not in a position to gauge the reasonableness of the terms and conditions of Evercore's employment at this time and whether the monthly and contingent fees proposed reasonably corresponds to the value of the services which Evercore is being asked to perform.25

Debtors, committees, and professionals alike should be aware of the analytical and evidentiary approaches used in section 328 applications in their district and circuit and should be prepared to satisfy the Bankruptcy Court’s scrutiny into the propriety and reasonableness of the professional’s fee agreement.

4. Lawyers must be mindful of the dictates of state ethics rules.

In addition to knowing and following the directives of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, attorneys retained in bankruptcy cases should not lose sight of the obligations imposed under applicable rules of professional conduct—in particular, the rules addressing the reasonableness of fees and candor to the court.

The standard for fees under state ethics rules is reasonableness.26 If the reasonableness standard is not met, even a compensation arrangement approved under section 328 does not

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26 See Model Rule of Professional Conduct R. 1.5 (Fees):
   (a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:
      (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
      (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
      (3) the fee customarily charged in the locality for similar legal services;
      (4) the amount involved and the results obtained;
      (5) the time limitations imposed by the client or by the circumstances;
      (6) the nature and length of the professional relationship with the client;
preclude a court from reviewing those fees—unless the amount of the fees was specifically pre-approved.\footnote{See Committee of Equity Security Holders of Federal–Mogul Corp. v. Official Committee of Unsecured Creditors (In re Federal-Mogul, Inc.), 348 F.3d 390, 397-98 (3d Cir. 2003); see also Cadle Co. II, Inc. v. Fashion Shop of Kentucky, Inc. (In re Fashion Shop of Kentucky), 350 Fed. Appx. 24, 27-28 (6th Cir. 2009).} Given that some professionals are beginning to request fee enhancements, the Task Force also recommends that any professional contemplating a fee enhancement based on defined “success” benchmarks should have the method for determining the fee enhancement (and, if possible, the amount of an enhancement itself) approved explicitly at the time that the professional is seeking approval of its employment application under section 328.

5. Employment applications under section 328 must contain truthful assertions supporting the compensation method.

In the same way that a professional should specify in the employment application that he or she is seeking approval of the compensation method under section 328, the professional should also make sure that the representations in support of the section 328 approval are accurate and truthful. An example of a faulty employment application was at issue in In re Mirant Corp. In Mirant, the court specifically mentioned its frustration with the representations made by the financial advisors in their employment application: “The court erred seriously in entering orders which left it so little discretion in assessing the work of the financial advisors. Though the court was given to understand [that the] Debtors and the Committees could not obtain competent financial advisors without assurance that there would be substantial ‘success’ bonuses, whether or not each advisor could show it had earned such a fee, the court has since learned that some financial advisors, at least, will accept

\begin{itemize}
  \item the experience, reputation, and ability of the lawyer or lawyers performing the services; and
  \item whether the fee is fixed or contingent.
\end{itemize}

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

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination. . . .


\footnote{28 354 B.R. 113, 128 (Bankr. N.D. Tex. 2006).}
more conventional arrangements in terms of compensation.” 29 Although the Mirant court determined that its hands were tied in terms of having to award the bonuses under section 328, it was none too happy about the bonuses.

Lawyers seeking section 328 approval for their own employment or for the professionals whom they represent have another reason to be both accurate and truthful. The rules demanding candor toward the tribunal subject a lawyer to sanctions for knowingly making an untrue statement.31 The time to establish or reinforce a professional’s reputation with the court is when the employment application is submitted. Professionals should be mindful of the disclosure requirements set forth in Rule 2014 when preparing employment applications.32

29 Id. at 128 (footnote omitted).
30 Id. at 127-31.
31 For veracity in a lawyer’s dealings with a court, see MODEL RULE OF PROFESSIONAL CONDUCT R 3.3 (“(a) A lawyer shall not knowingly . . . (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or (3) offer evidence that the lawyer knows to be false. . . .”). For veracity in representing one’s client, see MODEL RULE OF PROFESSIONAL CONDUCT R. 4.1 (“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; or (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.”). And, of course, MODEL RULE OF PROFESSIONAL CONDUCT R. 8.4 creates an independent ethics violation when dishonesty is involved (“It is professional misconduct for a lawyer to . . . (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another; (b) commit a criminal act that reflects adversely on the lawyer’s honesty, trustworthiness or fitness as a lawyer in other respects; [or] (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation. . . .”).
The Use of Conflicts Counsel in Business Reorganization Cases

Introduction

Before a court can approve the employment of counsel for the trustee or the DIP in bankruptcy cases, counsel must satisfy Section 327(a)'s twin requirements of (1) disinterestedness and (2) not holding or representing an interest adverse to the bankruptcy estate. Section 327(c) states that counsel will not be disqualified solely because of representation of a creditor, but the court will disapprove employment if a creditor or the United States trustee objects and the court determines that there is a disabling conflict of interest. Counsel for a committee may not represent any other entity having an adverse interest in connection with the case, but representation of creditors of the committee’s constituent class of creditors does not per se constitute representation of an adverse interest.

For certain DIPs, the company may be so large and the issues involved in the bankruptcy case may be so complex that only a handful of law firms will have the staffing and expertise to represent the DIP. But with the case’s heft may also come firm clients with interests potentially adverse to the estate. The preferred counsel—because of its enormous client base—may have some types of potentially disqualifying conflicts of interest. Smaller DIPs may also wish to employ counsel whose relationship with another party is potentially disabling—a choice to be honored if a means to address the conflict is available. In an attempt to respect the DIP’s desire to employ its counsel of choice, courts can sometimes find a way to approve the proposed counsel without running afoul of either the Bankruptcy Code’s restrictions or state ethics rules.

1 Susan Freeman should get credit for much of this background section—along with most of the drafting of the proposed rule. Al Togut should also get huge kudos for his work, as should Chip Bowles and Rob Charles.

2 11 U.S.C. § 327(a) provides: “Except as otherwise provided in this section, the trustee, with the court’s approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee’s duties under this title.”


4 See, e.g., Michel v. Eagle-Picher Industries, Inc. (In re Eagle-Picher Industries, Inc.), 999 F.2d 969 (6th Cir. 1993) (§ 1107(b) exception narrow); but see In re Talsma, 436 B.R. 908 (Bankr. N.D. Tex. 2010) (construing §§ 1107(b) and 327(a) contrary to majority rule).

5 11 U.S.C. § 327(c).


8 Because this issue of disqualifying conflicts also can appear when a trustee or committee wishes to employ counsel, these same considerations will apply to them.

9 Outside of bankruptcy, a waiver might fix the problem, but the Bankruptcy Code’s extra layer of “disinterestedness” makes the waiver inadequate, given the DIP’s role as a fiduciary.
Courts must balance the twin goals of giving the debtor an opportunity to reorganize with counsel of its choice and honoring applicable ethics rules. Sometimes, a proposed main counsel for a trustee, DIP, or committee may want to seek authorization to provide general bankruptcy representation but may have imputation issues that arise due to the firm’s representation of a creditor or other party in interest on unrelated matters. To address the imputation problem, bankruptcy courts in numerous cases have approved the appointment of a second law firm (“conflicts counsel”) to represent the client in matters that main counsel cannot undertake.

Some courts view certain client representations as too “small” to trigger a problem. In fact, some courts have recognized a 1% rule: if a law firm’s client represents less than 1% of that firm’s billings, those courts have considered such a representation to be too inconsequential to warrant disqualification.10 That 1% rule, though, has its limitations. In 1985, shortly after the Bankruptcy Code began, the largest law firm’s revenues were $129 million.12 Today, that same largest firm’s annual revenues are $2.1 billion.13 One percent of that amount means annual billings of $21 million, a significant client by any measure, calling into question the continued use of the 1% rule. The Reporters point this out for consideration without reaching any conclusion about what threshold should apply.

Although it is more appropriate for bankruptcy courts to rely on Code §§ 327(a) and (c) as authority in DIP conflicts counsel cases,14 sometimes courts will authorize the employment of

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10 See Norton Annual Survey of Bankruptcy Law, Volume 2004, Issue 2004 at 3; see also In re Clark Retail Enterprises, Inc., 308 B.R. 869 (Bankr. N.D. Ill. 2004) (finding no actual conflict of interest where a firm represented debtor and its post-petition lender where the lender accounted for only 1.03% of the firm’s annual revenue); In re Filene’s Basement, Inc., 239 B.R. 850, 853 (Bankr. D. Mass. 1999).
11 The first American Lawyer survey on bankruptcy firm revenues that could be found was for 1985, six years after the Code became effective but close enough in time to be relevant. See ALM’s Survey of Law Firm Economics Shows Firm Revenues Took Hit in 2011, ALM (Aug. 6, 2012) http://www.alm.com/about/pr/releases/alm-s-survey-law-firm-economics-shows-firm-revenues-took-hit-2011.
12 Technically, that figure may have been for the previous fiscal year.
14 11 U.S.C. § 327(a); see Tri-State Fin., LLC v. Lovald, 525 F.3d 649, 655-56 & n.5 (8th Cir. 2008) (recognizing propriety of using conflicts counsel); In re Blinder, Robinson & Co., 131 B.R. 872, 879-81 (D. Colo. 1991) (affirming with reservations bankruptcy court ruling that independent counsel to consider a claim by creditor client rendered SIPA counsel disinterested); see also In re eToys, Inc., 331 B.R. 176, 192 (Bankr. D. Del. 2005) (DIP counsel should have promptly filed disclosure affidavit and let another, disinterested professional handle matter involving creditor client); but see In re Cook, 223 B.R. 782, 791-92 (B.A.P. 10th Cir. 1998) (special counsel too limited and too late). Attorneys cannot purport to serve as special counsel to bypass disinterested requirements while actually acting as general bankruptcy counsel. See, e.g., In re Congoleum Corp., 426 F.3d 675 (3d Cir. 2005) (special insurance counsel’s role in plan process was too expansive for Code §327(e), and conflicts disqualified lawyer from Code §327(a) appointment); In re Running Horse, L.L.C., 371 B.R. 446 (Bankr. E.D. Cal. 2007) (real estate and transactional services would be central to case and plan); In re Argus Group 1700, Inc., 199 B.R. 525, (Bankr. E.D. Pa. 1996) (bankruptcy case was two-party dispute so litigation counsel was primary legal advisor). Because, under certain circumstances, main counsel would be entirely “conflicted out” without the ability to turn certain issues in a case over to conflicts counsel, one way to view the relationship of main counsel and conflicts counsel is that it is the combination of the two firms—
counsel to handle conflicts by using Code §§ 327(c) or 327(b). To a lesser degree, courts have used committee counsel to take responsibility for DIP counsel’s conflicted work in limited instances. Committee counsel may also employ conflicts counsel, under appropriate circumstances, under § 1103.

These work-arounds are not without their problems. Congress intended section 327(e) to allow pre-petition counsel that has been representing the debtor, particularly in litigation pending at the time of the commencement of the bankruptcy case, to continue its work post-petition on discrete matters (i.e., the same litigation) as special counsel for that purpose; and there are cases interpreting section 327(e) that limit such special counsel from counseling the debtor on plan

main counsel and conflicts counsel—that is necessary to satisfy Section 327(a)’s disinterestedness requirement, with both main and conflicts counsel appointed under Section 327(a).

In virtually all circumstances, Section 327(a) will be the appropriate section; occasionally, counsel appointed under Section 327(e) for other purposes may also be asked to handle conflicts issues upon court approval. Should the court wish to expand Section 327(e) counsel to include certain conflicts counsel work, provided that such work is within the scope of Section 327(e) and not advising on plan issues, the order approving the employment of the Section 327(e) counsel should clarify just what conflicts work the Section 327(e) counsel is appointed to do. The same clarification is necessary should the court use Section 327(b).

15 11 U.S.C. § 327(e) (“The trustee, with the court’s approval, may employ for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.”); 11 U.S.C. § 327(b) (“...if the debtor has regularly employed attorneys, accountants or other professional persons on salary, the trustee may retain...such professional persons if necessary in the operation of such business”); See In re Git-N-Go, Inc., 321 B.R. 54, 61 (Bankr. N.D. Okla. 2004) (representation request denied). Section 327(a) is more applicable than Section 327(e) in cases where aspects of general bankruptcy representation are needed, rather than limited litigation with a few clients. If proposed counsel has a conflict arising from representation of a creditor rather than prior representation of the debtor (as referenced in Code §327(e)), courts are divided on whether the attorney will be disqualified, with most cases authorizing such representation under Code §§327(a) and (c) and citing by analogy Section 327(e). See, e.g., In re AroChem Corp., 176 F.3d 610, 622 (2d Cir. 1999) (creditor’s counsel not disqualified; applying §327(a) by analogy to §327(e) to limited scope of representation and finding lack of actual conflict of interest under § 327(e) where creditor’s and estate’s interests aligned on limited representation); Stoumbos v. Kilimnik, 988 F.2d 949, 964 (9th Cir. 1993) (creditor’s counsel not disqualified as special counsel, reasoning by analogy to § 327(e)); In re Age Ref., Inc., 447 B.R. 786 (Bankr. W.D. Tex. 2011) (creditors’ committee counsel may represent chapter 11 trustee as special counsel to pursue avoidance actions); contra, In re M & M Marketing, L.L.C., 426 B.R. 796 (B.A.P. 8th Cir. 2010), aff’d, 397 F. App’x 258 (8th Cir. 2010) (§ 327(e) inapplicable; whether to follow AroChem not decided since lawyer represented an interest adverse to the estate with respect to the matter for which his employment was proposed); Meespierson Inc. v. Strategic Telecom Inc., 202 B.R. 845 (D. Del. 1996) (attorney representing creditor disqualified; § 327(e) only applies to prior representation of debtor); In re Abrass, 250 B.R. 432 (Bankr. M.D. Fla. 2000) (attorney representing creditor disqualified from service as special counsel).

16 The legislative history of Section 327(e) states that Section 327(e) “...will most likely be used when the Debtor is involved in complex litigation, and changing attorneys in the middle of the case after the bankruptcy case has commenced would be detrimental to the progress of that other litigation.” H.R. REP. NO. 595, 95TH CONG., 1ST Sess. 328 (1977), U.S. CODE CONG. & ADMIN. NEWS 1977, p. 5963; S. REP. NO. 989, 95TH CONG., 2D Sess. 38–39 (1978), U.S. CODE CONG. & ADMIN. NEWS 1978, p. 5787.
issues.\textsuperscript{18} Unless the particular conflict is discrete, the better (and majority) view is that both main counsel\textsuperscript{19} and conflicts counsel\textsuperscript{20} should be retained as co-counsel for a DIP or trustee under Section 327(a), which provides that a trustee may employ “one or more attorneys” as general bankruptcy counsel.\textsuperscript{21} Courts have also authorized conflicts counsel to work with a committee’s general bankruptcy counsel when the unrelated client representation would otherwise be disqualifying, although often courts do so without pointing to statutory authority that permits such a creative solution.\textsuperscript{22}

Use of conflicts counsel is especially important in mega-debtor cases of multinational corporations with complex capital structures, extremely diverse operations, and many subsidiaries that require the services of large multi-disciplinary firms. Almost without exception, these law firms for the DIP and committee have conflicts due to their massive size and diversity of clients. Disqualifying one such firm does not solve the problem because another firm of equal size and experience likely will have the same sort of conflict issues.\textsuperscript{23} In smaller cases, courts may approve the employment of conflicts counsel when the main bankruptcy counsel’s firm represents a few parties in interest on unrelated matters and those parties’ claims and issues can be discretely addressed by a separate lawyer, assuming of course that those parties’ claims or issues are not key to the bankruptcy case as a whole.\textsuperscript{24} In large and small cases, counsel must ensure that all applicable ethics rules are satisfied and that it makes full disclosures of connections. Conflicts of interest, however, cannot always be solved through the employment of conflicts counsel.

\textsuperscript{18} \textit{COLLIER ON BANKRUPTCY} is of the view that the “specified special purpose” referred to in §327(e) must be unrelated to the reorganization of the Debtor. For example, counsel previously retained by the Debtor to handle specific legal action for which that attorney is particularly suited. \textit{3 COLLIER ON BANKRUPTCY} (16th ed.) 327.04 [9][d] (2012).

\textsuperscript{19} The term “main counsel,” then, might be a misnomer, but for purposes of this Report, “main counsel” means the Section 327(a) general counsel handling issues other than those that the conflicts counsel is handling.

\textsuperscript{20} “Conflicts counsel” may be a misnomer as well, but we are using the term “conflicts counsel” to indicate the law firm hired to eliminate main counsel’s disqualifying conflicts problem or to take on some matters that are more cost-effectively handled by the conflicts counsel’s firm. In any event, conflicts counsel actually serves as co-counsel with the “main” counsel, albeit with a subset of main counsel’s duties.

\textsuperscript{21} \textit{In re Git-N-Go, Inc.}, 321 B.R. 54, 61 (Bankr. N.D. Okla. 2004) (“The Court finds that it is not appropriate or in the best interests of the estate to allocate to what might otherwise be ‘special counsel’ under Section 327(e) the duties described in Section 327(a)—that is, ‘to represent or assist the trustee in carrying out the trustee’s duties under this title’.”).

\textsuperscript{22} Just as Section 327(a) authorizes the retention of more than one general counsel, Section 1103(a) [Powers and duties of committees] authorizes the committee to employ “one or more attorneys” to perform services for the committee. 11 U.S.C. § 1103 (2006). E.g., \textit{In re Enron Corp.}, 2003 WL 223455, at *7-8 (S.D.N.Y. 2003), \textit{aff’d} 2002 WL 32034346 (Bankr. S.D.N.Y. 2002) (special conflicts counsel important to approval of committee counsel); \textit{In re National Century Financial Enterprises, Inc.}, 298 B.R. 112, 118 (Bankr. S.D. Ohio 2003).

\textsuperscript{23} In some large cases, co-counsel is used to perform routine services that do not require the breadth and depth of main counsel efficiently and cost-effectively. This report focuses on ethical issues, but conflicts counsel may be retained to perform other services as well. A clear division of duties should be made at the beginning of every case and coordinated, thereafter, to avoid duplication of effort and provide for economical estate administration.

\textsuperscript{24} \textit{See In re Project Orange Assocs., Inc.}, 431 B.R. 363 (Bankr. S.D.N.Y. 2010).
Although some otherwise disqualifying conflicts can be resolved with conflicts counsel, not all can. The more pervasive a disqualifying conflict is, the less appropriate appointment of the “conflicted out” law firm is. Those conflicts that (1) are unlikely to occur throughout the case, (2) involve just a few parties in interest, (3) do not involve the main issues in the case, and (4) are capable of being handed over to a non-conflicted law firm are more likely to be suitable for the appointment of “conflicts counsel.”

Conflicts counsel differs from full-fledged co-counsel in one respect: it is designed to have jurisdiction over the “conflicted-out” issues that hinder the main bankruptcy counsel’s appointment, meaning that the main counsel may not handle those issues. Courts are rightly concerned, when considering the appointment of law firms with disqualifying conflicts, about unnecessarily multiplying the magnitude of fees incurred during the case and about leaving the debtor with less than the full range of talent that it might need. Therefore, the best design for conflicts counsel involves separate spheres of issues, with only minimal overlap for coordination and communication purposes. (See Figure 1, which represents the overlap between the purviews of main counsel and conflicts counsel. Some overlap is unavoidable, at least for communication purposes, but the main and conflicts counsel should try to keep the overlap to a minimum.)

As mentioned in footnotes 23 and 26 below, an effective means of avoiding duplication of services between the two firms is to task conflicts counsel with additional (non-conflicts) work that it can perform more economically. Rather than be main counsel’s “shadow,” standing behind the main counsel and billing with limited benefit to the estate, conflicts counsel can perform services that do not require the breadth and depth of main counsel but that nonetheless need to be performed as part of a Chapter 11 case. Indeed, the United States Trustee Program recognizes the desirability of this approach in its megacase fee guidelines: in paragraph 5 of the “Summary of Significant Changes” Section, the Proposed Guidelines suggest that “[d]ebtors and official

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25 See also note 20 supra.

26 Conflicts counsel’s services may also involve bankruptcy projects, such as working on claims objections and executory contract rejections, that may be handled more cost-effectively through conflicts counsel. Some courts use conflicts counsel for this purpose; others do not. In addition to solving the problem of the disqualifying conflicts, conflicts counsel’s services on each special project have the added benefit of educating conflicts counsel about the case in ways that should help it to resolve other disputes efficiently. Conflicts counsel must know enough about the case to “hit the ground running.” The advantage of a clear division of responsibility is that, rather than shadow main counsel’s work, conflicts counsel does its own work. Because it is involved in the case, conflicts counsel knows what is going on in the case without duplicating the work of main counsel. Done right—aside from necessary coordinating communications—there is minimal duplication of effort. The Task Force recommends that, for clarity’s sake, the orders authorizing the employment of counsel specify a clear division of responsibility between conflicts counsel and main counsel. The Updated Proposed Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed Under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases; Summary of Revisions; and Analysis of Comments, USDOJ: U.S. TRUSTEE PROGRAM (Nov. 2, 2012), available at http://www.justice.gov/ust/eo/rules_regulations/guidelines/docs/proposed/AppendixB_Fee_Guidelines_Exhibits_Comments.pdf [hereinafter Proposed Guidelines], recognize the potential cost savings of such a division of labor. See Proposed Guidelines at 23-24.
committees are encouraged to use co-counsel arrangements to achieve better staffing and fee efficiencies."

Before a law firm can even seek approval of its employment from a bankruptcy court, though, it must also satisfy its state’s own ethics rules. We will refer generally to the Model Rules of Professional Conduct throughout, rather than referring to specific state provisions.

MODEL RULE OF PROFESSIONAL CONDUCT 1.7 provides that a lawyer has a conflict of interest and shall not represent a client if (a) the representation will be directly adverse to another client or (b) there is a significant risk that the representation will be materially limited by the lawyer’s responsibilities to another client, former client, third person, or the lawyer’s own interests, unless (1) the lawyer reasonably believes that the representation will not adversely affect the relationship, (2) the representation is not prohibited by law, (3) the representation does not involve assertion of a claim by one client against the other represented by the same firm in the same proceeding, and (4) each client consents after consultation. That consultation must include an explanation of the implications of common representation and the advantages and risks involved. Either (a) or (b) will disqualify a lawyer.

The first component of the MODEL RULE 1.7 test for ethical representation of two clients, i.e., direct adversity, is objective. It turns on whether such action will have a substantial effect on the other firm client, e.g., by staying pending litigation or preventing contract termination or a suit that would otherwise be brought, given the amount involved. In most single-asset bankruptcy cases, the mere filing of a petition will be “directly adverse” to the secured lender. In a Chapter 11 of an operating business, simply filing the case is likely not directly adverse to small creditors and other parties in interest. However, litigating a claim objection or avoidance action against the client would be “directly adverse” and would be “asserting or defending a claim” in the words of the RESTATEMENT.

27 The Guidelines go on to explain that the cost-saving “arrangements include using less expensive co-counsel for certain routine, commoditized, or discrete matters to avoid duplication, overlap, and [achieve] efficiencies.” That duplication is more likely when the orders appointing counsel and co-counsel do not specify the appropriate division of labor. Cf. In re S.T.N. Enterprises, Inc., 70 B.R. 823, 840-41 (Bankr. D. Vt. 1987) (judge warned both counsel and co-counsel against duplicating services and court subsequently denied attorney’s request for fees).

28 Model Rules of Prof’l Conduct R. 1.7 (2012); see also Restatement (Third) of the Law Governing Lawyers § 128 (2000):

Unless all affected clients consent to the representation under the limitations and conditions provided in § 122, a lawyer in civil litigation may not:

1. represent two or more clients in a matter if there is a substantial risk that the lawyer’s representation of one client would be materially and adversely affected by the lawyer’s duties to another client in the matter; or

2. represent one client to assert or defend a claim against or brought by another client currently represented by the lawyer, even if the matters are not related.


29 MODEL RULE OF PROFESSIONAL CONDUCT R. 1.9 concerns conflicts on account of duties to former clients. A relationship with a former client may also constitute a disqualifying adverse interest.
The second component of the Model Rule 1.7 test—determining whether there is a significant risk that representation of the DIP, trustee, or committee will be materially limited by responsibilities to another client—is subjective. It focuses on the effect of the conflict on counsel’s decision-making—e.g., will it affect counsel’s evaluation of whether to switch to another contract supplier, or whether to file preference litigation? Part of the determination of the materiality of any limitation will be the pervasiveness of the party in interest’s role in the case and how important a client that party is to the law firm.30

Conflicts counsel can enable general bankruptcy counsel for a DIP, trustee, or committee to avoid the “direct adversity” disqualification of Model Rule 1.7, and thereby avoid the obligation to obtain client consent. However, counsel must still consider the subjective test of whether there is a significant risk of a material limitation on counsel’s other responsibilities. The law firm and, eventually (if counsel is seeking approval of employment), the court must analyze the importance of the adverse party client’s position in the case and the extent of that party’s relationship with the proposed general bankruptcy counsel’s firm. If the party’s role in the bankruptcy case is so large and central to the debtor’s very existence, such a carve-out of general bankruptcy representation may be infeasible and would impermissibly force conflicts counsel to effectively take on the role of main bankruptcy counsel.32 As an ethical matter, the lawyer’s responsibilities to the adverse party client not to take action adverse to it in such circumstances will likely also materially limit her responsibilities to the DIP, trustee, or committee, thereby violating her state’s version of Model Rule 1.7(b). If the party is a significant client of the proposed general bankruptcy counsel’s firm, the lawyer may also be inclined to “pull her punches” on any issue that indirectly adversely affects the client party, again precluding the lawyer from meeting the subjective test of Model Rule 1.7(b).31 Conflicts counsel cannot “sanitize” such overwhelming conflicts. At that point, even the employment of conflicts counsel cannot salvage the proposed main counsel’s ability to satisfy the disinterestedness requirements of the Code or the subjective test of Rule 1.7. In such instances, the proposed main counsel cannot qualify to serve at all other than perhaps as special counsel under section 327(e). Even as special counsel, the professional could not advise the debtor on plan issues.

30 See, e.g., In re Project Orange Assoc., 431 B.R. 363 (Bankr. S.D.N.Y. 2010); In re Amdura, 121 B.R. 862, 866-67, 871 (Bankr. D. Colo. 1990) (largest creditor in the case was a significant client of the firm: “the hand that feeds the firm”).


32 See, e.g., Project Orange, 431 B.R. at 375 (representation on other matters of largest creditor, central to reorganization, and whose waiver still forbids bringing or threatening any actions, disqualified DIP counsel); Amdura, 121 B.R. at 866-67, 871 and 139 B.R. at 979 (creditor’s role in case too extensive to solve disinterestedness through local counsel handling creditor disputes).

33 Project Orange, 431 B.R. at 375 (court found that conflict waiver agreement with creditor severely limited the law firm’s ability to fully, adequately and vigorously represent the debtor; “the Court does not believe that DLA Piper can negotiate with full efficacy without at least being able to hint at the possibility of litigation”); In re EZ Links Golf, LLC, 317 B.R. 858, 864 (Bankr. D. Colo. 2004) (declaration that firm would not sue creditor raises inferences that potential claims against creditor have not been raised); In re Premier Farms, L.C., 305 B.R. 717, 720-21 (Bankr. N.D. Iowa 2003) (bank was one of most significant creditors and lawyer had “predisposition to bias in favor of Bank”); In re Envirodyne Indus., Inc., 150 B.R. 1008, 1016-18 (Bankr. N.D. Ill. 1993) (debtor, as fiduciary, may not waive conflicts on behalf of estate).
The point is to preclude adversity to the DIP, trustee, or committee by having conflicts counsel handle all matters considered directly adverse to that client. The Restatement of the Law Governing Lawyers states that conflicts can be eliminated by an agreement limiting the scope of the lawyer’s representation.\textsuperscript{34} Eliminating adversity could also be accomplished through permissible provisions in a conflict waiver letter.\textsuperscript{35} Thus, the client that would be the adverse party in interest (on unrelated matters) and the DIP, trustee, or committee could agree (ethically) that the firm would not represent the DIP, trustee, or committee on matters directly adverse to that party, and that objecting to the adverse party client’s proof of claim, or filing any adversary proceeding against it, would be deemed direct adversity, while plan treatment of the claim would not be directly adverse. They could agree that negotiating the terms for and seeking to assume a creditor client’s contract would not be considered direct adversity, while a motion to reject that contract would be deemed directly adverse.\textsuperscript{36}

Any waiver of a conflict of interest by the DIP or trustee is, of course, subject to the bankruptcy court’s approval of the employment of both the proposed general counsel and the proposed conflicts counsel under Section 327(a).\textsuperscript{37} The bankruptcy court will also have to consider a conflict waiver for committee counsel of a client creditor when it considers the approval of employment for the committee’s proposed general bankruptcy counsel and conflicts counsel. Conflict waivers must comply with applicable state professional rule requirements.\textsuperscript{38} The bankruptcy

\textsuperscript{34} Restatement (Third) of Law Governing Lawyers § 121 cmt. c(iii) (2000). The limitation must not render the remaining representation by the lawyer objectively inadequate. \textit{Id.; see also} Model Rule 1.2(c) (“A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.”).

\textsuperscript{35} Model Rule R. 1.7(b) (lawyer must reasonably believe he can provide competent and diligent representation to each client, and each client must consent in writing); Model Rule R. 1.7, Comment 15 (“Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest.”). \textit{See} Restatement (Third) of Law Governing Lawyers § 122, cmt. e (2000) (“A client’s informed consent to a conflict can be qualified or conditional… [T]he client might condition consent on particular action being taken by the lawyer or law firm… Such a partial or conditional consent can be valid even if an unconditional consent in the same situation would be invalid. For example, a client might give informed consent to a lawyer serving only in the role of mediator between clients, but not to the lawyer representing those clients opposing each other in litigation if mediation is unavailing.”) (citations omitted and emphasis added).

\textsuperscript{36} Any such limitations must be spelled out, and disclosed to the court. \textit{See} In re Amdura Corp., 139 B.R. 963, 976-77 (Bankr. D. Colo. 1992) (discussing whether DIP counsel’s agreement not to sue creditor client precluded DIP representation in cash collateral dispute, and explaining importance of disclosure). In the \textit{jere} case, DIP counsel agreed with the DIP lender, a client on unrelated matters, not to litigate against the lender, without disclosing the no-litigation carve-out from the waiver to the court. When a dispute over ability to impose a Section 506(e) surcharge arose, the lender considered that to be litigation within the scope of the waiver carve-out. \textit{In re Jere Corp.}, 298 B.R. 703 (Bankr. D. Mont. 2003).

\textsuperscript{37} \textit{See} In re Congoleum Corp., 426 F.3d 675, 690-91 (3d Cir. 2005) (court determines that waivers inadequate due to lack of informed consent); In re JMK Construction Group, Ltd., 441 B.R. 222, 237 (Bankr. S.D.N.Y. 2010) (court held conflict waiver did not satisfy the adverse interest requirement of 327(a)); Premier Farms, 305 B.R. at 720-21 (court found while firm had a waiver from debtor and firm’s client creditor bank, firm not disinterested); In re Git-N-Go, Inc., 321 B.R. 54, 60 (Bankr. N.D. Okla. 2004) (waiver needed for RPC compliance was given without independent advice and did not eliminate adversity).

\textsuperscript{38} \textit{See} Model Rule 1.0(e) (“informed consent”); Model Rule R. 1.2 (agreements on scope of representation); \textit{see} Task Force’s Report on Proposed Amendments to Rule 2014.

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court and/or the United States trustee may request a copy of any conflict waivers, subject to redaction for privileged information of the waiving client.

In order to inform the court regarding the necessity of conflicts counsel, main counsel seeking the approval of employment of conflicts counsel should ensure that the Rule 2014 disclosures address the following components:

- the need for the appointment of conflicts counsel in the first place;
- the nature of the conflict that the main counsel is facing;
- how pervasive the conflict is with respect to the entire case;
- the identity of the client with whom the main counsel’s conflict exists;
- the magnitude of the conflict and its importance to the case; and
- any discussions regarding any waivers of potential or actual conflicts.

Additional disclosures may be necessary in order to provide the court with sufficient information to judge whether the approval of conflicts counsel is an appropriate way to deal with the conflict that the main counsel is facing.

Note: This Report does not address the issue of when a court should appoint local counsel in general or when it should approve the appointment of both local counsel for the main counsel and conflicts counsel.39

Guidelines for Use of Conflicts Counsel

If general bankruptcy counsel for a DIP, trustee, or committee proposes the use of conflicts counsel, the court should examine the nature of the disqualifying conflicts to determine their magnitude and potential duration. Significant conflicts that are expected to last throughout the case will be more problematic than will be those smaller conflicts of limited duration (or that are only potential conflicts).40 Should a court find that a combined appointment of main 327(a) counsel and conflicts counsel would solve the problem of main counsel’s disqualifying conflicts, then the court should craft employment orders for both the main and conflicts counsel. Note that, sometimes, local counsel can serve as conflicts counsel. Those employment orders should delineate the purviews of main counsel and conflicts counsel in order to avoid any unnecessary duplication of effort and any unnecessary fees and expenses. If the DIP41 seeks approval of the employment of conflicts

39 The proposals contained in this Report are designed to deal only with the issues of appointment and scope of duties of conflicts counsel. The issues inherent in the appointment and scope of duties of local counsel implicate similar issues but are different in kind from the issues involving conflicts counsel and are not addressed here.


41 Or the trustee, or the committee.
Chapter 2—Bankruptcy Bermuda Triangle: Unbundling and Factoring in Consumer Bankruptcy Cases

Counsel not at the beginning of the case but later, when the necessity for conflicts counsel is first discovered, then the court should—as part of the order appointing conflicts counsel—simultaneously amend the main counsel's employment order to clarify the delineation of responsibility.\(^\text{42}\)

Main general bankruptcy counsel unable to meet the requirements of Section 327(a) or 1103(b) because of representation of another party in interest or third parties on unrelated matters (the “conflicting entity”) may be retained, in the court’s discretion, after appropriate waivers that comply with applicable non-bankruptcy ethics rules—even if the waivers do not permit estate-paid counsel to take positions adverse to the conflicting entity—if the court approves employment of conflicts co-counsel to assert or defend any claim against or brought by the conflicting party, provided that:

(1) the role of the conflicting party in the case is not so central to the outcome, extensive, and significant that such co-counsel would have to take over the primary duties of main general bankruptcy counsel, or would render division of responsibilities between co-counsel infeasible;

(2) the scope of duties is defined in the retention orders of main counsel and conflicts counsel, and the work is allocated to minimize costs and reduce duplication; and

(3) the relationship of the conflicting party with main counsel is not so extensive or significant that there is a significant risk that the representation will be materially limited by the counsel’s responsibilities to that conflicting client.

This standard does not alter conflict of interest waiver requirements for any counsel under non-Bankruptcy Code professional responsibility rules in the applicable jurisdiction. Notwithstanding such waiver, the court must approve counsel’s employment. All relevant details of all conflict of interest waivers, including any limitations on representation, must be fully disclosed to the court.

\(^{42}\) Courts should encourage main counsel, at the time that the DIP, trustee, or committee is seeking approval of that employment, to anticipate those potential conflicts that a reasonable main counsel should have anticipated, in order for the court to consider the early appointment of conflicts counsel.
Figure 1: Intersections of the purviews of “main” counsel and conflicts counsel.
Best Practices for Limited Services Representation in Consumer Bankruptcy Cases

Introduction

The ABI Bankruptcy Ethics Task Force has considered the issue of Limited Scope Representation (“LSR”), also known as “unbundling legal services” and “discrete task representation.” We have also briefly examined the issue of “ghostwriting,” a form of LSR. These practices have developed as a means to serve the ever-increasing number of self-represented debtors (also known as pro se debtors).

LSR on behalf of a consumer debtor typically consists of the provision by an attorney of a subset of legal services in connection with the filing of a consumer bankruptcy case. LSR is in contrast to the plenary representation of a debtor, where the lawyer is paid a full fee to represent a debtor with respect to all aspects of his bankruptcy case—from pre-filing counseling to post-discharge proceedings. LSR is undertaken to achieve a lower overall cost, and typically in lieu of filing pro se or filing with the assistance of a petition preparer. This arrangement allows for legal representation by an attorney for cost containment purposes.

The problem of the high cost of consumer bankruptcy representation is well documented. The recent Consumer Bankruptcy Fee Study revealed a 24% increase in attorney fees post-BAPCPA for Chapter 13 cases, with mean fees in some jurisdictions approaching $5,000. For no-asset cases filed under Chapter 7, mean attorney fees have increased 48%—as high as $1,500 at the mean in some jurisdictions.

Although in most jurisdictions there is a mechanism for attorney fees in Chapter 13 cases to be paid through the plan (thus limiting the amount of cash a financially distressed debtor must have...
in hand to pay an attorney prior to filing),8 high attorney fees remain a concern. In many instances, at least a portion of the fee must be paid to the attorney up front, and providing for the fee balance to be paid through the plan may adversely affect the plan’s feasibility. Thus, high fees in Chapter 13 cases may be pricing some debtors out of filing for bankruptcy under Chapter 13.9 Although it is difficult to measure how many consumers in financial distress do not file for bankruptcy protection, the Consumer Bankruptcy Fee Study did reveal that zero cases filed pro se under Chapter 13 ended with the debtor receiving a discharge.10 This is a result of the myriad new obligations imposed on debtors by BAPCPA, and the difficulty many debtors have had (and continue to have) in meeting these obligations.11

The problem of pro se representation is even more compelling in Chapter 7, where it is far more common. The Consumer Bankruptcy Fee Study found that 5.8% of all Chapter 7 cases are filed pro se.12 This descriptive statistic is reflective of a national random sample of cases filed post-BAPCPA. We recognize, however, that the incidence of pro se filings is considerably higher in many jurisdictions. In the ten courts with the greatest number of pro se cases, 9.5% to 27.1% of all cases are filed without attorney representation.13

The burden that pro se debtors place on the court system has been widely recognized.14 Judges, trustees, and court staff have detailed the extra time and system resources eaten up by aiding

8 Id. at 116.
9 Id. at 104.
10 Id. at 33-34.
11 As observed: BAPCPA’s enactment changed the consumer bankruptcy system in a myriad of small and not-so-small ways. For example, there is now an income and expense standard consumer debtors must meet in order to qualify for Chapter 7. The most critiqued of all new requirements, the means test, mandates that all debtors calculate their income and expenses using a system of complex calculations. It requires the application of various local and IRS expense standards to the debtor’s financial information, adjusted by geographic location and household size.

The list of necessary documents and records required by a consumer debtor filing under Chapter 7 or Chapter 13 has also notably increased. In addition to a schedule of assets and liabilities, a schedule of current income and expenditures, and a statement of financial affairs, a debtor must now produce: (i) evidence of payment from employers, if any, received within 60 days of filing; (ii) a statement of monthly net income and any anticipated increase in income or expenses after filing; (iii) a record of any interest the debtor has in a federal or state qualified education or tuition account; and (iv) a copy of his or her tax return for the most recent tax year.

Two educational courses are now also required of debtors—a debtor must complete a credit counseling course prior to filing, and a debtor education course must be completed prior to discharge.

Id. at 33-34 (footnotes omitted).
12 Id. at 31.
14 Lupica, supra note 5, at 102.
pro se debtors who are attempting to navigate the complexities of the bankruptcy process. Moreover, these efforts and resource expenditures are often for naught. The chance a pro se debtor’s case will be dismissed because of a failure to comply with the dictates of the Bankruptcy Code and Rules is considerably higher than if the debtor were represented.

In considering the issue of Limited Services Representation, the Task Force recognizes the necessity of reconciling the need to protect debtors from receiving inadequate and ineffective representation, even for a limited fee, and the interest of providing debtors with the option of limited legal representation in lieu of self-help resources or non-legal assistance. With the goal of addressing each of these concerns, the Task Force has examined the elements of debtor representation in consumer bankruptcy cases and has developed a framework for engagement of counsel for limited services. After due discussion and consideration, the Task Force is recommending a framework for LSR representation in Chapter 7 consumer cases only because of Chapter 13’s complexity and the difficulty of distinguishing between the “basic” and the “full service” elements of representation of a Chapter 13 debtor. In addition, the ability to pay legal fees paid through a plan and the historically low incidence of pro se Chapter 13 cases has led the Task Force to conclude that the concerns motivating the LSR Proposal are best met by the development of a proposal for best practices for limited services representation only in Chapter 7 consumer cases.

LSR and Model Rules, Local Rules, Bar Association Opinions and Judicial Pronouncements

Limited Scope Representation has been gaining attention among the federal and state judiciary. Typically, states and bar associations have been more receptive to “unbundled” legal services than federal courts. The Model Rules of Professional Conduct, largely adopted in some form in most states, permit Limited Scope Representation under certain, defined circumstances. Rule 1.2(c) reads, “[a] lawyer may limit the scope of representation if the limitation is reasonable under the circumstances and the client gives informed consent.” The Official Comments to Rule 1.2(c) provide:

The scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer’s services are made available to the client . . . . A limited representation may be appropriate because the client has limited objectives for the representation. In addition, the terms upon which representation is undertaken may exclude specific means that might otherwise be used to accomplish the client’s objectives. Such limitations may exclude actions that the client thinks are too costly or that the lawyer regards as repugnant or imprudent.

15 Id.
16 Id. at 103.
17 Note, however, that nothing in this Best Practices Statement obviates the need for attorneys for consumer debtors to comply with, e.g., the Bankruptcy Code provisions involving debt relief agencies. See 11 U.S.C. §§ 101(8), 101(12A), 526-258.
18 MODEL RULES OF PROF’L CONDUCT R. 1.2(c) (2011).
19 Id. at R. 1.2 cmt. 5.
The comments to Rule 1.2 further state that lawyers and clients may enjoy “substantial latitude to limit the representation,” so long as the proposed limitations are “reasonable under the circumstances.” The Official Comment [7] offers the following illustration.

If, for example, a client’s objective is limited to securing general information about the law the client needs in order to handle a common and typically uncomplicated legal problem, the lawyer and client may agree that the lawyer’s services will be limited to a brief telephone consultation. Such a limitation, however, would not be reasonable if the time allotted was not sufficient to yield advice upon which the client could rely.\(^{20}\)

Model Rule 1.0(h) defines “reasonable” as being consistent with the “conduct of a reasonably prudent and competent lawyer.”\(^{21}\) In determining the reasonableness of a proposed representation, the legal knowledge, skill, thoroughness and preparation required is informed by the nature of the unbundled representation.\(^{22}\)

Currently, dozens of federal judicial districts have adopted a local rule of bankruptcy procedure or written an opinion addressing LSR. The degree of enthusiasm for LSR by courts, who have examined this issue, ranges from high to very low. Some courts have embraced LSR as a tool to address the growing problem of pro se debtors.\(^{23}\) As reported above, legal fees have increased in almost every jurisdiction, pricing some debtors out of legal representation. Moreover, diminished funding for legal services organizations has decreased the availability of low- or no-cost legal representation for low-income debtors. Although the incidence of pro se debtors varies from jurisdiction to jurisdiction, at all levels pro se cases are reported to add to the already considerably administrative burdens on the courts and the trustees.\(^{24}\)

Other courts, however, have viewed the practice of unbundling more skeptically.\(^{25}\) Those

\(^{20}\) Id. at R. 1.2 cmt. 7; see also In re Minardi, 399 B.R. 841, 851-52 (Bankr. N.D. Okla. 2009) (examining the reasonableness requirement based on the nature of the case and the financial circumstances facing a chapter 7 debtor).

\(^{21}\) MODEL RULES OF PROF’L CONDUCT R. 1.0(h) (2011).

\(^{22}\) Id. at R. 1.2 cmt. 7.

\(^{23}\) See Hale v. United States Trustee, 509 F.3d 1139, 1148 (9th Cir. 2007) (agreeing with the bankruptcy court’s determination that bankruptcy counsel may not exclude from representation of the debtor “critical and necessary services”); In re Johnson, 291 B.R. 462, 469 (Bankr. D. Minn. 2003) (attorneys representing individual debtors in chapter 7 cases may not “unbundle the core package of ordinary legal representation reasonably anticipated in every case”); In re DeSantis, 395 B.R. 162, 169 (Bankr. M.D. Fla. 2008) (counsel for an individual chapter 7 debtor in a consumer case may not exclude from the scope of representation certain essential services; debtor’s counsel “must advise and assist their client in complying with their responsibilities assigned by Section 520 of the Bankruptcy Code, including helping their clients decide whether to surrender collateral or instead reaffirm or to redeem secured debts.”); In re Burton, 442 B.R. 421, 452-53 (Bankr. W.D. N.C. 2009) (disapproving of an attempt to limit representation to file lien avoidances or defend against stay relief motions on the basis that these constitute “key services” to the bankruptcy case).

\(^{24}\) Lupica, supra note 5, at 102.

courts that have viewed limited scope representation less favorably have expressed concern that LSR leaves debtors without guidance in the thick of the bankruptcy case, when they are most vulnerable. Moreover, some judges see full service representation as necessary to meet the minimum standards of a lawyer’s professional responsibility. Yet others have noted that what falls under the umbrella of “basic services” is fact-intensive and varies from case to case.

Although both sides of the argument have merit, the Task Force is viewing the LSR Proposal as a needed alternative to a debtor’s pro se representation. The Proposed Rule should be used as a guide for measuring the reasonableness of a particular Chapter 7 bankruptcy representation arrangement.

In recognizing that the concept of reasonableness is both fact-intensive and situation-specific, the Restatement (Third) of Law Governing Lawyers offers the following guidelines: (i) a client must be informed of and consent to any “problems that might arise related to the limitation,” (ii) a contract limiting the representation is construed “from the standpoint of a reasonable client,” (iii) if any fee is charged, it must be reasonable in light of the scope of the representation, (iv) changes to representation made after an unreasonably long time after beginning representation must “meet the more stringent tests...for post inception contracts or modifications,” and (v) the limitation’s terms must be reasonable in light of the client’s sophistication level and circumstances.

Informed Client Consent

The reasonableness of a representation cannot be evaluated without the client’s informed consent. Informed consent requires that the client knows of and understands the risks and benefits of the limited representation. The Model Rules define 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 and reasonably available alternatives to the proposed course of conduct.”

In the context of consumer bankruptcy, any attempt to limit the scope of representation

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26 In re Bulen, 375 B.R. 858, 866 (Bankr. D. Minn. 2007) (observing that unbundled legal representation is akin to putting a “Band-aid on a gun shot” and leads to an “unraveled legal process, no increased access to justice.”); see also In re Cuddy, 322 B.R. 12, 17 018 (Bankr. D. Mass. 2005).
28 MODEL RULES OF PROF’L CONDUCT R. 1.0(e) (2011). The Official Comments to Rule 1.0(e) further explain: “The communication necessary to obtain such consent will vary according to the Rule involved and circumstances giving rise to the need to obtain informed consent. The lawyer must make reasonable efforts to ensure that the client or other person possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client’s or other person’s options and alternatives.” Id. at cmt. 6.
must be fully disclosed and clearly understood by the debtor before proceeding with the engagement. This means that for a debtor to provide valid, fully informed consent to limited services representation, the lawyer must fully explain the services that are omitted from the representation, including the materiality of these services and the potential ramifications of their omission. As a matter of “best practices,” the Task Force recommends that any informed consent be in writing. A “Model Agreement and Consent to Limited Representation in Consumer Bankruptcy” is found below.

In addition to executing the “Agreement and Consent to Limited Representation in Consumer Bankruptcy,” the Task Force further recommends that an affidavit be signed by the attorney and filed with the Bankruptcy Court attesting that the “Agreement and Consent to Limited Representation in Consumer Bankruptcy” was signed by the debtor and the attorney and that the debtor understood its substance.

Despite well-founded concerns for protecting the interests of consumer debtors, the trend in bankruptcy cases (and non-bankruptcy cases) generally favors allowing limited representation in some form. The target of this proposed rule is the debtor who falls in the liminal space between not qualifying for legal aid but with limited funds to pay for full-service representation.

**Best Practices for Limited Scope Representation**

Given the fact-specific nature of limited scope representation in the context of consumer bankruptcy, it is difficult to design the contours of a limited scope representation that fully addresses the client’s needs for affordable counsel and that also meets the standard of competent representation. Best practices, at a minimum, require the following:

29 See Hale v. U.S. Trustee, 509 F.3d 1139, 1147 (9th Cir. 2007); In re Castorena, 270 B.R. 504, 529 (Bankr. D. Idaho 2001) (“Unless debtors truly understand what they are bargaining away, the bargain is a sham.”(citing In re Basham, 208 B.R. 926, 932-33 (B.A.P. 9th Cir. 1997), aff’d, 152 F.3d 924 (1998)).

30 In re Castorena, 270 B.R. at 530 (noting the difficulty of predicting which services would be deemed to “part and parcel” of any debtor-engagement, but that “the closer to heart of the matter—the debtors’ desire to obtain bankruptcy relief and the process necessary to do so—the less likely exclusion is appropriate.” The court identified the following services as core: (i) proper filing of required schedules, statements, and disclosures, including any required amendments thereto; (ii) attendance at the section 341 meeting; (iii) turnover of assets and cooperation with the trustee; (iv) compliance with tax turnover and other orders of the bankruptcy court; (v) performance of the duties imposed by section 521(1), (3) and (4); (vi) counseling in regard to and the reaffirmation, redemption, surrender or retention of consumer goods securing obligations to creditors, and assisting the debtor in accomplishing these aims; (vi) responding to issues that arise in the basic milieu of the bankruptcy case, such as violations of stay and stay relief requests, objections to exemptions and avoidance of liens impairing exemptions.). See also In re Kieffer, 306 B.R. 197, 207 (Bankr. N.D. Ohio 2004) (characterizing the following matters as “routine”: (i) motion for turnover of tax refund, (ii) Rule 2004 examination, (iii) objection to exemption, (iv) objection to motion for relief from stay, and (v) simple notice of sale); In re Wagers, 340 B.R. at 398–99 (observing that objections to exemptions, objections to discharge on the schedules and statements and motion to dismiss for substantial abuse under section 707(b) likely “are so closely related to the advice the attorney gave the pre-petition preparation for filing that the attorney would at least be morally bound, and might be legally bound, to defend the debtor’s position against such attacks.”).
1. The initial client interview and counseling should make clear the expected scope of representation and the expected limited fee.

2. Attorneys counseling unsophisticated consumer debtors must be mindful, when gathering initial information to assess a case, to avoid the formation of the debtor’s perception that a full-scale attorney-client relationship is being formed.

3. An engagement letter and informed consent should be prepared in plain language and carefully reviewed with the debtor. This letter must clearly and conspicuously set forth the services being provided, the services not being provided, and the potential consequences of the limited services arrangement.

4. The engagement letter must also clearly describe the fee arrangement, including a statement of how fees for additional services will be charged.31

5. All documents and disclosures filed with the bankruptcy court should be done with full candor consistent with the attorney’s duty of confidentiality, disclosing the exact nature of the representation and the calculation of fees for services being provided.

6. In the event that withdrawal from the unbundled representation becomes warranted, attorneys must be mindful of protecting their client’s interests to the fullest extent practical when exiting the case.

7. As is the case with all legal representation, if the attorney becomes aware of a legal remedy, problem, or alternative outside of the scope of his or her representation, the client must be promptly informed. The attorney has the further obligation to provide his or her client with a thorough explanation of the potential benefits and harms implicated, in order for the client to make an informed decision as to how to proceed.

In considering the range of tasks and services an attorney typically provides to consumer debtors, the Task Force recognized a distinction between the representation of Chapter 7 individual debtors with secured consumer debts, and those Chapter 7 debtors with only unsecured consumer debt.

31 There are always risks with asking the client to pay, post-petition, for fees incurred pre-petition as part of the engagement. If the Proposed Rule suggested in this Best Practices Statement is not enacted, then perhaps a better approach would be that taken by a case in the Middle District of Florida. In that case, the court approved a payment system in which “the client execute[d] separate fee agreements for prepetition and postpetition services.” See Walton v. Clark & Washington, 469 B.R. 383, 384 (Bankr. M.D. Fla. 2012).
Even in the context of providing limited services representation, a lawyer representing a
Chapter 7 debtor must comply with all of the relevant governing Rules of Professional Conduct. These rules include the requirements of (i) competency (Rule 1.1), 32 (ii) diligence (Rule 1.3), 33 (iii) communication (Rule 1.4), 34 (iv) confidentiality (Rule 1.6), 35 and (v) conflicts of interest (Rules 1.7, 36 1.8, 37 1.9, 38 1.10, 39 and 1.11 ). 40

32 “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” Model Rules of Prof’l Conduct R. 1.1 (2011). The issue of attorney competency in the bankruptcy context will be further addressed elsewhere in the Task Force’s Reports.

33 “A lawyer shall act with reasonable diligence and promptness in representing a client.” Id. at R. 1.3.

34 (a) A lawyer shall:

1. promptly inform the client of any decision or circumstance with respect to which the client’s informed consent, as defined in Rule 1.0(e), is required by these Rules;
2. reasonably consult with the client about the means by which the client’s objectives are to be accomplished;
3. keep the client reasonably informed about the status of the matter;
4. promptly comply with reasonable requests for information; and
5. consult with the client about any relevant limitation on the lawyer’s conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Id. at R. 1.4.

35 “(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).” Id. at R. 1.6.

36 Id. at 1.7 (prohibiting representation of current clients whose interests conflict with other current clients).

37 Id. at 1.8 (prohibiting the representation of clients whose interests conflict with the lawyer’s personal or business interests).

38 Id. at 1.9 (prohibiting the representation of current clients’ whose interests conflict with former clients).

39 Id. at 1.10 (imputing certain conflicts of interest to other members of a lawyer’s law firm).

40 Id. at 1.11 (addressing conflicts of interest when an attorney leaves government service and enters private sector practice).

41 For example, it is a breach of the obligations of competence and diligence to have non-lawyer staff to counsel a debtor. See generally In re Sledge, 353 B.R. 742, 749 (Bankr. E.D.N.C. 2006); In re Pinkins, 213 B.R. 818, 820-21 (Bankr. E.D. Mich. 1997).
Proposed Rule Providing for Limited Scope Representation in Consumer Bankruptcy Cases

(1) If permitted by the governing Rules of Professional Conduct, a lawyer may limit the scope of the representation of an individual debtor (or debtors in a joint case),\(^\text{42}\) whose debts are primarily consumer debts, if the limitation is reasonable under the circumstances and the client gives informed consent in writing.

(2) Limited Services Representation for Individual Chapter 7 Debtors with No Secured Debts.

A. With respect to a Chapter 7 case filed by an individual debtor, whose debts are primarily consumer debts, where such debtor has no secured debt listed on the bankruptcy schedules or statements, reasonable limited representation includes all of the following:

1. An initial meeting with the debtor to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
2. Advice to the debtor concerning the debtor’s obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
3. Preparation and filing of the documents and disclosures required by the Bankruptcy Code, including performance of the duties imposed by Section 521 of the Code.
4. Provision of assistance with the debtor’s compliance with Section 707(b)(4) of the Bankruptcy Code.
5. Preparation and filing of the petition, the Statement of Financial Affairs, and the necessary schedules.
6. Attendance at the Section 341(a) meeting.
7. Communication with the debtor after the Section 341(a) meeting.
8. Monitoring the docket for issues related to discharge.

B. In addition to the limited service representation in a Chapter 7 case, as it is defined above, the representation may also include the following services, to be indicated with a check on the Model Agreement:

• Representation of the debtor in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
• Representation of the debtor in connection with a challenge to the debtor’s discharge and/or the dischargeability of certain debts.

\(^{42}\) As used herein, the term “debtor” shall include an individual debtor, as well as debtors in a joint case. Counsel should be particularly careful in joint debtor cases to ensure that both debtors are fully cognizant of the limitations of LSR. Counsel should also be mindful of the danger of joint debtors implicating conflict of interest concerns.
Preparation and filing of all motions required to protect the debtor's interests.

Representation of the debtor with respect to defending objections to exemptions.

Preparation and filing of responses to all motions filed against the debtor.

Representation of the debtor in connection with a motion for relief from stay.

Representation of the debtor in connection with a motion for relief from stay that is resolved by agreement.

Representation of the debtor in connection with a motion seeking dismissal of the case.

Other

(3) Limited Services Representation for Chapter 7 Debtors with Listed Secured Debts.

A. With respect to a Chapter 7 case filed by an individual debtor, whose debts are primarily consumer debts, where such debtor has listed secured debt on the bankruptcy schedules or statements, reasonable limited representation includes all of the following:

1. An initial meeting with the debtor to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.

2. Advice to the debtor concerning debtor's obligations and duties under the Bankruptcy Code and Rules and applicable court orders.

3. Preparation and filing of the documents and disclosures required by and performance of the duties imposed by Section 521 of the Bankruptcy Code.

4. Provision of assistance with the debtor's compliance with Section 707(b)(4) of the Bankruptcy Code.

5. Preparation and filing of the petition, the Statement of Financial Affairs, and the necessary schedules.

6. Representation of the debtor (including counseling) with respect to the reaffirmation, redemption, surrender, or retention of consumer goods securing obligations to creditors.

7. Attendance at the Section 341(a) meeting.

8. Communication with the debtor after the Section 341(a) meeting.

9. Monitoring the docket for issues related to discharge.

B. In addition to the limited service representation in a Chapter 7 case, as it is defined above, the representation may also include the following services, to be indicated with a check on the Model Agreement:

- Representation of the debtor in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.

- Representation of the debtor in connection with a challenge to debtor's discharge and/or the dischargeability of certain debts.
- Preparation and filing of all motions required to protect the debtor’s interests.
- Representation of the debtor with respect to defending objections to exemptions.
- Preparation and filing of responses to all motions filed against the debtor.
- Representation of the debtor in connection with a motion for relief from stay.
- Representation of the debtor in connection with a motion for relief from stay that is resolved by agreement.
- Representation of the debtor in connection with a motion seeking dismissal of the case.
- Other ____________________________
Model Agreement and Consent to Limited Representation in Consumer Bankruptcy Cases

In order to provide you with reasonable and affordable representation in connection with your consumer bankruptcy case, I, ________________________, attorney-at-law, licensed in the State of ___________, Bar No. __________, agree to provide you, for a limited fee (as described in Section III below, hereinafter referred to as the “Fee”), with some, but not all, of the services and advice you may need in connection with your bankruptcy case.

You agree that I am being hired to provide you limited bankruptcy-related representation and recognize that at any time between now and when your case is concluded (either because you receive a discharge, your case is converted to a case under another chapter, or because your case is dismissed), circumstances may arise that require additional legal advice and/or legal services. In such event, you have the option of engaging my services for an additional fee, hiring another attorney, or representing yourself.

You understand that you are seeking legal representation under Section ___ (I OR II) below.

Within the scope of my representation, I agree to act in your best interest at all times, and agree to provide you with competent legal services.

I. For Chapter 7 Debtors Who Have No Secured Debts.

If you have no secured debts and are filing for bankruptcy under Chapter 7, the Fee includes all of the following services:

1. An initial meeting with you to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
2. Advice to you concerning your obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
3. Preparation and filing of the documents and disclosures required by and performance of the duties imposed by Section 521 of the Bankruptcy Code.
4. Provision of assistance with respect to your compliance with Section 707(b)(4) of the Bankruptcy Code.
6. Attendance at the Section 341(a) meeting.
7. Communication with you after the Section 341(a) meeting.
8. Monitoring the docket for issues related to discharge.
If you have no secured debts and are filing for bankruptcy under Chapter 7, the Fee does not include any of the following services unless the box next to the service is checked. If a box next to a service is checked, that service will be included in the Fee.

- Representation of your interests in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
- Representation of your interests in connection with a challenge to your discharge and/or the dischargeability of certain debts.
- Preparation and filing of all motions required to protect your interests.
- Representation of your interests with respect to defending objections to exemptions.
- Preparation and filing of responses to all motions filed against you.
- Representation of your interests in connection with a motion for relief from stay.
- Representation of your interests in connection with a motion for relief from stay that is resolved by agreement.
- Representation of you in connection with a motion seeking dismissal of the case.
- Other

II. For Chapter 7 Debtors Who Have Secured Debts.

If you have secured debts and are filing for bankruptcy under Chapter 7, the Fee includes all of the following services:

1. An initial meeting with you to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
2. Advice to you concerning your obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
3. Preparation and filing of the documents and disclosures required by and performance of the duties imposed by Section 521 of the Bankruptcy Code.
4. Provision of assistance with respect to your compliance with Section 707(b)(4) of the Bankruptcy Code.
6. Representation of your interests (including counseling) with respect to the reaffirmation, redemption, surrender or retention of consumer goods securing obligations to creditors.
7. Attendance at the Section 341(a) meeting.
8. Communication with you after the Section 341(a) meeting.
9. Monitoring the docket for issues related to discharge.
If you have secured debts and are filing for bankruptcy under Chapter 7, the Fee does not include any of the following services unless the box next to the service is checked. If a box next to a service is checked, that service will be included in the Fee.

- Representation of your interests in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
- Representation of your interests in connection with a challenge to your discharge and/or the dischargeability of certain debts.
- Preparation and filing of all motions required to protect your interests.
- Representation of your interests with respect to defending objections to exemptions.
- Preparation and filing of responses to all motions filed against you.
- Representation of your interests in connection with a motion for relief from stay.
- Representation of your interests in connection with a motion for relief from stay that is resolved by agreement.
- Representation of your interests in connection with a motion seeking dismissal of the case.
- Other

III. The Fee

Because you have agreed to a limited services representation arrangement, I have agreed to a limited fee (the “Fee”). You shall pay for the services described and indicated in Section __ (I or II) above as follows:

- A flat fee of $_____, plus $___ for out of pocket expenses, OR
- An hourly fee. The current hourly fee that I charge is $_____. The current hourly fee that my legal assistant charges is $_____. I expect your case will take about ____ hours. The total Fee you will be charged will be capped at $____, plus $____ for expenses.

In the event that you ask me to provide additional services (in addition to those services set forth in Section ____ (I or II) above) after I have begun representing you, there shall be an additional fee paid to me to be calculated as follows: _______________________

You acknowledge that the fee for additional services (on top of those services set forth in

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43 These expenses may include long-distance telephone and fax costs, photocopy expenses, and postage. Costs such as filing fees, if any, and debtor counseling and debtor education fees shall be paid directly by you.
Section ____ (I or II) above) requested after your bankruptcy petition is filed must be paid from funds that are not part of your bankruptcy estate (such as your post-petition earnings).

You understand that I will exercise my best judgment while performing the limited legal services described in Section ____ (I or II) above, and you also understand:

a. that I am not promising any particular outcome;

b. that you entered into this agreement for limited services because I am charging you a Fee that is less than a fee would be for full-service legal representation in connection with your bankruptcy case;

c. that issues may arise in your case that are not covered by the list of core tasks. If that happens, you have the option of (i) representing yourself with respect to the new issues, (ii) entering into another agreement with me, whereby I will continue to represent you for an additional fee, or (iii) hiring another lawyer to represent you; and

d. that I have no further obligation to you after completing the above-described limited legal services unless and until we enter into another written representation agreement.

Except as required by law, I have not made any independent investigation of the facts and I am relying entirely on your limited disclosure of the facts necessary to provide you with the services described in Section ____ (I or II) above.

If any dispute arises under this agreement concerning the payment of the Fee, we shall submit the dispute for fee arbitration in accordance with [______________]. This arbitration shall be binding upon both parties to this agreement.

YOU ACKNOWLEDGE THAT YOU HAVE READ THE ABOVE AGREEMENT BEFORE SIGNING IT. YOU FURTHER ACKNOWLEDGE THAT I HAVE ANSWERED ANY QUESTIONS YOU HAVE ABOUT THE LIMITED SERVICE REPRESENTATION ARRANGEMENT INTO WHICH WE ARE ABOUT TO ENTER.

Signature of client/s

1.____________________________________________

2.____________________________________________

Signature of attorney ____________________________________________

Date:   ___________________
Competency for Debtors’ Counsel

Introduction

Rule 1.1 of the MODEL RULES OF PROFESSIONAL CONDUCT, adopted by most states and the District of Columbia, sets forth the standard for lawyer competency: “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 5 to MODEL RULE 1.1 states that “[c]ompetent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners.” In addition to the standard set forth in Rule 1.1, most federal courts, including some bankruptcy courts, have adopted a court-specific competency standard. These standards typically include the requirement that lawyers are familiar with the applicable rules of procedure, evidence, and in some cases, substantive law.

The generalized pronouncement that a lawyer must be “competent,” however, does not provide specific needed guidance to lawyers, clients, or judges about what precise skill sets a lawyer must have in order for him or her to provide competent client representation. As such, this Report describes, with some specificity, the substantive information that a bankruptcy lawyer must understand, as well as some of the specific skills that the lawyer must possess, to provide competent representation to a debtor in bankruptcy.

The Bankruptcy Context

Bankruptcy is a complex area of law, practiced in myriad contexts, with very different types of debtors accessing the bankruptcy system. For example, the bankruptcy reorganizations of public companies such as General Motors and American Airlines implicate very different issues and require different sets of skills for debtors’ lawyers than the liquidation of small privately-held business enterprises. Further, the representation of a consumer debtor in a Chapter 13 case requires a body of knowledge and strategy significantly different from that required to represent, for instance, a liquidating nursing home.

Because the context and type of client can be so varied across the spectrum of potential debtors, bankruptcy lawyers typically specialize. They usually restrict their practice to consumer bankruptcy or business bankruptcy cases. Lawyers within the two broadest bankruptcy categories

1 The Reporters would like to thank Task Force members Richard P. Carmody, James H. Cossitt, Steven A. Schwaber, and Andy Vara for their excellent background research that formed the basis of this Report.
2 Model Rule of Professional Conduct R. 1.1.
4 Although it is not unusual for lawyers to represent both consumers and small businesses, including sole proprietors (and in fact, there are lawyers with dual certifications as specialists in business and consumer
may further specialize: some attorneys may primarily represent Chapter 13 debtors, while others may primarily represent debtors who file under Chapter 7; yet others may focus on the representation of sole proprietors and small family businesses or individual Chapter 11 reorganizations. Business bankruptcy lawyers may develop a specialization by the type of debtor, using such categories as market capitalization or industry sector. A lawyer must recognize the extent to which each of these individual types of bankruptcy practices requires different bodies of knowledge and skill sets. As noted below, to the extent that the lawyer’s client or the type of case implicates issues about which the lawyer has little or no knowledge or with which he has little or no experience, the lawyer should either seek to educate himself (time and resources permitting) or seek counsel or assistance from a professional with experience and expertise in the particular issue or matter.5

Although the objective of this Report is to list the core competencies and skills required to represent both consumer and business debtors competently, the Task Force is mindful that many, if not all, of these same competencies and skills are required to represent the other parties in interest in bankruptcy cases. Some of these parties include trustees, examiners, ombudsmen, secured and unsecured creditors, various official and ad hoc committees, indenture trustees, lenders, asset purchasers and brokers, liquidators, landlords, trade suppliers, franchisers and franchisees, licensors and licensees, and equity owners. The representation of these parties will require lawyers to have similarly specialized skills and knowledge, tailored to their clients’ role in the bankruptcy process, in order to provide competent representation to their clients.6

The Task Force’s primary goal is to ensure that debtors receive the competent representation to which they are entitled. Although this Report detailing “best practices” for bankruptcy lawyers is not seeking to restrict entry into bankruptcy practice, the Report recognizes that bankruptcy practice is complex and specialized and demands a substantial investment of time in the form of education and practical experience over a career. There is no lack of reasonably-priced educational resources available to aspiring bankruptcy lawyers. Lawyers for all parties in a bankruptcy proceeding or case also should realize that there are significant risks in providing less bankruptcy law), it is less typical for lawyers to represent consumers and large business debtors in complex reorganizations or liquidations. See Lois R. Lupica, The Consumer Bankruptcy Fee Study: Final Report, 20 AM. BANKR. INST. L. REV. 17, 93 (2012). Even if a lawyer typically represents a particular type of debtor or files most of his or her cases under one chapter or category (e.g., chapter 13 and consumer chapter 7 cases), the competency standard requires that the lawyer be able to recognize a range of bankruptcy-related issues that may arise in individual cases, as well as the circumstances when a client may benefit from relief under another chapter.

5 See MODEL RULE 1.1 cmt. 2 and MODEL RULE 1.2 cmt. 6.

6 The focus of the discussion in this proposal is on counsel for the debtors in consumer and business bankruptcy cases. Similar capacities, skill sets, and competencies are necessary for counsel for other participants in the bankruptcy process (e.g., counsel for creditors, counsel for a standing, panel, or case trustee, and committee counsel), albeit in a somewhat different context. A thorough discussion of specific best practices for counsel for parties other than the debtor in bankruptcy is outside of the scope of this Report. We recognize that competency is not solely an issue with respect to debtors’ counsel, but with the debtor’s fresh start on the line, competent representation through the bankruptcy process is an ‘all or nothing’ event for debtors. For this and a variety of other reasons, including time and resource issues, the Task Force chose to focus on the issue of competency of counsel in this one role. Other ABI working groups may choose to pursue competency issues of counsel serving in other roles.
than competent representation, such as being subject to fee reductions, sanctions, civil liability and, in rare instances, criminal liability.

**Consumer Practice**

Consumer debtors, according to the Bankruptcy Code’s definition, are individuals who have incurred debts primarily for personal, family, or household purposes. The vast majority of consumer bankruptcy filers are represented by counsel. Because there are numerous complex legal and strategic decisions to be made in even the simplest no- or low-asset consumer case, competent counsel serves as a valuable guide through the bankruptcy labyrinth. If a consumer client in financial distress presents a more complicated scenario, such as wanting to retain a home or car by paying the debt over time, then the need for legal advice from a knowledgeable attorney becomes even more compelling. The absence of professional counsel can adversely affect both seemingly simple and complex consumer bankruptcy case outcomes, as well as the long-term value of the remedy of bankruptcy.

A lawyer seeking to represent a consumer debtor must possess certain core competencies and skills. These include an awareness of alternatives to the bankruptcy system, an understanding of bankruptcy as a substantive and procedural remedy, knowledge of the bankruptcy process, the skill to provide counseling to a client in financial and emotional distress, proficiency in the courtroom, the ability to negotiate with multiple parties with adverse interests, the judgment to aid a client to make decisions in his or her best interest, and the diligence to see what can be an arduous process through to its resolution. By agreeing to represent a consumer bankruptcy debtor, a lawyer is certifying that he or she possesses the requisite legal knowledge and skills. Further, the lawyer accepts the trust and reliance of his or her client to provide competent representation in response to the client’s oft-changing needs.

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7 11 U.S.C. § 101(8). Many individual debtors, however, file for bankruptcy seeking to discharge business debts. The debtor typically incurs these business debts in the course of operating a small business.

8 In most jurisdictions, a small percentage of consumers file for bankruptcy pro se. Lupica, supra note 4, at 139. In some jurisdictions, however, the percentage of pro se cases is considerably higher than the national mean. See e.g., In re Castorena, 270 B.R. 504, 524-26 (Bankr. D. Idaho, 2001) (“…fully 90% of the debtors filing in this District [retains] … a licensed lawyer to assist them in successfully navigating the statutory channels of bankruptcy law.”)

9 A recent empirical study of thousands of randomly selected consumer bankruptcy cases found that no pro se Chapter 13 debtors received a discharge. Lupica, supra note 4, at 81.

10 “The counseling of a client in financial matters, particularly about his or her choice of remedies under the Bankruptcy Code or whether a bankruptcy proceeding can be avoided, is a serious matter that deserves the attention of a qualified attorney.” Columbus B. Ass’n v. Flanagan, 77 Ohio St. 3d 381, 383, 674 N.E.2d 681, 683 (Ohio 1997).

11 This section addresses primarily representation of consumers under chapter 13 and chapter 7. Individual Chapter 11 cases are a hybrid between Chapter 11 business reorganization and Chapter 13 cases. If individuals want or need to reorganize their finances, and they exceed Chapter 13 debt limits, Chapter 11 offers an option. The process of representing an individual under Chapter 11 is considerably different than representing a debtor under Chapter 7 or 13, but there are similarities in the general skills required of an attorney.
The core capacities and skills possessed by a competent lawyer representing consumer bankruptcy debtors include, but are not limited to, the following:

1. **A lawyer should understand and be able to communicate to his or her client the advantages and disadvantages of bankruptcy as a debt relief remedy.**

   **Comment:** At the first client meeting, prior to any bankruptcy filing, the lawyer should be able to evaluate whether bankruptcy is the appropriate remedy for the particular consumer’s problems. As a “debt relief agency” under the Bankruptcy Code, the lawyer must be able to assess the particular facts and circumstances presented by the client in order to weigh them against the advantages and disadvantages of filing a bankruptcy case. If the lawyer and client conclude that bankruptcy is an appropriate remedy, the lawyer’s next concern is the appropriate chapter under which to file and the proper timing for filing. The timing consideration requires the lawyer to understand the consequences of a decision to file now in order to address exigent issues (such as a pending foreclosure sale or an eviction proceeding), or to wait in order to engage in acceptable pre-bankruptcy planning.

   Pre-bankruptcy planning requires the identification of applicable and available exemptions, a discussion of tax liabilities, and the identification of any pre-petition financial transactions, to name a few. A review of the consumer’s eligibility for relief under each chapter includes a consideration of any prior cases filed, the constraint imposed by statutory debt limits, and the balance between the debtor’s consumer and non-consumer debts, as well as an appraisal of the benefits, burdens, and intended and unintended consequences offered by each chapter.

2. **A lawyer should be familiar with the information necessary to prepare a bankruptcy case.**

   In addition, the lawyer must have developed efficient and effective systems and procedures to obtain from the client the information and documentation required by the Bankruptcy Code.

   **Comment:** Before a bankruptcy case is filed, a lawyer representing a consumer debtor must recognize the need to assemble and evaluate accurate and complete information and documentation from his or her client. This information and documentation should include copies of (a) pay advices; (b) tax returns; (c) bank statements; (d) inventories of all property owned by the debtor; (e) itemizations of all debts owed by the client, with appropriate back-up documentation; (f) itemizations of real estate owned and mortgages obligated on with appropriate back-up documentation; (g) financial statements and other financial information necessary to complete.

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13 See 11 U.S.C. § 101 (12A) (“The term ‘debt relief agency’ means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include [certain exceptions]”). Under 11 U.S.C. § 101(5), (“[t]he term ‘assisted person’ means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000.”).
required schedules; (h) itemizations of all expenses in appropriate detail; and (i) a credit report. This list is not exhaustive, and the lawyer should be mindful of any additional information necessitated by the facts of a particular case.

In addition, the lawyer must be aware of the dictates and prohibitions set forth in the governing state rules of professional conduct on criminal or fraudulent behavior, including engaging in criminal, fraudulent, or prohibited transactions. The lawyer must further be familiar with the evolving case law relating to pre-bankruptcy and exemption planning, including the line between permissible and impermissible conduct. It is the responsibility of the lawyer to apply the relevant rules to his or her client’s goals and advise the client as to whether the proposed conduct is clearly proper, clearly improper, or falls within the gray area between the two ends of the spectrum. If the proposed conduct falls in the gray area, the lawyer must provide appropriate guidance and an informed opinion sufficient to allow the client to make an informed decision. The lawyer must make reasonable inquiry to ensure information supplied by the consumer debtor is accurate and complete. The scope of the reasonable inquiry to be performed by debtor’s counsel may vary depending upon the type of client, the size of the case and the scope of the issues presented.

3. A lawyer should be aware of the Bankruptcy Code provisions mandating certain disclosures by the lawyer. A lawyer should also know what types of information he or she is required to communicate to consumer debtor clients.

Comment: The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) requires attorneys to make certain disclosures and provide specific information to their consumer debtor clients. A lawyer should know that each of the following should be provided to his or her client: (i) a form notice under 11 U.S.C. § 342(b) and § 527(a)(2) describing bankruptcy’s requirements and consequences, (ii) general information about legal services and rights of an assisted person, (iii) a form notice setting forth general information on how to arrive at certain values and information mandated by the official schedules, statements and forms, and (iv) a fully executed written contract (a retention letter) that identifies the services to be provided and the fees or charges for such services.

14 MODEL RULES OF PROFESSIONAL CONDUCT R. 1.2(d) prohibits a lawyer from “counseling a client to engage, or assist a client in conduct that the lawyer knows is criminal or fraudulent . . . .” Official Comments 9, 10, and 12 offer lawyers further guidance.


In addition, the lawyer should facilitate the client’s enrollment in the credit counseling course required of all consumer debtors as a predicate to filing a petition.\footnote{The debtor in a Chapter 7 “asset” case was deemed to have satisfied the Bankruptcy Code’s credit counseling requirement without filing his credit counseling certificate; debtor had stated under oath that he had completed the credit counseling required by the BAPCPA and would file his credit counseling certificate, debtor later failed to file the certificate. When debtor later failed to file the certificate and to appear at the first meeting of creditors, the debtor was found to be judicially estopped from denying that he completed the requisite credit counseling. Robin Miller, \textit{Validity, Construction, and Application of Credit Counseling Requirement Under Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)}, 11 U.S.C.A. § 109(h), 11 A.L.R. Fed. 2d 43 (originally published in 2006); see also Lindsay Sherp, \textit{To Strike or To Dismiss, That Is the Question: How Courts Should Dispose of Bankruptcy Cases Filed by Debtors Who Failed to Obtain Credit Counseling}, 60 \textit{BAYLOR L. REV.} 317, 320 (2008) (“By requiring individual debtors to undergo credit counseling before filing for bankruptcy, Congress ‘intended to give consumers in financial distress an opportunity to learn about the consequences of bankruptcy—such as the potentially devastating effect it can have on their credit rating—before they decide to file for bankruptcy relief.’ In other words, Congress has determined that bankruptcy should be a last resort instead of ‘the first place where an individual consumer debtor turns for help.’”).}

4. A lawyer should know how to efficiently and effectively prepare and file a bankruptcy petition and the related schedules, statements and other necessary documents.

\textbf{Comment:} Once a lawyer has conducted his or her initial client counseling, gathered the necessary information and documentation, made the required disclosures, and provided advice with respect to the appropriate case, the lawyer must then prepare the necessary petition, schedules, statements, and forms. Preparation of these documents requires the lawyer to know how to analyze the available and applicable exemptions, determine the appropriate treatment of collateralized debts, (\textit{e.g.}, surrender, redemption, reaffirmation, or retention), evaluate priority debts and administrative claims, and assess the debtor’s ability to repay creditors from income or assets. If the debtor is filing a case under Chapter 13, the lawyer must also prepare the Chapter 13 plan.\footnote{If the debtor is not eligible for chapter 7 and has debts that exceed the chapter 13 debt limits, an individual chapter 11 case may be appropriate. In such instance, the lawyer for the debtor must be aware of the host of specific issues that arise in such cases. \textit{See, e.g.}, Eduardo V. Rodriguez, \textit{Bankruptcy and Individual Chapter 11s: The Newest Battleground for the Absolute Priority Rule}, 60-FEB Fed. Law. 49 (Jan./Feb. 2013); Hon. Alan R. Jaroslovsky, United States Bankruptcy Court for the Northern District of California, Notice to Bar Regarding \textit{Individual Chapter 11 Cases}, www.canb.uscourts.gov/.../notice%20re%20chapter%2011.pdf (“A Chapter 11 is not just a big Chapter 13.”).}

As noted above, the lawyer must make reasonable inquiry to ensure information supplied by the consumer debtor is accurate and complete and must conduct an inquiry sufficient to satisfy his or her obligation to sign the petition pursuant to Section 707(b)(4)(D) of the Bankruptcy Code.\footnote{In addition, an attorney is subject to Federal Rule of Bankruptcy Procedure 9011, which requires that an attorney represent to a court that the document being filed is not being presented for an improper purpose, that the claims and defenses are warranted by existing law, and that the factual contentions and denials contained in the filings have evidentiary support.} As recently observed, “[w]here a lawyer systematically fails to take any responsibility for seeking adequate information from her client, makes representations without any factual basis because they are included in a “form pleading” she has been trained to fill out, and ignores obvious indications...
that her information may be incorrect, she cannot be said to have made reasonable inquiry.” A lawyer must also be familiar with the privacy protections afforded debtors pursuant to Federal Rule of Bankruptcy Procedure 9037. These protections include filings with redacted information and filings made under seal. A lawyer should understand the circumstances under which it is advisable for a client to take advantage of the privacy protections afforded by this Rule (including, for example, where a debtor has been subject to domestic violence, or where a minor is listed).

In addition, a lawyer must be familiar with the Electronic Case Filing (“ECF”) system, and have hardware, software, and operating systems that allow for efficient access to the ECF system. In addition, consistent with the ABA amendment to Comment 6 to Model Rule of Professional Conduct R. 1.1, a lawyer must “keep abreast of changes in the law and its practice, including the benefits and risk associated with relevant technology… .” The recent ABA Commission on Ethics 20/20 further recognized and detailed the responsibility of lawyers with respect to technological advances and issues relating to communication and confidentiality. The responsibility to acquire and maintain appropriate technological competency is relevant to lawyers practicing bankruptcy law.

Because of the nature of consumer bankruptcy practices, lawyers often use subordinate lawyers and non-lawyer assistants to perform routine case-related services. Typically, in high-volume consumer bankruptcy practices, non-lawyer assistants are integral to a law firm’s efficient functioning. In such cases, the senior lawyer must recognize the high level of responsibility he or she has for thoroughly training and properly supervising such subordinate lawyers and non-lawyer assistants. Attention to detail is imperative in connection with debtor representation in consumer bankruptcy cases, and a lawyer’s effort to keep legal fees in individual cases low by engaging in a high volume practice does not diminish a lawyer’s professional responsibility to his or her client.

20 In re Taylor, 655 F. 3d 274, 286 (3d Cir. 2011). Although this case involved the behavior of creditor’s counsel, the court was clear to observe that all attorneys in a bankruptcy case have a duty to review information provided by clients and evaluate its reasonability. Moreover, once additional information brings its reasonableness into question, attorneys has an affirmative duty to determine which facts can be reasonably supported.

21 For a cautionary tale about the misuse of the ECF system, see In re Smith, 462 B.R. 783 (Bankr. D. Nev. 2011) (misuse of ECF credentials).

22 American Bar Association, Commission on Ethics 20/20, Resolution adopted August 2012.

23 Id.

24 See In re Taylor, 655 F.3d 274 (3d. Cir. 2011). (“This case is an unfortunate example of the ways in which overreliance on computerized processes in a high-volume practice, as well as a failure on the part of clients and lawyers alike to take responsibility for accurate knowledge of a case, can lead to attorney misconduct before a court.”) Id. at 277.

25 See Model Rule of Professional Conduct R. 5.1 (Responsibilities of a Partner or Supervisory Lawyer).
5. A lawyer should understand the consumer bankruptcy case process and system and have the skills to represent the debtor's interests diligently in connection with the case proceedings, keep his or her client informed, provide ongoing advice and responses to the debtor's inquiries, and be responsive to inquiries and requests made by the court and by other professionals in the case.\(^{26}\)

**Comment:** The lawyer must be familiar with both the relevant facts of his or her client's case as well as with the applicable law. Typically, debtor representation requires a working knowledge of the Bankruptcy Code and the relevant parts of the U.S. Code addressing bankruptcy jurisdiction (Title 28) and bankruptcy crimes (Title 18); the jurisdiction's Local Rules; practice customs in the relevant jurisdiction;\(^{27}\) the Federal Rules of Bankruptcy Procedure; the Federal Rules of Evidence; state law property rules, such as Article 9 of the U.C.C. and the law regarding real property title and transfer; and state law governing domestic relations. To the extent an issue or matter arises that is outside of the bankruptcy lawyer's area of expertise (e.g., a tax or ERISA matter, or a domestic relations issue), the lawyer must seek counsel from another professional with expertise in that area.\(^{28}\)

After the bankruptcy petition is filed, the case trustee sets a date for the Section 341 meeting of creditors. The lawyer should explain the process of that meeting to his or her client in order to raise issues in defense of the debtor's interests and to answer questions as they arise. Counseling at this stage in the process includes advice to debtors on the consequences of the incurring of post-petition debt.

In addition, a lawyer should be able to represent his or her client's interest in all proceedings before the bankruptcy court that are within the scope of his or her representation of the client. When appropriate in a particular case, a lawyer should have the knowledge and skills to (i) investigate and defend any avoidance actions initiated by the case trustee against the debtor, (ii) facilitate the turnover of property and documents upon the request of the trustee, (iii) appear at and represent a client's interest during a Rule 2004 examination, (iv) take steps necessary to enforce the automatic stay, including providing advice to debtors on actions for relief from stay, and (v) review reaffirmation requests and provide counsel and advice as to their advisability. A lawyer must also understand and be able to advise debtors on the extent and limits of the bankruptcy discharge, represent the debtor's interest in response to any objections contesting the discharge or the dischargeability of a particular debt, and provide counsel in the event of a violation of the discharge injunction.\(^{29}\) Prior to discharge, the lawyer should facilitate the client's enrollment in the Personal Financial Management course required of all consumer debtors. Throughout the case, the lawyer should respond to calls and requests for information about the case from his or her client, from

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\(^{27}\) If a lawyer practices in a district in which more than one judge sits, a lawyer is well advised to become familiar with each judge’s specific style and temperament, as well as the particular requirements each judge imposes upon counsel.

\(^{28}\) See MODEL RULE R. 1.1 cmt. 2 and MODEL RULE 1.2 cmt. 6.

\(^{29}\) See 18 U.S.C. §§ 152-156.
other professionals in the case, including bankruptcy trustees and the United States Trustee’s Office, and respond to any and all requests made by the court.30

Business Practice

As is true with representing consumers in bankruptcy, lawyers for business debtors must also possess certain core competencies and skills.31 Though, on the surface, there is considerable overlap in the skills needed to represent debtors in consumer and business cases, the context in which these competencies are required and are applied can be quite different. In both types of cases, a lawyer must have an awareness of alternatives to the bankruptcy system, an understanding of bankruptcy as a substantive and procedural remedy, knowledge of the bankruptcy process, the skills to provide advice to clients in financial distress, the ability to negotiate with multiple parties with adverse interests, the organizational skills to manage an administratively complex process, the judgment to aid a client to make decisions in his best interest, and the diligence to see what can be an arduous process through to its resolution.

In addition, by agreeing to represent a business bankruptcy debtor, a lawyer is representing that he or she possesses the requisite legal knowledge and skills required to navigate a business client through a reorganization or liquidation proceeding.32 In many cases, this includes a working knowledge of finance, accounting, and asset valuation procedures. Moreover, in some types of cases, a lawyer is also representing that he or she is familiar with (or will become familiar with) the rules and practices that uniquely apply to a debtor’s particular industry, market niche, or type of case (e.g., a health care industry debtor, a single-asset real estate case, or an oil and gas producer debtor). To the extent that a lawyer is not competent to provide advice and counsel with respect to an issue in connection with a business bankruptcy case (e.g., a tax matter, a stockbroker debtor, a Chapter 15 debtor’s case), the lawyer must seek counsel and advice from another professional with expertise in that area.33

By agreeing to represent a business in connection with its bankruptcy case, the lawyer is safeguarding the trust and reliance of his or her client to provide competent representation in response to the client’s oft-changing needs. The core capacities and skills possessed by a competent lawyer representing business bankruptcy clients include, but are not limited to, the following:

30 “[W]hen a person hires an attorney, he or she is entitled to a certain level of professional services and those services are to be rendered in a competent manner. An attorney should regularly communicate with his clients to insure that the clients understand the impact and scope of their case and the consequences of certain actions that may be taken in the case.” In re Sledge, 352 B.R. 742, 748 (Bankr. E.D. N.C. 2006).
31 As noted above, a lawyer representing an individual in a chapter 11 cases must have knowledge of the issues need to represent debtors under both chapter 13 and chapter 11. Competent representation in an individual chapter 11 case also requires an understanding of the issues that are uniquely implicated in these cases. See Sally S. Neely, How BAPCPA Changed Chapter 11 for Individuals, or No, This is Not Your Mother’s Chapter 11 (2012).
32 See MODEL RULE R. 1.1 cmt. 2 and MODEL RULE 1.2 cmt. 6.
33 Alternatively, the lawyer can ask the client to authorize the lawyer to affiliate with another professional with the needed expertise. At the outset of an engagement, the lawyer should describe in the engagement letter the protocol to be used if it is discovered that the representation involves an issue that is outside of the lawyer’s expertise. See MODEL RULE 1.1 cmt 2 and MODEL RULE 1.2 cmt. 6.
1. A lawyer must have the knowledge and skill to provide pre-petition operational and exit strategy counseling and information to a client or prospective client in financial distress.

**Comment:** Competent handling of a business bankruptcy case begins with one or more pre-petition strategy and information sessions with a bankruptcy client (or prospective bankruptcy client). A lawyer must have the depth of knowledge and experience to offer operational strategies and a sound exit plan. The lawyer should explain the myriad options and remedies available, including non-bankruptcy remedies. This discussion typically involves disclosures by the client or prospective client of financial, management and market information. The lawyer must have the skills to understand the company information, including the financial information, in order to provide useful advice as to the possible courses of action, and each course’s potential consequences.

A lawyer must also make clear to the principals contemplating bankruptcy early on that the lawyer will be engaged by and will represent the debtor-in-possession and not any individual members of management. The lawyer should describe the fiduciary duties of the DIP, provide examples of how the interests of the principals and the DIP may diverge, and explain what the lawyer’s professional responsibilities are in such situations. Finally, the lawyer should advise the principals that it might be in their best interest to engage their own counsel. The lawyer must recognize the need for a written retention letter, setting forth the scope of the representation and executed by both parties. In addition, the lawyer must be familiar with the required procedures for the retention of professionals under the Bankruptcy Code.

The lawyer must also have the requisite knowledge and skills to negotiate with some or all the client’s creditors at this stage in an effort to either avert a bankruptcy filing or, in certain circumstances, to evaluate if a pre-packaged or pre-negotiated bankruptcy is feasible and advisable. In addition, the lawyer should be aware of, and communicate to his or her client, the advantages and disadvantages of: (i) liquidation, (ii) reorganization through a plan, (iii) the sale of assets under § 363 of the Bankruptcy Code, or (iv) an asset sale pursuant to a plan.

2. A lawyer should understand and be able to explain the myriad legal and business issues implicated by the prospect of a client’s business bankruptcy filing. A lawyer should also be aware of the pre-petition steps required to be taken to prepare a case for filing. In addition to this substantive knowledge, a lawyer should have systems and procedures to execute the case filing efficiently and effectively.

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35 This of course assumes that this is the case. In the event it is not clear who the client will be prior to the lawyer’s engagement, the lawyer should be mindful of any communication that may implicate issues relating to attorney-client privilege, conflicts of interest and Model Rule 1.18 governing communications with prospective clients.

36 See ABI Task Force on National Ethics Standards Report on Duties of Counsel for a DIP as Fiduciary and Responsibilities to the Estate (April 2013).
Comment: The lawyer must have the knowledge and skills to understand and explain the issues of chapter choice and its consequences, as well as the matter of the appropriate venue and the proper timing of the filing. Chapter choice requires an assessment of the client’s objectives, its eligibility under each chapter, whether reorganization is desirable and feasible, and whether, if liquidation is the course of action, the case should be filed under Chapter 7, 11, 9, 12, or 15.

In addition, if the substantive and/or procedural bankruptcy law differs in the courts or jurisdictions in which a case may potentially be filed, the lawyer should be aware of these differences and make a determination, in consultation with his or her client, as to which courts or jurisdiction’s laws are more in accord with his or her client’s interests. Further, the lawyer should have the knowledge and skills to prepare a substantive analysis of the case, based on the available venue options, and taking into consideration the differences, if any, in applicable non-bankruptcy law.

The lawyer should understand the pre-bankruptcy planning steps that may need to be taken, including the identification of pre-petition financial transactions (which in turn affects the timing of the filing), a review of the firm’s capital structure, and an assessment of the business’s assets and liabilities. The lawyer should also be aware of the need for, and consult with his or her client about, the engagement of a claims and noticing agent, as well as the engagement of other professionals, including financial advisors and accountants. The lawyer should understand the structure of his or her entity client and obtain proper authorization to file the bankruptcy case from the appropriate client body (e.g., a corporation client’s board of directors).

Moreover, the lawyer should be aware of and analyze how numerous issues may affect or be affected by the filing of the bankruptcy case. This non-exhaustive list includes:

- The necessity and availability of cash collateral;
- The necessity and availability of post-petition financing;
- The necessity and feasibility of hiring non-lawyer professionals, including financial advisors and accountants;
- The debtor’s executory contracts and unexpired leases and their proposed treatment under § 365; and
- Potential avoidance actions and the likelihood, costs and benefits of their being brought.

The number and types of issues to be considered pre-filing will vary from case to case.

In addition, the lawyer must be aware of the nature and type of information and documentation necessary to be collected prior to preparing a case for filing. This information and documentation may include (depending upon the chapter selected) (a) financial statements; (b) insurance policies; (c) tax returns; (d) bank statements; (e) an inventory of all property owned by the debtor, with appropriate documentation; (f) an itemization of all debts owed by the client, with appropriate documentation; (g) real estate and mortgage information; (h) other descriptive information necessary to complete required schedules, plan and disclosure statement; and (i) Potential avoidance actions and the likelihood, costs and benefits of their being brought.

37 A lawyer should be aware that the timing of the case must be in the best interest of the debtor and not in the best interest of the principals or other insiders. See Wallach v. Bucheit (In re Northstar Dev. Corp.), 465 B.R. 6 (Bankr. W.D.N.Y. 2012).
identification of all going-forward expenses with appropriate detail. The lawyer must make reasonable inquiries to ensure information supplied by his or her client is accurate and complete. In the event that the lawyer recognizes an irregularity or other “red flag,” he or she should be aware of the necessity of bringing the matter to the attention of his or her client, or taking other appropriate steps.  

Finally, the lawyer must have developed administrative systems to keep the client’s information organized and accessible throughout the case. In addition, the lawyer must confirm that the client has the administrative and substantive capacity to prepare periodic financial reports, pay all interim expenses, including attorney’s fees, and perform all other necessary administrative duties.

3. A lawyer should know how to prepare and file a bankruptcy petition and the related schedules and statements efficiently and effectively.

Comment: Once the initial client counseling has been conducted, information and documentation gathered, and disclosures made, the lawyer must then prepare the necessary petition, schedules, statements, and forms. The lawyer must have the knowledge and skills to prepare the filing and its related schedules and statements and to conduct a reasonable inquiry into the validity and accuracy of the financial information on the Schedules and Statement of Financial Affairs provided by the client. The lawyer must understand the consequences of the timing of the case filing.

The lawyer must also be familiar with the Electronic Case Filing (“ECF”) system and have hardware, software and operating systems that allow for efficient access to the ECF system. Furthermore, a lawyer must “keep abreast of changes in the law and its practice, including the benefits and risk associated with relevant technology.” The recent ABA Commission on Ethics 20/20 further recognized and detailed the responsibility of lawyers with respect to technological advances and issues relating to communication and confidentiality. The responsibility to acquire and maintain appropriate technological competency is relevant to lawyers practicing business bankruptcy law. In addition, if a lawyer is aided in his or her practice by subordinate lawyers and non-lawyer assistants, the senior lawyer is responsible for thoroughly training and properly supervising such subordinate lawyers and/or non-lawyer assistants.

39 For a discussion of the ramifications of abusing ECF credentials, see note 21 supra.
40 American Bar Association, Commission on Ethics 20/20, Resolution Adopted August 2012. For information on the Ethics 20/20 revisions involving technology, see http://www.americanbar.org/groups/professional_responsibility/aba_commission_on_ethics_20_20/house_of_delegates_filings.html.
41 See American Bar Association, Commission on Ethics 20/20, Resolution Adopted August 2012.
42 See Model Rule of Professional Conduct R. 5.1 (Responsibilities of a Partner or Supervisory Lawyer).
4. Lawyers must be aware of and comply with the provisions of the Bankruptcy Code and related rules relevant during the immediate post-filing time period. A lawyer should have the knowledge and skills to argue first-day motions and otherwise take steps to address the substantive and procedural issues that arise at the beginning of a case.

**Comment:** The business bankruptcy lawyer must be familiar with both the relevant facts of his or her client’s case as well as with the applicable law. Typically, debtor representation requires a working knowledge of the Bankruptcy Code and the relevant parts of the U.S. Code addressing bankruptcy jurisdiction (Title 28) and bankruptcy crimes (Title 18); the jurisdiction’s Local Rules; practice customs in the relevant jurisdiction; the Federal Rules of Bankruptcy Procedure; the Federal Rules of Evidence; state law property rules, such as Article 9 of the U.C.C. and the law regarding real property title and transfer; and state law governing domestic relations. To the extent an issue or matter arises that is outside of the bankruptcy lawyer’s area of expertise or implicates issues that are less commonly encountered, (such as stockbroker debtors, railroads, health care facilities, Chapter 15 cases, Chapter 12 cases, tax and ERISA matters, to name a few), the lawyer should gain an understanding of the relevant issues, or seek counsel from a professional with experience and expertise in the issue or matter.

In addition to being a skilled advisor, negotiator and drafter, in many cases lawyers for debtors in possession must also have the ability to advocate for their clients in bankruptcy court. In a Chapter 11 case, the lawyer typically addresses his or her client’s exigent issues by arguing “first-day motions.” By way of illustration, these motions may include:

- A motion to employ counsel and other professionals (this process involves the disclosure of connections, as set forth in Rule 2014);
- A motion to extend time to file schedules and statements;
- A motion to retain “ordinary course professionals”;
- A motion to authorize procedures for notice;
- A motion to approve investment guidelines;
- A motion to apply cash management procedures;
- A motion to obtain post-petition financing;
- A motion to establish interim professional fees procedures;
- A motion to use cash collateral;
- A motion to pay pre-petition employee wages; and
- A motion to honor pre-petition obligations to vendors and taxing authorities.

A lawyer must be aware of and communicate the numerous issues necessary to be addressed on an exigent basis in each individual case and have the skill to argue in support of his or her client’s interests. Moreover, the lawyer must be aware of and comply with the applicable operational provisions in the Bankruptcy Code and related Rules, such as certain required notices, disclosures,

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43 If a lawyer practices in a district in which more than one judge sits, a lawyer is well advised to become familiar with each judge’s specific style and temperament, as well as the particular requirements each judge imposes upon counsel.

44 American Bankruptcy Institute, *FIRST DAY MOTIONS* (2010).
and filings. These include the noticing rules for motions that must be sent to appropriate parties. The applicability of many of these requirements turns on the nature, size, and type of business case.

In addition, a lawyer for a business DIP must have the knowledge and skills to:

- Facilitate the turnover of property and documents upon request of parties in interest;
- Take steps necessary to enforce the automatic stay, including providing advice to the client on actions for relief from stay;
- Represent his or her client’s interests in connection with objections to claims;
- Represent the debtor in possession at the Section 341 meeting; and
- Appear and represent his or her client’s interests at Rule 2004 examinations.

A lawyer must provide continuing disclosures to the court, as necessary (e.g., Rule 2014 disclosures).\textsuperscript{45} A lawyer must also respond to calls and requests from his or her client, the court, and creditors and other parties in interest, including bankruptcy trustees and the United States Trustee.

5. The lawyer representing a reorganizing DIP must have the knowledge and skills to draft an effective and confirmable plan of reorganization and disclosure statement in compliance with the relevant Bankruptcy Code provisions.

Comment: If a plan is to be drafted, it must satisfy the requirements of Chapter 11 and, more specifically, the plan confirmation requirements of Section 1129(a). This requires the lawyer’s familiarity with the nuances for structuring a plan, including the classification of claims, and the satisfaction of the “best interests” test (which in turn requires a liquidation and feasibility analysis). The lawyer must further understand the various methods used to value assets, and be able to assess any such valuations. In addition, the lawyer for the DIP must be familiar with bankruptcy procedure, including the timing of key events in the case, such as the exclusivity period, the deadline for filing a disclosure statement and plan, the timing of vote solicitation, and the confirmation hearing.

The lawyer must also have the knowledge and skills to draft a disclosure statement, which must include thorough and complete information about the proposed plan and its consequences. A lawyer must understand the required standards for disclosure in order to solicit plan votes effectively. In the case of a publicly held DIP, the lawyer should also follow the applicable securities laws.

6. A lawyer should have the substantive and procedural knowledge and skills to manage the bankruptcy case and to effectively represent his or her client in all case proceedings.

Comment: The business bankruptcy lawyer must be aware of the range of matters that may need to be addressed throughout the pendency of the case and must possess the skills and experience to address them. An illustrative list includes:

- The consideration of whether to accept or reject executory contracts and the relevant rules with respect to the timing of such actions;

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• Ongoing assessments of cash collateral availability and need;
• Ongoing assessments of post-petition financing availability and need;
• The providing of advice concerning retaining non-lawyer professionals;
• The pursuit of any avoidance actions determined to be in the client’s interest; and
• The monitoring of the DIP’s ongoing financial performance.

7. A lawyer must be aware of the need to offer his or her client ongoing advice and provide the court with relevant disclosures throughout the duration of the bankruptcy case.

Comment: During the pendency of the case, the lawyer should continue to confer with and respond to inquiries from his or her client and provide proactive assistance with respect to the DIP’s fulfillment of its fiduciary duties to the estate. In addition, a lawyer must be aware of his or her duty to comply proactively with any reporting requirements imposed by the court and by the Office of the United States Trustee.

8. The lawyer should have knowledge and understanding of the process of getting retained by the client, as well as the procedures required to be followed in order to receive professional fees. In addition, the lawyer must ensure that other professionals in the case understand the retention and payment requirements imposed by the Bankruptcy Code.

Comment: As an estate professional, the lawyer for the DIP must understand the process of retention, how time is to be billed, and the procedure necessary to be followed in order to have fees approved by the court. This includes the proper structure and use of pre-petition retainers and payments of pre-petition fees (or waiver of claims for such fees) to preserve continued employability and disinterestedness. In addition, a DIP’s lawyer must ensure that any non-bankruptcy professionals, such as securities or corporate counsel, financial advisors, accountants and real estate agents, and fellow professionals within the lawyer’s own firm understand the particulars of the bankruptcy retention and fee application process.

9. A lawyer must have the knowledge and skill to provide his or her client with advice concerning plan confirmation and the post-confirmation injunction.

Comment: A lawyer must understand and advise debtors on the extent and limits of the bankruptcy discharge and represent the debtor’s interest in response to any objections contesting the discharge.46 In addition, the lawyer must counsel the debtor about the scope of, and if necessary, respond to actions in violation of the post-confirmation injunction.

Maintaining Competence

As Comment 6 to ABA Model Rule 1.1 observes, “[t]o maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risk associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject.”

- In the field of bankruptcy, lawyers must be aware of new developments in both statutory and case law. Lawyers should remain cognizant of any changes to the Official Forms and be aware of changes to federal and local rules of procedure and evidence. Lawyers should also be familiar with changes and developments in relevant technology.47

- A lawyer representing debtors in both consumer and business cases should adhere to the requirements for admission and continued practice established by local bankruptcy courts.

- A lawyer representing consumer debtors, business debtors, or DIPs should participate in relevant continuing education courses.

- A lawyer desiring to begin a practice representing consumer debtors should participate in education courses, mentoring, and/or individual instruction prior to preparing cases for filing.

- A lawyer desiring to begin practice representing business debtors should similarly participate in education courses and, preferably, gain experience working under the supervision of more experienced attorneys.

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47 American Bar Association, COMMISSION ON ETHICS 20/20, Resolution adopted August 2012.
Proposed Rule

PROPOSED BANKRUPTCY RULE [ADMINISTRATIVE ORDER]
GOVERNING THE ADMISSION AND PRACTICE
OF PRIMARY ATTORNEYS IN BANKRUPTCY
COURT PROCEEDINGS

1.1 An attorney is qualified for admission to and practice in this Court as primary bankruptcy attorney for a party in interest if the attorney:
(a) is currently a member in good standing of the State Bar of _____________ and the Bar of the United States District Court for the _________ District of _________; and
(b) certifies that he/she has, and will maintain, a working knowledge of this Court’s local rules and administrative orders, the relevant provisions of Title 28 (bankruptcy jurisdiction), the Bankruptcy Code, all of the applicable federal rules of procedure and evidence, Title 18 (bankruptcy crimes), and the Rules of Professional Conduct of the State Bar and any other state bar of which the attorney is a member, and will reasonably supervise the work of others working for with him/her in the representation.

1.2 By appearing in matters before this Court, a primary bankruptcy attorney is continually certifying that, during the past two years, he/she has completed at least ten hours of continuing legal education in the areas of Federal Bankruptcy Law and relevant federal and state law and at least two hours of continuing legal education in bankruptcy-related ethics or has associated with an attorney who makes such a certification.

1.3 In order to represent debtors in bankruptcy cases, the attorney’s working knowledge should demonstrate competence requisite to the nature of the case being filed. It may be necessary for an attorney to associate with an attorney who has demonstrated such appropriate working knowledge.

1.4 This rule is not intended to preclude an attorney who is not qualified as a primary bankruptcy attorney from giving emergency representation to a party in interest as long as such representation is limited to that which is reasonably necessary under the circumstances.

1.5 Attorneys residing in other jurisdictions who do not meet the requirements of 1.1(a) may be admitted pro hac vice pursuant to Local Rule/Order _____.

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Report on Best Practices for Creditors’ Committee Solicitation

Introduction: The Problem of Improper Solicitation

Pursuant to § 1102 of the Bankruptcy Code, in a Chapter 11 case, the United States Trustee is empowered to appoint an official committee of unsecured creditors. Creditors’ committees serve a very real and significant purpose in Chapter 11 bankruptcy reorganizations. They represent and protect the interests of unsecured creditors throughout the entire bankruptcy case and have a right to be heard on any issue that arises. Creditors’ committees protect their constituents’ interests by monitoring the case’s progress and keeping abreast of important developments. They are also empowered to evaluate the case’s viability, as well as the feasibility of any proposed plan. In short, creditors’ committees are the watchdogs of the interests of unsecured creditors in the reorganization.

The important role of the creditors’ committee is facilitated by a committee’s employment of various professionals to help it fulfill its fiduciary duties to the unsecured creditors. Those professionals can include lawyers and non-lawyers. Pursuant to § 1103(a) of the Bankruptcy Code and Bankruptcy Rule 2014, the bankruptcy court must first approve their employment applications. If the committee chooses to employ counsel, the Bankruptcy Code provides that counsel be selected at or after a scheduled meeting attended by a majority of the committee members or at any time after the committee is formed.

Obtaining employment for committee work necessarily requires that a committee be aware of a professional’s skills and experience and the degree to which that professional may satisfy the committee’s professional needs. Some committee members are repeat players across a variety of

1 The Reporters are particularly grateful to Susan Freeman, Ted Gavin, Richard Meth, Michael P. Richman, and Andy Vara for their significant contributions to this Report.
2 11 U.S.C. § 1102 by the use of its word “shall” mandates that the Office of the United States Trustee appoint a committee of unsecured creditors when sufficient creditor interest is shown. See 7 Collier on Bankruptcy (16th rev. ed.), ¶ 1102.02[1] at 1102.6.
3 11 U.S.C. § 1109(b).
4 11 U.S.C. § 1103(c) defines the duties of the committee. See also H.R. Rep. No. 595, 95th Cong., 1st Sess. 235, 401 (1978) (creditors’ committees will be the “primary negotiating bodies for the formulation of a plan of reorganization,” will represent the class of creditors from which selected, will provide “supervision of the debtor in possession and of the trustee, and will protect their constituents’ interests.”); see also In re Arkansas Company, Inc. 798 F.2d 645, 649 (3rd Cir. 1986). See generally Greg M. Zipes & Lisa L. Lambert, Creditors’ Committee Formation Dynamics: Issues in the Real World, 77 Am. Bankr. L. J. 229 (2003). See also In re Caldor, Inc. NY, 193 B.R. 165, 169-70 (Bankr. S.D.N.Y. 1996) (“A creditors’ committee stands as a fiduciary to the class of creditors it represents. Its principal function “is to advise the creditors of their rights and the proper course of action in the bankruptcy proceedings.”
5 Although this Report deals with the issue of creditors’ committee solicitation, many of its observations would apply equally to ad hoc committees and equity committees.
7 Id.; 11 U.S.C. §§ 1103(a) and 328(a)
8 Id. at § 1103(a).
bankruptcy cases, and thus, may have existing relationships and experience with certain attorney and non-attorney bankruptcy professionals. Other committee members, however, are first-time participants in the bankruptcy process and may not know professionals with the skills to counsel and advise them. Both single-case and repeat player committee members may lack familiarity with many bankruptcy professionals who might seek employment by a committee in a new bankruptcy case.

This variation in committee member experience raises the question of how a committee can find appropriate professional representation. Committees need a procedure to identify and consider qualified firms to represent them. Likewise, attorneys desiring to undertake such representation need to be able to inform committee members of their expertise and availability. Given the importance of providing committee input on actions taken and decisions made early in the case, committee counsel is often chosen at the initial committee meeting. Thus, the choice of committee counsel is often made almost immediately after committee members, themselves, are selected. If committee members are to make reasoned choices among options for counsel, they need information—while they are still prospective committee members—that they can discuss during their initial committee meeting, and, potentially, determine which attorney(s) to interview as a committee. Those committee members who have worked with, and thus know, skilled and experienced professionals can suggest these professionals to the committee as a whole. Unless the committee is going to defer to such recommendations, however, prospective committee members will want to hear from potential counsel, and those lawyers will need to have some contact with the prospective committee members. The contact between the lawyer and a prospective committee member may be considered solicitation—permissible or otherwise—under applicable professional ethics rules.9

Issues surrounding solicitation of committee members include (1) whether professionals who are not known to a committee member or potential committee member may solicit potential employment (and whom they may permissibly solicit); (2) whether it is possible or permissible10 for a professional to solicit a committee member before the committee has been formed; and (3) when solicitation is permissible, what specific actions, in particular contexts, a professional may take before those actions become “prohibited solicitation.”

Unfortunately, although there are clear rules in every state regulating cold, live client solicitation by attorneys, many attorneys and non-attorney professionals have expressed concern that the rules, as they are applied to professionals seeking retention as counsel for an official committee of unsecured creditors (or other committees), leave several questions unanswered. Moreover, there is no single or consistent code of ethics for non-attorney professionals that appears to cover the issue of solicitation. This Report, therefore, is designed to provide guidance as to the parameters for permissible solicitation by all such professionals.


10 There is a school of thought among the legal profession that the committee is the prospective client and, therefore, that the solicitation of individual creditors who might ultimately be appointed to the committee does not constitute solicitation of a prospective client under the applicable rules. Under this theory, the prospective client is the committee itself, not any individual creditors. This theory has been effectively negated with the Universal Building Products decision, which will be discussed below.
To provide background and context, the Committee Solicitation Subcommittee (the “Subcommittee”) first assessed the current landscape of ethics rules applicable to parties seeking employment by an official committee. The Subcommittee then assessed the current state of practice through a two-pronged analysis. First, the Subcommittee and Reporter Lois R. Lupica created a survey (the “Survey Instrument”) to solicit anonymous input from the ABI membership as to their observations of behavior by professionals seeking employment by a committee. Second, Reporter Lupica convened a focus group of sitting bankruptcy judges (the “Focus Group”) at the 2012 National Conference of Bankruptcy Judges to discuss committee solicitation issues. By comparing the present statutory landscape, the current state of practice by observation from those in the profession, and the current state of practice from the judiciary’s perspective, the Task Force was able to understand more fully current practice and how that practice aligns with the present rules. This information “from the trenches” enabled the Task Force to propose how best to address the topic of committee solicitation.

Governing Rules

Bankruptcy lawyers must not only comply with the dictates of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure, but they must also ensure that their behavior conforms to the state ethics rules governing professional conduct. When an attorney is seeking engagement as committee counsel, the principal relevant state rules are those similar to Model Rules 7.3 and 8.4.1

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11 Rule 7.3 Solicitation of Clients
(a) A lawyer shall not by in-person, live telephone or real-time electronic contact solicit professional employment when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted:
   (1) is a lawyer; or
   (2) has a family, close personal, or prior professional relationship with the lawyer.

... Official Comment:
[1] A solicitation is a targeted communication initiated by the lawyer that is directed to a specific person and that offers to provide, or can reasonably be understood as offering to provide, legal services. In contrast, a lawyer's communication typically does not constitute a solicitation if it is directed to the general public, such as through a billboard, an internet banner advertisement, a website or a television commercial, or if it is in response to a request for information or is automatically generated in response to internet searches.

[2] There is a potential for abuse when a solicitation involves direct in-person, live telephone or real-time electronic contact by a lawyer with someone known to need legal services. These forms of contact subject a person to the private importuning of the trained advocate in a direct interpersonal encounter. The person, who may already feel overwhelmed by the circumstances giving rise to the need for legal services, may find it difficult fully to evaluate all available alternatives with reasoned judgment and appropriate self-interest in the face of the lawyer's presence and insistence upon being retained immediately. The situation is fraught with the possibility of undue influence, intimidation, and over-reaching.

[3] This potential for abuse inherent in direct in-person, live telephone or real-time electronic solicitation justifies its prohibition, particularly since lawyers have alternative means of conveying necessary information to those who may be in need of legal services. In particular, communications can be mailed or transmitted by email or other electronic means that do not involve real-time contact and do not violate other laws governing solicitations. These forms of communications and solicitations make it possible for the public to be informed about the need for legal services, and about the qualifications of available lawyers and law firms, without
Model Rule 7.3 proscribes in-person, live telephonic, or real-time electronic solicitation of potential clients, when the motive for doing so is “pecuniary gain” and where the target of the solicitation (i) is not a lawyer, (ii) does not have a close family or personal relationship with the lawyer or (iii) does not have a prior professional relationship with the lawyer.”

Model Rule 7.3 was recently amended to clarify the types of communications that constitute a “solicitation.” Official Comment [1] explains that a lawyer is engaged in a solicitation when he or she “offers to provide, or can be reasonably understood to be offering to provide, legal services to a specific potential client.” Recognizing that “technology has enabled various kinds of online interactions between subjecting the public to direct in-person, telephone or real-time electronic persuasion that may overwhelm a person’s judgment.

The ABA Model Rules of Professional Conduct were adopted by the ABA House of Delegates in 1983. The most recent major revision to the Model Rules was in 2000, but the various rules have also been revised more recently. The Model Rules serve as models for the ethics rules of most states. As of the first quarter of 2013, 49 states and the District of Columbia and the Virgin Islands have all adopted a version of the Model Rules of Professional Conduct.

The Supreme Court has been clear that direct live solicitation of potential clients can be categorically prohibited, and that other forms of direct solicitation of potential clients can be regulated without implicating First Amendment concerns. Ohralik v. Ohio State Bar Ass’n, 436 U.S. 447 (1978) (the state may ban all in-person lawyer solicitation for profit); Shapero v. Ky. Bar Ass’n, 486 U.S. 466 (1988) (state may categorically ban in-person solicitation by lawyers for profit, but may only regulate and not ban written communications that the prospective client can read without pressure and can discard; the Supreme Court expressly approved the type of regulation set forth in current Model Rule 7.3, revised after Shapero). As the Court has observed, the state’s interest in preventing “those aspects of solicitation that involve fraud, undue influence, intimidation, overreaching, and other forms of vexatious conduct” overrides the lawyer’s interest in communication. See also Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626 (1985) (“possibilities for overreaching, invasion of privacy, the exercise of undue influence[,] outright fraud” and other “unique features of in-person solicitation by lawyers … justify a prophylactic rule prohibiting lawyers from engaging in solicitation for pecuniary gain”); Edenfeld v. Fane, 507 U.S. 761, 774-75 (1993) (where the Supreme Court struck down a statute prohibiting all solicitation by certified public accountants, in part based upon reasoning relevant to solicitation of most potential committee members, i.e. that business clients are different from the “unsophisticated, injured or distressed lay person.”). Edenfeld cited and did not overrule Shapero or limit state regulation of attorney solicitation.

Revised Model Rule 7.3 also addresses the distinction between “potential” and “prospective” clients. As noted, “[w]ith the creation of Rule 1.18 in 2002, the phrase “prospective client” refers to a potential client who has actually shared information with a lawyer. Model Rule 7.3 clearly intends to cover contacts with all possible future clients, not just those who have had some contact with lawyers and have become “prospective clients” under Rule 1.18. … Accordingly, the Commission proposes to replace the word “prospective” with the word “potential” throughout Rule 7.3 and its Comments. See http://www.legalethicsforum.com/blog/2012/02/ethics-2020-proposal-on-rule-73-direct-contact-with-prospective-clients.html.

The phrase “reasonably understood to be offering to provide” is intended to ensure that lawyers are governed by the Rule even if their communications do not contain a formal offer of representation, but are nevertheless clearly intended for that purpose. For example, if a lawyer approaches potential clients at their homes and describes various legal services, the lawyer’s communications constitute a “solicitation” even if the lawyer does not formally offer to provide those services, as long as a reasonable person would interpret the lawyer’s communications as an offer to provide those services. See http://www.legalethicsforum.com/blog/2012/02/ethics-2020-proposal-on-rule-73-direct-contact-with-prospective-clients.html.
lawyers and potential clients,” the revised rule and clarifications in the Official Comments are designed to more clearly identify the contours of the types of prohibited lawyer solicitation. If a real-time contact with a potential client exerts pressure and demands an immediate response, “without providing an opportunity for comparison or reflection,” such a contact falls within the rationale that Model Rule 7.3 is designed to address, i.e., “undue influence, intimidation, and over-reaching” when seeking to obtain new clients. State regulation is justified by the potential for such pressure and its effects.

Moreover, pursuant to Model Rule 8.4, a lawyer may not engage a third party to do something that he or she is prohibited from doing directly. Thus, in the context of real-time committee solicitation of potential clients, lawyers may not direct an agent to contact members of the committee or to solicit proxies in order to gain employment as counsel.

Other relevant Model Rules include Model Rule 7.2(b), which prohibits a lawyer from giving anything of value to a person for recommending the lawyer’s services, except for the reasonable costs of permitted advertisements and communications and for certain lawyer referral services. This Model Rule is relevant to, for example, offers of meals and transportation to meetings to discuss counsel’s capabilities and to the committee formation meeting. Also, Model Rule 7.1 provides that solicitations cannot contain false or misleading statements of fact or law or omissions that cause

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16 Model Rule 7.3, Comment [1]. Some jurisdictions, however, have addressed this evil short of an absolute prohibition on “live” solicitation. See, e.g., Maine Rule of Professional Conduct 7.3 (prohibiting in-person, live telephone, or real-time electronic professional employment solicitation from a non-commercial client if “such solicitation involves or has substantial potential of harassing conduct, coercion, duress, compulsion, intimidation or unwarranted promises of benefits.”) The Rule continues by making clear, “The prospective client’s sophistication regarding legal matters; the physical, emotional state of the prospective non-commercial client; and the circumstances in which the solicitation is made are factors to be considered when evaluating the solicitation.” The Reporter’s Notes explain “[t]he Model Rule’s original formulation … categorically prohibits “in-person, live telephone or real-time electronic contact” with prospective clients. The Task Force discussed the concerns underlying this categorical prohibition: lawyer overreaching or harassing vulnerable prospective clients through direct solicitations. The Task Force ultimately concluded that such concerns were adequately addressed by limiting solicitation to circumstances in which a lawyer could overreach or harass non-commercial clients. Non-commercial prospective clients are those individual clients in need of legal services in non-commercial or personal matters or circumstances.

17 Rule 8.4 states that “[i]t is professional misconduct for a lawyer to: (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another.” Comment [1] provides that “[l]awyers 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 when they request or instruct an agent to do so on the lawyer’s behalf.”

18 See, e.g., In re O’Keefe, 877 So. 2d 79 (La. 2004) (where an attorney was disbarred for paying “runners” to solicit personal injury cases); Miss. Bar v. Turnage, 919 So. 2d 36 (Miss. 2005) (where an attorney was suspended for hiring an agent to solicit clients for potential class suit); Md. Ethics Op. 98-30 (1998) (where a lawyer was prohibited from having a bail bondsman distribute his business cards with the attorney’s contact information printed on back); see also Cincinnati Bar Ass’n v. Rinderknecht, 679 N.E.2d 669 (Ohio 1997) (where an attorney was indefinitely suspended for establishing a direct marketing service to solicit accident victims as clients for himself and a chiropractor).

19 Comment 5 to Model Rule 7.2 explains the rationale: “Lawyers are not permitted to pay others for channeling professional work. Giving or receiving a de minimis gift that is not a quid pro quo for referring a particular client is permissible.”
statements to be misleading. Attorneys should beware of touting their prior work in a way that would mislead committee members about what will happen in a case for which the professional is seeking employment. Model Rule 8.4(e) says solicitation may not state or imply an ability to improperly influence the court, the United States Trustee, or other official, or to achieve results by means that violate professional conduct rules or other laws; therefore, statements about familiarity and good relations should be made with care. Model Rule 7.4 provides that a lawyer may communicate his or her practice in a particular field, but it limits what can be said about whether the lawyer is a “specialist,” which bears on the wording of communications to potential committee members. Model Rule 1.18 sets forth various duties to “prospective clients” and mandates care in obtaining information about prospective committee members’ positions, in case the attorney is not chosen as committee counsel.

Notably, in addition to the applicable Model Rules, Bankruptcy Rule 2014 requires the disclosure of all “connections” with the debtor, creditors, any other party in interest, and their respective attorneys and accountants (interpreted to include non-attorney financial advisory professionals of all types, including accountants, financial advisors, investment bankers, and the like) and the United States Trustee.\(^20\) As explained by the bankruptcy court in the Universal Building Products case discussed below, solicitation of prospective committee members, including through other professionals, constitutes disclosable “connections.”

**Recent Creditor Committee Solicitation Case Law**

**A. Creditor Contacts and Solicitation**

The court in Universal Building Products\(^21\) squarely addressed the proscription in Delaware Lawyers Rule of Professional Conduct 7.3 against real-time direct client contact in the context of creditor committee solicitation.\(^22\) In that case, several law firms were seeking engagement as counsel to the creditors’ committee. At least two of the interested law firms sent Mr. Liu, an individual who had provided translation services to official creditors’ committees in the past, the list of the twenty largest unsecured creditors. Liu, who had not had prior dealings with any of the creditors on the list, contacted a number of overseas creditors to discuss the case, including discussing the engagement of at least two of these law firms as committee counsel. He also asked the creditors if he could act as proxy for them on the committee. One creditor granted Liu its proxy,\(^23\) allowing him to attend the committee formation meeting and vote for the engagement of the soliciting law firms. Liu was subsequently engaged by the committee to provide translation services. At the time that the

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\(^22\) The relevant language in the Delaware Rule of Professional Conduct Rule 7.3 (which is identical to Model Rule 7.3), reads: “A lawyer shall not, by in-person, live telephone, or real-time electronic contact solicit professional employment from a prospective client when a significant motive for the lawyer’s doing so is the lawyer’s pecuniary gain . . . .”

\(^23\) Another proxy was granted to a “friendly” professional, with the understanding that he would also vote in favor of engaging the soliciting law firms.
committee voted for the appointment of counsel, there had been no disclosure of Liu’s relationship with the soliciting lawyers.

In considering these behaviors, Judge Walrath found that the solicitation behaviors by the attorneys seeking appointment as creditors’ committee counsel violated Delaware Rule 7.3. Their active encouragement of Liu’s cold communications with creditors, even after learning that Liu had no prior relationship with any creditor on the list, was a clear violation of the proscription against solicitation. The opinion points out that Delaware’s version of Rule 8.4 states that an attorney may not use an intermediary to solicit prospective clients when the attorney is prohibited by Rule 7.3 from doing so directly. Accordingly, the court found sufficient reason to disqualify the law firms from serving as counsel to the committee.

Judge Walrath also addressed the issue of required disclosures under Bankruptcy Rule 2014(a). Rule 2014(a) requires that “the application [of any professional person seeking retention by the debtor or committee] shall be accompanied by a verified statement setting forth the person’s connections with the debtor, creditors, any other party of interest, etc. …” Delaware Local Rule 2014-1 further requires that additional disclosures be made promptly after learning any additional material information. The court explained that the solicitation communications were relevant “connections” and noted that the lawyers’ failure to disclose such connections was enough to require disqualification of counsel from committee employment. The evidence supported disqualification of both soliciting law firms because their initial disclosures were inadequate and, notwithstanding the ongoing duty to disclose, subsequent disclosures were insufficient to cure the original deficiencies.

Judge Walrath concluded her opinion in the Universal Building Products case by stressing the importance of disclosure of the practice of using others to solicit proxies to act at committee formation meetings and by further urging the Office of the United States Trustee to consider implementing additional procedures in connection with its procedures concerning committee formation and solicitation. These recommended procedures included amending the prospective committee member questionnaire and separating creditors from prospective professionals in order to reduce the possibility of undue influence of the committee in connection with its decision to hire counsel.

24 The court found nothing wrong with the law firms’ transmission of the list of creditors and its analysis of the debtor’s case to their existing clients and contacts. Id. at 659.
25 The court stated that making cold contacts between soliciting counsel and creditors is particularly improper when creditors are foreign and unfamiliar with committee formation procedures. Id. at 660. The court also took pains to note that the practices employed by these law firms had been criticized in the past. The current disclosure rules surrounding proxy solicitation grew out of creditors’ lawyers’ past behaviors of actively participating in the selection of committee members in order to then be selected as counsel for the committee.
26 Id.
28 2010 WL 4642046, at 11 (“[T]he law firms should have fully disclosed at the outset their efforts in support of Dr. Liu’s attempt to obtain proxies from creditors to attend the Committee formation meeting.”).
29 Id. at 12. In another case addressing the issue of committee solicitation by attorneys, In re Diva Jewelry Design, Inc., 367 B.R. 463 (Bankr. S.D.N.Y. 2007), the court deferred to the trustee’s choice of counsel over the objection of the United States Trustee. The United States Trustee argued that, because of a prior
The court in *In re ABC Automotive Products Corp.* similarly examined the contours of permitted behaviors in the context of creditor committee solicitation.\(^{30}\) The debtor in this case, an auto parts distributor, filed for Chapter 11 and the United States Trustee appointed a four member creditors’ committee. The committee then selected committee counsel. Simultaneously, another attorney was seeking appointment as committee counsel. The debtor’s president identified this new attorney as the person whom creditors should contact if they had a question. The attorney sent these creditors proxy forms authorizing his firm to vote on the creditors’ behalf on all matters, including the retention of professionals. The new attorney then contacted the United States Trustee, who amended the creditors’ committee list to include the new members. The new attorney ultimately held proxies for four of the seven committee members and convened a committee meeting. At this meeting the new attorney informed the committee of his intention to use their proxies to appoint his firm as counsel for the committee.

The United States Trustee and a firm both objected, arguing that the law firm could not act both as a member of the committee by virtue of its proxies, and also as its counsel. The court denied the law firm’s committee retention application, holding that the law firm’s self interest impermissibly motivated the process by which it was selected. In its role as committee counsel, the firm would not be taking direction from actual creditors, but rather it would effectively control the committee’s decision-making. Thus, the actual creditors would be deprived of any meaningful role in the decisions regarding the committee’s governance. It was not the *per se* use of proxies to elect committee counsel to which the court objected, but rather how the proxies were used in this case. The court had “no confidence that [the committee’s choice of counsel] reflect[ed] the will of the Committee, if indeed it ha[d] one.”\(^{31}\) The court further observed:

... It is not uncommon at an in person organizational meeting of creditors conducted by the United States [T]rustee for creditors who are unable to be physically present to send counsel with their proxy. That is far different than a lawyer securing the proxies and then calling and conducting a “meeting” not calculated to secure any participation other than his own to elect himself. The approach utilized here smacks of the much maligned attorney activism criticized by the Third Circuit in *Arkansas* and intended to be replaced under the current Code. ... [I]t is not the fact that proxies were used, but how they were used that dictates the resolution of this contested matter.\(^{32}\)

Engagement by creditors in the case, the counsel represented interests adverse to the estate, was not disinterested, and had an actual conflict of interest. Moreover, the United States Trustee argued that “the pattern of . . . [counsel’s] clients electing a trustee and then having that same trustee retain the Applicant indirectly fosters the problems that the election procedure was intended to proscribe.” In finding for the trustee, Judge Gerber observed, “an attorney is not barred from assisting the solicitation efforts of a creditor or committee, so long as it is clear that the attorney is not the solicitor and that the solicitation is not on behalf of the attorney. *Id.* at 475.


\(^{31}\) *Id.*

\(^{32}\) *Id.* at 445.
 Members of the Task Force have reported, in at least one district, several post-Universal Building Products committee organizational meetings in which the prospective committee members were kept apart from the professionals attending the meetings at which they were seeking employment. Whether this practice is, or will be, consistently applied across the United States Trustee Program’s regions and offices, remains to be seen.33

B. Proxies and Avoiding the Appearance of Impropriety34

In the predecessor to the Model Rules of Professional Conduct, the American Bar Association codified in Canon 9 of the Model Code of Professional Responsibility that attorneys should avoid even the appearance of impropriety.35 Comments that judges in the Focus Group made regarding unseemly behavior—whether or not it rose to the “appearance of impropriety” standard—indicated the judges’ sensitivity to the issue of misbehavior. Some of the participants in the Focus Group specifically noted that an attorney’s or firm’s reputation in other cases or other districts would be a factor in evaluating their retention applications—some going so far as to raise specific examples.

In the Universal Building Products litigation, for example, much ado was made of proposed committee counsel’s history with two cases in other districts, referred to here as the “Texas cases.” The court itself did not mention Texas cases, but instead was raised by debtors’ counsel in their objection to the motion to employ committee counsel. Debtors’ counsel argued that, because of its involvement in the Texas cases, proposed committee counsel should have been “on notice” that its actions would be subject to scrutiny. The court’s position, as stated on the record, was that it could take judicial notice of the Texas cases because, having faced accusations of improper solicitation before, counsel in the Texas cases was “on notice of the issue regarding solicitation of clients through another.”36

33 In many districts outside of New York and Delaware, committees are appointed by the Office of the United States Trustee without any formal organizational meeting and, thereafter, advised, by a United States Trustee representative overseeing a particular chapter 11 case, generally about their duties, including a recommendation to seek out and select professionals.

34 This section borrows heavily from Richard M. Meth & Jessica D. Gabel, An Icy Reception to Cold Calls: Committee Solicitation After Universal Building Products, 2011 American Bankruptcy Institute Southwest Bankruptcy Conference (2011).

35 Under the Model Code, Canon 9’s “avoid the appearance of impropriety” principle was set forth in DR 9-101:

(A) A lawyer shall not accept private employment in a matter upon the merits of which he has acted in a judicial capacity.

(B) A lawyer shall not accept private employment in a matter in which he had substantial responsibility while he was a public employee.

(C) A lawyer shall not state or imply that he is able to influence improperly or upon irrelevant grounds any tribunal, legislative body, or public official.

Courts over the years, however, have construed the avoidance of impropriety principle far more broadly than DR 9-101 ever suggested, using “appearance of impropriety” as a catch-all for behavior that a court believed to be unseemly. See, e.g., In re Marvel Entertainment Group, Inc., 140 F.3d 1463 (3d Cir. 1998) (rejecting use of “appearance of impropriety” standard as a discredited concept).

The case of *In re TKO Sports Group USA*[^37] highlighted the difficulties associated with “connections” and their disclosure pursuant to Bankruptcy Rule 2014. The case also addressed the issue of with whom the duty to disclose rests. In *TKO*, the controversy arose in the context of a long-standing professional relationship between the committee’s counsel and a non-attorney professional who appeared at the committee formation meeting holding a proxy for a foreign creditor. This representative then went on to serve on the committee on the creditor’s behalf, ultimately seeking appointment as the liquidating trustee in the case. Neither the non-attorney professional, nor his counsel, disclosed the relationship and the matter subsequently arose, in the heat of a contentious Chapter 11 case, in the form of an objection to committee counsel’s fees.

Discovery in the litigation showed the relationship between the non-attorney and counsel to be extensive, generating millions of dollars in fees to the law firm as the result of their engagement on the non-attorney’s behalf in his role as liquidating trustee in other cases. In fact, the law firm represented the non-attorney in at least seventy-five adversary proceedings. When, after the fact, the law firm disclosed the relationship with the non-attorney, the disclosure was limited to the bare mention of having represented the individual in other cases. The law firm, in its defense, argued that representing a creditor committee’s representative in the past was not a connection requiring disclosure under Bankruptcy Rule 2014 and that such disclosure would have been necessary only had the individual been appointed the liquidating trustee in the present case. As in many such cases, the matter was eventually consensually resolved and the pleadings in the case were ordered sealed and then unsealed, as noted below.

More recently, in *In re North Bay General Hospital*[^38], another dispute arose involving the same firm and the same non-attorney in the same district as the *TKO* case. In this case, the parties again failed to disclose their other business connections. Once the failure to disclose was brought before the court, the debtor filed adversary proceedings against the law firm seeking disgorgement of fees and findings of, among other things, fraud, conspiracy, a civil RICO, breach of fiduciary duty and negligence. The debtor also moved to unseal the *TKO* pleadings. In ruling to unseal the records, the court noted that, even though the unsealing of the records might harm the law firm’s reputation, in the absence of the law firm showing that the information in the record was untrue, there was no sufficient basis to keep the records sealed.

Both of these cases were referenced heavily in the *Universal Building Products* debtor’s objections to the employment application of the same law firm and were mentioned specifically by several judges in the Focus Group. That these cases could well have been meritless and were not adjudicated to completion is immaterial: the bell, once rung, is heard. And in the sphere of professional conduct, a question as to one’s reputation, once raised, can follow a professional far beyond a single case.

Much of the complexity in the issue of disclosures of connections by retained committee professionals derives from the use of proxies: agency relationships between a party in interest in a case (typically, an unsecured creditor) and an agent appointed to be present on the creditor’s behalf.

[^37]: Bankr. S. D. Texas, Case No. 05-48509, available on PACER.
[^38]: 404 B.R. (Bankr. S. D. Tex. 2009)
at the organizational meeting of the committee. Proxies are both a useful and necessary way for the United States Trustee to form a committee that is representative of the estate’s diverse creditor interests without individual creditors, often small business owners, incurring the cost and inconvenience of traveling—sometimes cross-country, sometimes internationally—to attend the committee organizational meeting. Proxies, in and of themselves, are not problematic. The manner in which they are obtained and for what purpose, however, can raise significant issues, especially in light of thirty-eight percent (38%) of survey respondents having reported observing proxy-seeking behavior by attorneys and the vast majority of these respondents (eighty-seven percent (87%)) observing such behavior “sometimes or “often.” The Task Force suggests that:

a) misuse of proxies raises questions of compliance with the rules;
b) professionals’ failure to disclose their participation in proxy relationships or connections to proxy holders is a potential violation of Rule 2014; and
c) the proxyholder owes a duty to the creditor whom the proxyholder represents.

Information on Current Practices

A. Survey Instrument

One purpose of a survey is to gather generalized and subjective information from and about a cohort of people in an effort to elicit information about a practice, an event, or a program. In its consideration of the issue of best practices in connection with committee solicitation, the Task Force wanted further insight into current committee solicitation practices. It used an anonymous survey that asked respondents to report on their own practices and behaviors, as well as observed practices and behaviors, in order to develop a clear picture of current practices.

The Survey Instrument was designed to gather descriptive and impressionistic data from a broad group of stakeholders so that patterns, themes, and trends would come to light. The Survey Instrument was sent to 8,861 ABI members (attorney and non-attorney professionals, including financial advisors and accountants) who are identified in the ABI membership database as having a business bankruptcy practice. 496 members responded to the survey – a 5.6% response rate.39 Of all respondents, 66.7% identified themselves as attorneys, and 33.3% identified themselves as non-attorney professionals. 85.7% of attorney respondents reported having been in practice for ten years or more. The state bars with the largest number of Survey respondents were California, Delaware, Illinois, Massachusetts, New York, Pennsylvania and Texas.

1. Pre-Meeting Conduct of Business Bankruptcy Professionals

39 This response rate is typically considered reasonable in order for the responding group to be considered a “representative sample” of the ABI membership. It should not be inferred, however, that this sample is representative of the national bankruptcy bar.
The Survey Instrument asked respondents about their personal knowledge of certain pre-committee meeting contacts between lawyers and creditors. Fifty-three percent (53.3%) of respondents reported having knowledge of an attorney who made one or more telephone calls to one or more prospective committee members without that professional having a prior relationship with the phone call recipient. Of the respondents who reported this observation, over ninety percent (90%) of them reported observing this practice “sometimes” or “often.” A similar number of respondents reported having knowledge of “cold” telephone contacts by non-attorney professionals.

When asked about e-mail “cold contacts” with prospective committee members, forty-five percent (45%) of respondents reported having personal knowledge of pre-meeting e-mail contacts. Eighty-seven percent (87%) of respondents who had knowledge of “cold” e-mail solicitation observed this behavior “sometimes” or “often.” Thirty-three percent (33%) of respondents observed non-attorney professionals engaging in “cold” e-mail contacts. Thirty-three percent (33%) of respondents reported having personal knowledge of arranged “cold” meetings with one or more prospective committee members. Of these respondents, over eighty percent (80%) reported observing these behaviors “sometimes” or “often.” Moreover, forty-six percent (46%) of these respondents reported observing the exchange of value (including food, drinks or gifts) at these meetings. Twenty-eight percent (28%) of respondents observed these behaviors with similar frequency in non-lawyer professionals.

When asked about the use of proxies, thirty-eight percent (38%) of respondents reported observing the request by an attorney that a prospective committee member give a voting proxy to an agent for use at the organizational meeting, with an advance understanding of how the proxy would be voted for purposes of hiring counsel for the creditors’ committee. Of these respondents, eighty-six percent (86%) reported seeing such behaviors “sometimes” or “often.” Sixty-two percent (62%) of respondents reported personal knowledge of an existing client and creditor in a case calling one or more prospective committee members during which the non-lawyer professional recommended counsel for the committee. Of these respondents eighty-seven percent (87%) reported seeing these behaviors “sometimes” or “often.”

2. Committee Meeting Conduct of Bankruptcy Professionals

Survey respondents were initially asked about attendance at official or ad hoc committee organizational meetings. Thirty-one percent (31%) of respondents reported attending an organizational meeting without having received an invitation. Two percent (2%) of respondents reported trying to attend a committee organizational meeting without having received an invitation but being turned away. Of those who attended and tried to attend a committee meeting, a strong majority reported learning about the meeting from either the United States Trustee, a creditor or an attorney connected to the case.

Of those respondents who have attended an organizational committee meeting, eighty-four percent (84%) reported being having been invited to do so by an unsecured creditor. Only eighteen percent (18%) reported having been required to fill out a form or obtain some type of authorization or permission to attend the meeting and only ten percent (10%) were given an unsecured creditors’ proxy and directed how to vote. Of those given a proxy, a strong majority obtained the proxy form...
directly from the unsecured creditor or from a lawyer for the unsecured creditor. Seventy-three percent (73%) of those who attended an organizational meeting reported being permitted to be in the same room as the various persons representing the debtors’ unsecured creditors.

Those who appeared at a committee organizational meeting reported a variety of pre-meeting communications. These pre-meeting communications included communications with (i) a law firm (about representing or co-representing the committee); (ii) any other professional (about representing or co-representing the committee); (iii) any other professional (about that professional representing the committee); (iv) the United States Trustee; or (v) another party in interest in the case. Other parties in interest included creditors, debtor’s counsel, secured lenders’ counsel, purchasers, landlords, and unsecured creditors. Illustrative reasons cited for the pre-meeting communications included, (i) to respond to a client asking for representation in the case or to pitch the committee or support another law firm at the organizational meeting; (ii) to determine the level of interest and the degree of competition, and to gain facts about the case; (iii) to ascertain the nature of the case and to ascertain any likely recovery for unsecured creditors, (iv) to advise the party contacted regarding any likely issues in the case and the professional’s expertise; (v) to determine the potential availability of funding for professional fees; (vi) to discuss the committee meeting with his or her client who is or will be on the committee; (vii) to introduce himself or herself and talk about his or her qualifications and experience in order to represent the committee; (viii) to plan strategy; (ix) to show interest in and knowledge of the case; (x) to provide comfort and ideas to creditors; (xi) to gain support from potential committee members and to gain information about the case and the debtor; and (xii) to try to get an invitation to pitch to be counsel. As highlighted previously, the types of communications and the parties with whom the pre-meeting communications took place are neither all permissible, nor all impermissible. For example, a lawyer contacting debtor’s counsel to inquire about funds available to pay professionals violates no Model Rule; however, a lawyer contacting unsecured creditors in a manner regulated by Model Rule 7.3 to gauge their interest in serving, or to try and gain an invitation to pitch to be counsel, either approaches or entirely crosses the line demarcating a violation of Model Rule 7.3.

This distinction is, again, entirely contextual based on who the parties to the communication are, and the intent behind the communication. Although this difference may be of some comfort to those attorneys inclined to make contacts with creditors, it bears noting that the controversy in Universal Building Products arose originally out of a dispute between the parties’ counsel over the terms of proposed debtor-in-possession financing. From this, the lesson to be learned is that, once an attorney acts, that attorney can no longer control the context or light in which others view the action.

3. Conflicts Checks and Questions About Behaviors

Ninety-five percent (95%) of respondents reported performing a conflicts check prior to any official committee or ad hoc committee solicitation. Only four percent (4%) of respondents reported seeking advice from their state bar ethics hotline.

The need for attorneys to perform a conflicts check prior to soliciting a committee client is key. Unfortunately, it is not uncommon for counsel to be hired by a committee, only to later inform the committee that a conflict exists between the lawyer and some party in interest in the bankruptcy
case, and asking that the committee engage conflicts counsel to perform necessary work in fulfillment of the committee's fiduciary duties. But there are minor conflicts and disqualifying conflicts, and the Report addressing the use of conflicts counsel elaborates on this important difference. Conflicts can run to the mundane, such as an individual creditor being the target of an avoidance action where the lawyer representing the post-confirmation trust has represented that party previously or presently (raising conflict issues pursuant to Model Rules 1.9 or 1.7, respectively); or they can run to the heart of the Chapter 11 case, where committee counsel is precluded from taking any action potentially adverse to the secured lender in that case, including such tasks as lien investigation or loan document review. 40

The gravity of these two conflicts is fundamentally distinct, and each has a different economic effect on the bankruptcy case. In the former example, selecting another firm that can bring an avoidance action, as conflicts counsel, likely presents little to no economic effect or impairment. Conversely, when committee counsel is unable to perform basic tasks at the heart of the committee's function, then engaging conflicts counsel will not cure the problem. Although it is possible that a conflict will arise during the case, e.g., when a firm's client becomes a bidder for estate assets, the information about the debtor, significant secured and unsecured creditors, equity owners, and advisors is available in the initial filing documents. Attorneys should perform a conflicts check using at least that information before communicating with any potential committee members about serving as committee counsel.

B. Focus Group Interview

Focus groups provide an effective and efficient way to gather qualitative data from study subjects, the goal being to produce “concentrated amounts of data on precisely the topic of interest.”41 Focus groups can offer the opportunity for participants to respond to questions provided by the researcher, as well as to engage in and interact with other members of the group.42 “The hallmark of focus groups is their explicit use of group interaction to produce data and insights that would be less accessible without the interaction found in the group.”43


41 There are clearly weaknesses associated with focus group interviews as a data-gathering tool. As observed, “[t]he fact that focus groups are driven by the researcher's interests can . . . be a source of weakness . . . . The fact that the researcher creates and directs the group makes them distinctly less naturalistic than participant observation so there is always some residual uncertainty about the accuracy of what the participants say. In particular, there is a very real concern that the moderator, in the name of maintaining the interview’s focus, will influence the group’s interactions.” DAVID L. MORGAN, FOCUS GROUPS AS QUALITATIVE RESEARCH 14 (2nd ed. 1997). There is also the concern that “the presence of the group will affect what [participants] say, and how they say it.” Id.

42 Id. at 2.

43 Id.
The bankruptcy judge participants in the Focus Group were selected by a method known as “purposive” or “theoretical” sampling. The participants were not randomly identified, but were invited because they were “information rich,” and offered useful, yet varied experiences of working within the system being studied. The Focus Group was homogenous, comprised of bankruptcy judges with experience in cases in which committees were formed. The homogeneity allowed for unrestrained conversations among participants.

1. Committee Formation and Solicitation

The Focus Group was asked a series of open-ended questions, beginning with a general query about how committees were formed and committee counsel was selected. The answers revealed a great deal of variation in process from jurisdiction to jurisdiction. This variation was identified as a problem with the system in that it makes it difficult “to think through … the right way do this.” Local culture, as that may vary from jurisdiction to jurisdiction, plays a significant role in whether and how committees are formed and, ultimately, how counsel comes to be interviewed and/or hired.

The Focus Group consistently asserted that nationally uniform standards for committee formation (by the United States Trustee Program) and standards addressing committee solicitation (by prospective counsel) would improve the process and address existing uncertainties and inconsistencies with respect to the best practices and preferred processes. The participants suggested that, if the Executive Office of the United States Trustee announced a uniform policy, United States Trustee regions and offices would follow it.

Focus Group judges discussed the importance of committees as overseers of the Chapter 11 process, describing committees as playing a “broker role” between the secured creditor and the debtor, often serving as a debtor’s ally in the process of negotiations with the secured creditor. The judges further observed, in describing committee formation practice and the hiring of committee counsel, that it was important to distinguish between “large” cases and medium or “middle market” cases. In some jurisdictions, it was reported that the bulk of cases with committees are middle

\[\text{Equation}\]

44 Morgan, supra note 40, at 35.

45 Marshall, supra note 40, at 523 (“Qualitative researchers recognize that some informants are ‘richer’ than others and that these people are more likely to provide insight and understanding for the researcher. Choosing someone at random to answer a qualitative question would be analogous to randomly asking a passer-by how to repair a broken down car, rather than asking a garage mechanic—the former might have a good stab, but asking the latter is likely to be more productive.”)

46 Morgan, supra note 40, at 35.

47 A respondent observed, “Defining big and small has lots of facets to it. It seems to me it might mean a total number of assets. It might mean any potential for reorganization. It might mean simply a case of where the assets are going to get sold and so there is going to be some negotiations there about something as opposed to something that is dead on arrival and has filed for 11 for reasons that I never really understood so there’s – it’s going to be – it would be difficult. What I’m trying to say is if you are looking at the cases that are New York and Delaware those are different worlds from everywhere else. I think that Chicago is probably the third leg of that stool.”
market. In other jurisdictions, committees are formed only occasionally in anything other than large cases, because of the difficulty in getting creditors interested in serving.48

2. Proxies

The Focus Group further noted that when proxies are used, they take a wide variety of forms. As observed, “[proxies are] sometimes firm-specific. It’s very unclear what powers someone holding a proxy actually has. I have seen proxies that say ‘well you have my proxy to go and be my representative with a formation of the Committee but not for the voting on counsel’.”

When asked about committee formation and counsel engagement, Focus Group judges reported that lawyer-to-lawyer relationships play a significant role in the selection of committee counsel. As observed, “a lot of the large creditors just don’t come because they’re in every case and they send their lawyer. They just call up their lawyer and say “go,” and some of those lawyers are actually are barred by their client from pitching the Committee. They say ‘you are my lawyer, you represent me, [and] I don’t want you representing the Committee.’ So those lawyers are actually highly sought-after relationship wise, lawyer to lawyer … because everyone knows that they will vote for [their] buddy who has the office across the hall.”

Another solicitation scenario described in the Focus Group was where a lawyer calls his or her client’s credit manager to “hear [about who] the six other credit managers [are], and the lawyer calls them” in order to solicit committee employment. It was further observed, that this behavior is not “limited to lawyers. I think that there are other professionals that are involved in that chase as well. Not in part for their own engagements, but I think more engagement of professionals who are friendly to them seeking lead counsel who would be friendly to hiring the right accounting firm, turn around advisory firm or investment banking firm . . . .”

Focus Group judges observed that a lot of business gets done via video conferencing or via telecom conferencing and that’s how committees operate anyway. Rarely do you have that monthly face-to-face meeting that you used to have.

3. Disclosure

With respect to the issue of disclosure of connections, Focus Group judges asserted that, from the bench, “it’s hard to know what adequate disclosure is, [but] what you can tell pretty clearly is what is inadequate disclosure. And then you will get someone who files something and [the filing] says, “I have had contacts with creditors in this case, period, full stop, moving on and you look at that and that’s not enough.” It was clear, however, that the bench relies on the Office of the United

48 One respondent noted that they often observed the “U.S. Trustee … fil|ing] a record saying that they had solicited creditors in a Chapter 11, for participation in Creditors’ Committee and they couldn’t get anybody who’s interested …[in] particip|ating] so they were not going to appoint a Committee.”
States Trustee to monitor retention applications and disclosures. The Focus Group judges consistently observed that “they are much more involved in the case, they knew who the players are and they’ve looked at the affidavits and the attachments and they . . . ask the right questions.”

Observations & Conclusions

1. Solicitation of Prospective Committee Members

The Survey Instrument observations span a number of different patterns of behavior, any of which on their own may or may not indicate violations or potential violations of Model Rules 7.3 and 8.4. For example, although a significant portion of respondents observed non-attorney professionals engaging in certain behavior—twenty-eight percent (28%) of such professionals participating in “cold” meetings with creditors where something of value was exchanged, and thirty-three percent (33%) observing “cold” email contact between non-attorney professionals and creditors—this behavior does not, in and of itself, appear to violate any ethics rules. As mentioned above, non-attorney professionals generally do not have ethics rules prohibiting solicitation in the same manner as do attorneys. The practice, however, becomes a violation of Model Rule 8.4 (and, by extension, Model Rule 7.3) if the non-attorney professional undertakes the behavior on behalf of an attorney who cannot him or herself engage in such practices.

For attorneys engaging in the observed behavior, the situation is more complicated. The practices described in the responses to the Survey Instrument all predicate the hallmarks of improper solicitation: no existing or past professional association between lawyer and creditor; the creditors contacted were neither family members nor did they have close personal relationships with the lawyer; and, the goal was the lawyer’s pecuniary gain. The Survey Instrument did not ask if the persons contacted were themselves lawyers, though if they were, then Model Rule 7.3 would not apply. All of the behaviors observed—cold calls, cold emails, and attendance by lawyers at meetings with creditors—are potential violations of Model Rule 7.3. Assuming that the cold emails did not include language that the communication was “attorney advertising,” those emails could also be interpreted as a violation of a state’s version of Model Rule 7.2.

The challenge posed by these ethics rules is the difficulty of meeting a committee’s needs to learn about qualified and available prospective counsel and avoid limiting the choice of counsel to a favored few firms, all while meeting the ethics rules’ regulatory requirements for lawyers who want to be considered for employment. The Task Force found no reported decisions finding a violation of Model Rule 7.3 (solicitation) or Model Rule 7.2 (advertising) on recommending a lawyer’s services in exchange for value when a lawyer goes to dinner with an existing business client and that client’s friend (who also owns a business) for the purpose of having the existing client introduce the lawyer to the prospective client. The prospective client has consented to the contact and was invited by his friend. If the lawyer asked his client to arrange the dinner in the hope of getting new business, he likely did so to gain the benefit of his client’s support and recommendation rather than to circumvent Model Rule 7.3. And a normal business dinner is not likely to be deemed a quid pro quo to the existing client for the referral. If Mr. Liu had known the prospective committee members in the Universal Building Products case and had called them to recommend lawyers based on his personal knowledge, offering to arrange a meeting, then the court likely would have reacted very differently.
Uncertainty as to how Model Rule 7.3 applies in differing circumstances leaves attorneys with an obligation (if only for their own self-interest) to presume that, given the chance, the ethics rules on solicitation will be interpreted in the manner least favorable to whatever activity they happen to be undertaking. Inviting creditors who have no past business relationship with the attorney to a pre-committee-formation breakfast, where the attorney pays for the meal and thereby “give[s] anything of value to a person for recommending the lawyer's services,” might violate both Model Rules 7.3 and 7.2(b). An email sent to a non-client with whom the attorney has no past association, if the email does not bear the words “attorney advertising,” could, in most states, be construed as solicitation. However, not all states require the notation of “attorney advertising,” and some states, including Florida, require the pre-approval of solicitation materials.

A safer practice, in those instances where the nature of the creditor allows the practice, is to determine the identity of inside counsel for the company or outside counsel who has represented it in other cases and then contact the prospective committee member through that lawyer. The attorney should also check her firm’s conflicts database and circulate an email within the firm to ascertain if there are any past client or social relationships that would excuse the applicability of Model Rule 7.3. That would level the playing field with lawyers whose firms have previously represented prospective committee members in other cases. Telephone calls after business hours to non-lawyers in order to leave voice mail messages appear to be permissible under Model Rule 7.3. And if a lawyer teams up with lawyer or non-lawyer professionals who know persons at a prospective committee member’s company, and these professionals submit materials jointly, this also does not violate Model Rule 7.3, provided that care is taken to avoid (i) quid pro quo referrals and (ii) the non-lawyer professional engaging in activities on the lawyer’s behalf as to which the lawyer would be prohibited by the Model Rules.

As with most ethics issues that bear upon a lawyer’s conduct, the most pragmatic rule is that which cautions the attorney against engaging in any activity that he or she would not want to explain to a court or a jury, or have published in detail on the front page of a newspaper. In short:

- If an attorney contacts a creditor who is not a present or past client and who is not a family member or close personal friend, where the contact is not made through inside counsel or another lawyer of that creditor, and where the reason for the contact is ultimately rooted in the attorney’s desire to be hired by a committee on which that creditor might serve, that contact can easily be viewed as a violation of Model Rule 7.3.
- If a non-lawyer creditor is contacted by a non-lawyer who does not already know the creditor, but the contact is intended to benefit, through hiring, any attorney or attorneys,

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50 “Comment 5 to Model Rule 7.3 also provides that “[i]f after sending a letter or other communication to a client, as permitted by paragraph (e), the lawyer receives no response, any further effort to communicate with the prospective client may violate Rule 7.3(b).”
then both Model Rules 7.3 and 8.4 are likely being violated, either intentionally or inadvertently.

- If an attorney attends a meeting of non-client, non-lawyer creditors with whom the attorney does not have a client relationship or close personal relationship, and anything of more than de minimis value is provided to the non-client, non-lawyer creditors by the attorney (either actively, in the form of gifts, or passively, in the form of meals, drinks and the like beyond what professional courtesy warrants), then Model Rules 7.3 and 7.2(b) are likely being violated.

Given the prevalence with which the Survey Instrument’s population observed these behaviors, it is reasonable to surmise that the variety of questionable (or sanctionable) practices is widespread enough to be recognizable and, therefore, widespread enough to capture the attention of the United States Trustee Program and the courts. Attorneys engaging in such conduct should be forewarned; the penalties for violating the Model Rules extend far beyond a single case. The reputational effect of violations not only spreads from judge to judge, as was confirmed by the Focus Group participants, but lasts years beyond a single court’s opinion in a given case.

Based on data from the Survey Instrument, the review of relevant cases, and observation from the Focus Group judges, the Task Force notes that there have been, and currently are, observable practices that violate both the spirit and the language of Model Rules 7.3 and 8.4. These violations exist in the forms of cold-calling non-lawyer creditors, the exchange of value in the hopes of securing business, the use of proxies, and the use of non-attorney professionals to do that which attorneys are prohibited from doing.

The challenge, then, comes from the fact that the problem is not so much an ethics rules problem as it is an enforcement problem, although the differences in state-by-state implementation of their own versions of Model Rules 7.3 and 8.4 move the goal of universal compliance even further from the realm of possibility. There are few, if any, mechanisms for a process by which parties in interest in a case will learn that lawyers have solicited committee engagements if committee counsel does not make full disclosure of all connections, as required by Bankruptcy Rule 2014, and there are no follow-up questions by the United States Trustee or other parties. As a result, the solicitation rules have sometimes been violated with impunity. Further, lawyers who observe the rules may, with some justification, view themselves as being placed at a competitive disadvantage to those lawyers who violate the rules. Therefore, insistence by the courts, the United States Trustees, and parties in interest on the full compliance with applicable ethics rules and with Bankruptcy Rule 2014 is important.

An additional problem is the variability of the solicitation rules among the States and the difficulty of applying choice-of-law principles to determine which State’s solicitation rules ought to apply. The choice of which jurisdiction’s ethics rules to apply can involve the state where the bankruptcy case is filed, the state or states in which the soliciting lawyer is licensed, and the state or

51 The Task Force in no way endorses the concept of violating ethics rules as a way of evening out any perceived competitive advantage.

52 To say nothing of an officer of the court’s duty to report known ethical violations to the appropriate State Bar.
states in which the solicited parties reside. The Task Force has determined that, given the problems, generally, with breaches of the solicitation rules, and due to the federal nature of bankruptcy practice, the bar and the judiciary would be better served by bringing uniformity to this area. However, the Task Force is equally cognizant that the ethics rules are creations of state law and, as such, vary from state to state, thereby making uniformity problematic and unrealistic. Nevertheless, as a matter of best practices, therefore, the Task Force recommends that, in situations in which more than one jurisdiction’s ethics rule might apply, the attorney should assure that his or her solicitation activities are permitted under the most restrictive of the potentially applicable rules.

The Task Force considered the disparity between the language of the ethics rules, on the one hand, and the reports of significant instances of observable conduct that appeared to violate the Model Rules and Bankruptcy Rule 2014, on the other. Given this intersection of reported (and proscribed) practice, attorneys may be well-served by their respective state bar association’s ethics hotlines. At the very least, such hotlines may confirm acceptable behavior in the state law context and, at the very most, they may provide guidance to attorneys considering engaging in conduct that might violate an ethics rule. If the middle ground is that an ethics hotline provides clarity to a set of Model Rules that can be construed to favor many differing types of viewpoints regarding solicitation, then the effort of calling the hotline is worth it.

2. Checking for Conflicts

As is the case when any new client engagement is undertaken, a law firm must undertake a conflicts check before committing to the representation and, to the extent practicable, prior to seeking employment in the case. It is misleading to a prospective client to solicit an engagement, only to later advise the client that the attorney has a conflict and cannot undertake the work after all. In some instances in which a conflict is discrete and not central to the representation, “conflicts counsel” can be engaged to supplement the services of primary counsel. In a committee context, a conflict with a secured creditor whose lien is to be investigated by the committee may be disqualifying, for example, when that analysis is likely to be the heart of the committee’s role in the case. Or that dispute may be a minor issue where another firm can bring an avoidance action, on behalf of the estate, as conflicts counsel.

If counsel were to seek engagement by a committee without first disclosing any potential conflict, the behavior would be tantamount to deception. The committee client is entitled to know about the conflicts and their implications before consenting to the representation. It is certainly a violation of Bankruptcy Rule 2014 to seek court approval of engagement by the committee and not disclose any such conflicts.

54 See article cited in note 44 supra.
3. **Proxies**

With respect to proxies, the Task Force finds no basis for regulation of the form or content of proxies by the United States Trustee Program, but notes that it is the United States Trustees who are ultimately responsible for the formation of committees and, therefore, are the parties most likely to have to deal with proxies. When determining the acceptability of proxies, the interests of creditors and the committee formation process are best served by clear and transparent standards from the United States Trustee Program, with those standards applied consistently across regions and offices. This consistency from the United States Trustee Program is more easily achieved when there is a predictable level of integrity in the process by which a proxy relationship is established. Therefore, some consistency regarding a proxyholder’s relationship with its principal is desired, as it maintains an avenue for creditors to participate in the Chapter 11 committee process.

To that end, the Task Force offers these recommendations to provide some degree of transparency and independence in the use of proxies in order to maintain the use of proxies for creditors to participate in the committee formation process without the need to incur the time and expense of in-person participation:

1. A party holding a proxy for a creditor must communicate with the creditor prior to the organizational meeting and should have a clear understanding of:
   a. the creditor’s relationship with the debtor(s);
   b. the nature of the creditor’s claim;
   c. the creditor’s plans for a future relationship with the debtor(s); and
   d. any potential conflicts that the creditor might have (e.g., a 503(b)(9) claim; a pending sale of its claim; an interest in acquiring the debtor(s)’ business(es), and the like).56

2. The party holding the proxy should discuss with the creditor the creditor’s preference or instructions as to the interviewing or selection of professionals to represent the committee.
   a. The creditor should be given the opportunity to voice:
      i. a desire that the proxyholder advocate for the retention of specific committee professionals in the creditor’s absence;
      ii. a desire to defer selection of professionals until the creditor can participate personally; or
      iii. a decision to defer to the proxyholder’s discretion as to selection of professionals.
   b. If the proxyholder has a pre-existing relationship with any of the professionals that it knows or believes will be seeking employment by the committee, including any professionals who contacted the proxyholder with the intent of asking the proxyholder to serve in that capacity, the proxyholder should disclose these facts and any pre-existing relationship to the creditor.

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56 When communicating with the creditor about the proxy and the claim, the conversation can easily slip into a discussion of legal rights, e.g., to priority treatment that might disqualify the creditor from service on the committee. Legal advice in such situations is within the scope of the attorney-client privilege despite lack of a formal engagement as counsel. Counsel should be cognizant of the restrictions on subsequent disclosures of privileged information in Model Rule 1.18, and on the disclosure obligations described in *Universal Building Products*, 486 B.R. 650, 658-65 (Bankr. D. Del. 2010).
3. If a professional seeking employment by the committee has arranged for a party to hold a proxy for a creditor later named to the committee or has a past connection to a party who held a proxy for a creditor named to the committee, that professional should disclose this information at the time of the initial disclosures required by Rule 2014.

The Task Force’s recommendations for modifications to Rule 2014 has added language to that Rule that, if adopted, will require professionals to disclose such circumstantial connections. This language is reported elsewhere in our Final Report.

4. Disclosure

Bankruptcy Rule 2014 requires disclosure of all connections of the professional seeking approval of employment with, *inter alia*, creditors and their other professionals. The court in *Universal Building Products* found that solicitation relationships constitute disclosable connections, and counsel is advised to follow that precedent. The one catch-all observation that the Task Force offers is this: as in most cases involving disclosure, if the idea of disclosing an activity is undesirable to a professional, then the activity is probably questionable on its face. In disclosing any of these actions, one might argue about whether or not the activity constituted improper solicitation, but the idea that the professional sought to conceal the activity—with deliberate non-disclosure typically being viewed as the more damning act and being clearly impermissible—is removed from the debate.
Chapter 3A
Nonbankruptcy Alternatives to Asset Sales

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I. INTRODUCTION

Under U.S. law, the most potent and comprehensive process for dealing with creditor-debtor relationships is bankruptcy as codified in Title 11 of the United States Code (the “Bankruptcy Code”):

- Statutory provisions of the Bankruptcy Code are powerful;
- Case law interpreting the Bankruptcy Code is extensive and establishes a predictable forum for case administration on which debtors, creditors, and their counsel can rely; and
- The Bankruptcy Code provides for the sale or disposition of assets either directly through a Section 363 sale or through a confirmed plan of reorganization.
- But bankruptcy does not always provide the most attractive solution to creditor-debtor and asset disposition problems:
  - Asset valuation, secured-status, and lien priority issues can significantly affect the length and expense of a bankruptcy case and its process for administering the sale of assets;
  - Under some economic circumstances, particularly in times of tight credit, a debtor may find it difficult or impossible to obtain the financing necessary to fund a Chapter 11 case and the costs of post-filing operations; and
  - The large number of professionals required to administer a bankruptcy case make bankruptcy proceedings expensive.

Despite the comprehensive reach and application of the Bankruptcy Code, creditors (particularly secured creditors) and debtors should be aware that there are other options available to them to effect the disposition of assets; and some of these alternatives can accomplish some of the same things that a bankruptcy proceeding can produce—and in many cases arguably more efficiently:

- UCC Article 9 Foreclosure;
- State Court Receivership;
- State Law Assignment for the Benefit of Creditors.

II. UCC ARTICLE 9 FORECLOSURE

A. Overview

In Washington and Oregon (as in other states), foreclosure on personal property is governed by Article 9 of the Uniform Commercial Code. RCW 62A.9A-101 et seq.;
ORS 79.0101 et seq. As a threshold matter, a number of features are characteristic of both Article 9 foreclosures and Section 363 bankruptcy sales: assets are sold/disposed of; the secured creditor may typically participate in the sale as a bidder; junior liens on the assets being sold can be cleared; and a deficiency claim may be fixed.

Differences between a bankruptcy sale and a UCC foreclosure include the following:

- An Article 9 foreclosure sale can be faster than a bankruptcy sale and certainly faster than the entire bankruptcy process;
- An Article 9 foreclosure sale typically carries lower professional expenses;
- An Article 9 foreclosure sale is limited in scope, since it deals solely with the secured party's personal property collateral and junior liens on that collateral;
- An Article 9 foreclosure sale is not available for the liquidation of real property collateral; and
- There is typically no court order approving an Article 9 sale or any deficiency claim and, as a result, the sale may spawn litigation with the borrower or any guarantors.

B. Key Elements of the Process

1. Commercial Reasonableness

UCC Section 9-610 requires that a foreclosure be conducted in a “commercially reasonable” manner. This requirement applies to “every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable.” This UCC section also confirms that so long as it would be commercially reasonable to do so, “a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.”

The commercial reasonableness requirement is critically important and failure to comply with the commercial reasonableness standard may result in judicial interference with the sale or liability for damages under UCC 9-625. Failure to observe the commercial reasonableness standard can also expose the sale to scrutiny as a potentially fraudulent transfer, in the event of a post-sale bankruptcy or through a similar state law proceeding. The UCC provides limited guidance on what constitutes commercial reasonableness. Section 9-627 provides that the mere fact that a greater amount could have been obtained by a different method of disposition “is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.” Under 9-627, a disposition of collateral is also made in a commercially reasonable manner if the disposition is made:

1 These remarks deal only with the UCC as applied to non-consumer goods.
“(1) in the usual manner on any recognized market;

“(2) at the price current in any recognized market at the time of the disposition; or

“(3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.”

Section 9-627 also provides that a collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:

“(1) in a judicial proceeding;

“(2) by a bona fide creditors' committee;

“(3) by a representative of creditors; or

“(4) by an assignee for the benefit of creditors.”


2. Public v. Private Sales

Section 9-610 of the UCC provides that the secured party's collateral may be sold at either a public or a private sale, with either method permitted so long as it is commercially reasonable. The right of the secured creditor to purchase at the sale, however, differs between the two sale forms. A secured creditor may purchase its collateral at the public sale but in the case of a private sale may purchase its own collateral if the collateral is of a specific type:

“(c) Purchase by secured party. A secured party may purchase collateral:

“(1) at a public disposition; or

“(2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.”

If the creditor wishes to purchase collateral that is not customarily sold on a recognized market, it must conduct the foreclosure by public sale. This UCC restriction contrasts with Bankruptcy Code Section 363(k), which explicitly provides that at a Section 363 sale, “unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.”
3. Warranties and Value

Section 363(f) of the Bankruptcy Code provides a significant benefit for buyers by allowing a court to strip assets sold by a debtor of the claims that might otherwise attach to them: “The trustee may sell property under subsection (b) or (c) of this section [363] free and clear of any interest in such property of an entity other than the estate. . . .” This provision makes the assets more attractive to a buyer and thus more likely to attract a higher price.

By contrast, an Article 9 UCC sale transfers to a transferee for value all of the debtor's rights in the collateral and discharges the foreclosing secured creditor's lien and any subordinate security interest (other than liens created under state law that are not to be discharged). The UCC does, however, permit the selling secured party to market the assets without any meaningful representations or warranties. UCC Section 9-610(d), (e) and (f). This difference between the Article 9 warranty provision and Section 363's protection from pre-existing interests suggests that the purpose of the UCC is more to authorize a quick and efficient sale on an “as-is, where-is” basis, rather than to maximize sale proceeds to the debtor's estate.

4. Notice

Section 9-612(b) of the UCC provides that outside of consumer transactions, 10 days or more before the earliest scheduled sale/disposition is considered a reasonable time for notice. This is plainly shorter than the 21 days' notice required for a sale of assets under Rule 2002 of the Federal Rules of Bankruptcy Procedure.

5. Application of Proceeds

UCC 9-615(a) provides that the secured party has the right to be reimbursed from sale proceeds for the reasonable expenses of the foreclosure sale as well as reasonable attorney's fees and legal expenses. UCC 9-615(d) also provides for the debtor to receive any surplus and to be liable for any remaining deficiency. The proceeds of an Article 9 sale will normally be available immediately and distribution need not wait until the confirmation of a bankruptcy plan of reorganization.

6. Strict Foreclosure

Article 9 provides for a secured party to take possession of its collateral directly and simply keep it in satisfaction of debt. This process is commonly referred to as “strict foreclosure” and it is governed primarily by UCC 9-620 and UCC 9-621. If the secured party takes possession of the collateral but still retains a deficiency claim, it is called “partial strict foreclosure” and if there is no deficiency claim, it is termed “complete strict foreclosure.” The debtor's consent is needed for partial strict foreclosure and its non-objection (as well as a non-objection after notice from a variety of affected parties, including other lienholders in the collateral) is required for complete strict foreclosure. The objection period is 20 days from transmission of the creditor's notice of foreclosure.
C. **Article 9 Foreclosure or Bankruptcy?**

- An Article 9 foreclosure has the advantage of being quick and cheap and being able to eliminate junior liens.

- An Article 9 foreclosure provides the secured creditor with substantial control over the process, particularly in cases in which there is an identified willing buyer or a defined market with multiple bidders likely to participate.

- The Article 9 process is not available for the liquidation of real property collateral.

- The Article 9 process is susceptible to interruption by the filing of an involuntary or voluntary bankruptcy petition at any time before the sale is consummated.

- An Article 9 foreclosure lacks the predictability and certainty of a bankruptcy proceeding since it is normally not accompanied by a court order approving the sale. This factor creates the risk of hindsight analysis and future litigation.

III. **RECEIVERSHIP**

A. **Statutory Overview**

A receiver is a disinterested person typically appointed by a court to collect and protect property that is the subject of diverse claims. Receivers are agents of the appointing court and are charged with performing certain tasks, often the preservation and liquidation of specified assets. Historically, and in many states, a receiver's powers and responsibilities were specifically set forth by the court order that initiated the receiver's appointment.

In Washington, most powers of a receiver were established by common law and court order, with little statutory specificity. In 2004, however, the Washington state legislature adopted a comprehensive revision to Washington's existing receivership statute. Codified as RCW 7.60.005 et seq., this revision supplemented common law receivership principles and created an expanded, detailed, and relatively complete statute that articulated—among other procedural and substantive provisions—a receiver's powers and procedures for the liquidation of assets. *See*, Marc Barreca, “Washington's New Receivership Act,” *WSBA Creditor-Debtor Law News Letter*, Vol. 22, No. 1 (2004) (attached hereto as Appendix A).

B. **The Washington/Oregon Sales Provisions**

RCW 7.60.260 and ORS 37.250 authorize a receiver to sell assets of the receivership estate. Both of these statutes incorporate language familiar from Bankruptcy Code Section 363 and both the Washington and Oregon statutes share the following provisions:

- A receiver may sell assets outside the ordinary course of business;
- Sales will be free and clear of liens and of all rights of redemption;
- Liens on the property sold will attach to the sale proceeds in the same order, priority, and validity as the liens had with respect to the property immediately before the sale;
- A creditor may use its allowed secured claim as a credit bid against the purchase price;
- The reversal or modification on appeal of an authorization to sell estate property does not affect the validity of a sale to an entity that purchased the property in good faith;
- If estate property includes an interest as a co-owner, the receiver will have the rights and powers of a co-owner afforded by applicable law, including the right of partition; and
- Agricultural property (Washington) and residential/homestead property (Washington/Oregon) is subject to stricter sale requirements.

C. **Receivership or Bankruptcy?**

- Given the substantial overlay of administrative and procedural requirements imposed by the Bankruptcy Code, receivership is likely to be a somewhat less expensive legal process.

- Bankruptcy Code Section 363(f) provides for sales “free and clear of any interest in such property.” This language is broader than the Washington and Oregon receivership statutes' sanctioning of sales “free and clear of liens.” Accordingly, there may be uncertainty as to the post-sale status of, for example, a leasehold interest or other non-security-agreement based “interest” in the property sold, although practitioners may be able to reduce such uncertainty: (1) by identifying in the motion and sale order any non-lien “interests” in property that the receiver proposes to administer or resolve through the receivership sale process; or (2) by obtaining participation and consent from any affected “interest” holder prior to the hearing on sale approval.
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- Receiverships are state-court and state-law specific. Accordingly, the existence of saleable out-of-state assets may create procedural complications and thereby increase costs.

- The receivership process is susceptible to interruption by the filing of an involuntary or voluntary bankruptcy petition at any time before the receivership sale is consummated.

IV. ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

A. Introduction

An assignment for the benefit of creditors (“ABC”) is a state law insolvency proceeding designed to effect a quicker, less expensive liquidation than a Chapter 7 bankruptcy. In an ABC, the debtor transfers all of the property it owns at the time of the assignment to an assignee. In a role similar to that of a trustee in bankruptcy, the assignee accepts the assets of the debtor, liquidates them, and distributes the proceeds to creditors. The assignee is a fiduciary to all of the creditors and the assignee’s obligation is to maximize the value of property for the estate.

Laws governing ABCs vary from state to state. They can either be based on common law or statute. Whether or not the assignment process requires court supervision also varies from state to state.

As a threshold matter, federal bankruptcy law preempts state ABCs from granting a discharge of debt and probably also from engaging in state-law based preference avoidance actions. See, e.g., Sherwood v. Lycos, 394 F.3d 1198 (9th Cir. 2005).

B. ABCs in Washington and Oregon

Oregon does not have a dedicated ABC statute and the common law use of ABCs in Oregon is not widespread. Washington is a different story.2

When the Washington legislature in 2004 enacted sweeping changes to Washington's existing receivership statute (RCW 7.60) it also replaced Washington's old Assignment for the Benefit of Creditors Act (RCW 7.08).3 Washington's ABC statute now provides that general assignments of the property of a person who is insolvent or “in contemplation of insolvency” for the benefit of creditors must be administered for the benefit of all of the assignor's creditors in proportion to their claims. The 2004 act also provided that assignments must be in substantially the form set forth in the statute, which includes an articulation of the duties of an assignee to take possession of, and administer, estate assets; to liquidate the assets; and to pay, to the extent of


3 Washington's old ABC statute, although it remained codified at RCW 7.08 until its 2004 repeal, was effectively useless because its “discharge of debt” provision (former RCW 7.08.170) was constitutionally defective. See, Armour & Company v. Becker, 167 Wash. 245, 9 P.2d 63 (1932) (Federal Bankruptcy Act supersedes state insolvency law and state law is void insofar as it relates to distribution of property and discharge of the debtor).
available funds, the costs of administration and debts due from the debtor/assignor. Through the
required assignment form, the assignor declares under penalty of perjury that his list of creditors
and assets is true and correct to the best of the assignor's knowledge and that the assignee accepts
the assets in trust and agrees faithfully to carry out the assignee's duties under the statute.
RCW 7.08.030(1).

Working in tandem with the revised receivership statute, Washington's ABC statute
provides that upon the filing of a petition by the assignor, assignee, or any creditor of the
assignor with the clerk of the superior court, the superior court shall appoint the designated
assignee as a general receiver with respect to the assignor's property. Venue lies in the county of
the assignor's residence or, for non-individual assignors, the assignor's principal place of
business or registered office within the state. All ABCs are thus effectively—and immediately
upon filing—converted into general receivership actions; and all ABCs proceed under the
provisions of the receivership statute. RCW 7.08.030(4).

The basic purpose of the common law assignment and of Washington's ABC statute is to
provide debtors with a straightforward and efficient method of liquidating their assets and paying
their creditors. The Washington ABC statute facilitates this goal but brings with it a number of
features that practitioners should also appreciate:

- **Ex Parte Right to Initiate Process.** It has traditionally been the case that
receivership is a remedy most often employed by secured creditors to enforce
their loan and security documents against their defaulting borrowers. The vast
majority of receiverships are initiated by secured lenders in order to obtain control
of their collateral pending foreclosure or to achieve other administrative control of
their collateral. Washington's ABC statute, by contrast, gives debtors the power
to initiate their own receiverships. Even more, the statute provides that such ABC
receiverships may be commenced *ex parte*, with no advance notice at all to the
secured lender (or any other creditors) or hearing on the appointment of the
assignee/receiver. The ABC receivership automatically becomes effective upon
the filing of the petition. RCW 7.08.030(3). The assignment is irrevocable.
RCW 7.08.030(1). Once the case has been filed, moreover, it has become the
practice for the debtor/assignor to present an *ex parte* order appointing the
receiver—an order which may contain many of the provisions traditionally
included in receivership orders of appointment, such as specific grants of power
to the receiver and terms for financing the receivership estate.

- **Selection/Replacement of Assignee/Receiver.** In Washington, the secured
creditor commencing the receivership typically picks the receiver in advance. At
the hearing on appointment, the court approves the receiver and enters an order
clarifying the receiver's powers and duties and also establishing the mechanism
for compensating the receiver. Under Washington's ABC statute, the debtor now
has the power to select its own assignee/receiver and to incorporate into its order
of appointment the duties of its hand-picked assignee/receiver. The statute does
provide creditors with an elaborate procedure for replacing the receiver; but this
procedure requires that at least two creditors ask the court to make a change.
RCW 7.08.030(5).
• **Automatic Stay.** The revised receivership act provides for an automatic stay against property of the debtor. RCW 7.60.110. Accordingly, an ABC debtor in Washington can now not only commence its own receivership *ex parte* but can also protect itself from its creditors with an automatic stay.

C. **Washington ABC or Bankruptcy?**

• An ABC is potentially less expensive than a bankruptcy filing and can likely provide for a faster closing on an asset sale than could a Section 363 sale.

• An ABC, as opposed to a Chapter 7 bankruptcy, can potentially be used to capture going concern value.

• A bankruptcy provides a built-in forum that requires greater threshold transparency from the debtor than an ABC typically does.

• An ABC initiated by the debtor shifts control of the liquidation process from the secured creditor.

V. **PRACTICAL TAKEAWAYS**

• In lieu of a bankruptcy sale process, secured creditors should seriously consider pursuing their Article 9 liquidation remedies (with respect to their personal property collateral), particularly if they have identified a willing buyer in advance of sale or if their collateral is or will be attractive to a defined universe of potentially competitive bidders.

• In lieu of a bankruptcy sale process, both secured and unsecured creditors should seriously consider a Washington debtor's ABC option. The ABC liquidation is likely to be cheaper and quicker than a bankruptcy sale and, if necessary, affords ready access to judicial oversight. With respect to administrative costs and expenses, however, ABC creditors should carefully examine the order appointing the assignee to understand the amounts, sources, and procedures for the assignee's compensation.

• In lieu of a bankruptcy sale process, both secured and unsecured creditors in Washington and Oregon should seriously consider a debtor's receivership option. Both Washington and Oregon receivership proceedings are likely to be cheaper and quicker than a corresponding bankruptcy case, while affording the comfort of ready judicial oversight but with reduced judicial administrative and procedural overlay. Again, with respect to administrative costs and expenses, receivership creditors at the outset of the case should carefully examine the order appointing the receiver to understand the amounts, sources, and procedures being proposed to cover the receiver's compensation.
Chapter 3A—Nonbankruptcy Alternatives to Asset Sales

Washington’s New Receivership Act

Introduction

On March 26, 2004, Governor Locke signed into law Substitute Senate Bill 6189, an Act relating to Receiverships (“the Act”), substantially replacing the current receivership statute, Chapter 7.60 RCW and the current assignment for benefit of creditors (“ABC”) statute, Chapter 7.08 RCW.

The Act is the product of an effort that began in 1990 when Irvin W. Sandman of Graham & Dunn and the Creditor-Debtor Law Section sought and obtained the Executive Committee’s approval to form and chair a subcommittee to draft a new receivership statute. The subcommittee then established its two principal objectives: bring organization to Washington State’s receivership laws and provide a less expensive, streamlined alternative to liquidating business cases under the Bankruptcy Code.

This effort continued over the ensuing years, and sixteen members of the WSBA Creditor-Debtor Law Section contributed time, work, and leadership. Special mention should be made of the tireless, scholarly efforts of Jim Austin of Karr Tuttle Campbell. His years of involvement in the development of the legislation included handling most of the extensive drafting chores, with periodic helpful nudging by Rick Hyatt. Other prior subcommittee members included: Dale Armitrage, Suzanne Barnett, Bill Courshon, Chuck Ekberg, Commissioner Epstein, Chris Meleney, Mark Northrup, and Prof. Marjorie Rombauer. In the final effort over the last two years, a substantial contribution was made by Ian Ledlin, Cynthia Kuno, and Brian Lynch. The Act is a comprehensive receivership statute that gives greater guidance to the bench and bar on the powers and duties of a receiver, in some cases codifying existing receivership case law, and in other cases, expanding or modifying current law. The Act also substantially amends the state’s ABC statute, replacing out-of-date and confusing provisions, establishing a more usable standard notice of assignment, and providing the assignee with the powers of a receiver for administration of assets and resolution of claims.

Summary of Provisions

The following is a summary of the Act’s major provisions. For purposes of this summary, the person as to whose property the receiver is appointed will be referred to as “debtor,” although receivers are appointed in various settings, not necessarily involving insolvency.

Types of Receivers

Section 3 of the Act provides a distinction between two types of receiverships—a general receivership and a custodial receivership. A general receiver is appointed to take possession and control of “substantially all of a person’s property with authority to liquidate that property.” A custodial receiver is “appointed to take charge of limited or specific property of a person or is not given authority to liquidate property.” Receivership appointments made solely to collect rents during the pendency of a judicial or nonjudicial real property foreclosure
are expressly designated as custodial receiverships. As various provisions of the Act only apply in general receiverships, the court is required to specify in the appointment order whether a receiver is a general or custodial receiver but may later convert one type of receivership to the other.

**Appointment of Receiver**

Section 4 of the Act enumerates in one location the various statutory grounds for appointment of a receiver previously scattered throughout the Revised Code of Washington. Section 4 also clarifies that, except where a receiver’s appointment is expressly mandated by statute or is made in connection with a real property foreclosure to enforce an assignment of rents, a receiver shall only be appointed if the court finds that the appointment is “reasonably necessary” and that other available remedies are inadequate. A seven-day notice requirement for receivership applications is established, but may be shortened or expanded for good cause shown.

Note that, pursuant to Section 32 of the Act, Chapter 7.60 is inapplicable to insurance under receiverships initiated under RCW Title 48.

**Eligibility to Serve as a Receiver**

Receiver eligibility requirements are set forth in Section 5 and preclude appointment of a convicted felon, a party to the receivership action, certain insiders, as defined, and parties having a materially adverse interest to persons affected by the receivership.

**Receiver’s Bond**

Section 6 of the Act requires a receivership bond (or cash deposit in lieu of bond) except where expressly provided by statute or court rule but does not require a minimum amount.

**Turnover of Property**

Section 9 of the Act provides that a receiver, by motion, may seek to compel turnover of receivership estate property from any person unless the receiver’s interest in the property is in bona fide dispute, in which case a lawsuit by the receiver is required.

**Schedules of Property and Liabilities; Inventory of Property, Appraisals**

Section 11 requires the completion of a schedule of assets and liabilities on a prescribed form. For ABC, the schedules are to be annexed to the assignment document. In the case of a general receivership, the schedules are to be filed by the receiver within twenty days of the general receiver’s appointment. The person making an assignment for benefit of creditors is required to verify the schedules. Under Section 10 of the Act, the debtor has the duty to cooperate with the receiver, provide information necessary for completion of the schedules, deliver control of property and records to the receiver, and submit to an examination by the receiver (equivalent to a Bankruptcy Rule 2004 examination).

**Automatic Stay of Certain Proceedings**

Section 13 of the Act provides a limited automatic stay of certain proceedings. Unless otherwise ordered by the court, entry of an order appointing a general receiver or a custodial
receiver with respect to all of a person’s property (i.e., like a general receiver but without the power to liquidate) creates a stay of actions against the debtor or actions to obtain possession of receivership properly. The stay automatically expires sixty days after the appointment unless continued for good cause shown. Affected parties may move for relief from or modification of the stay. The stay does not prevent prosecution of criminal proceedings, proceedings regarding support obligations, regulatory actions, or issuance of a notice of tax deficiency.

Although the automatic stay is a substantial new addition to the state’s receivership law, assets of the receivership’s stay are already considered to be in the custodia legis of the receivership court and not generally subject to new liens or transfer other than after order of the receivership court. No specificity is given for grounds for relief from the limited duration stay or grounds for continuation of the stay past the initial sixty-day period. The Act is also indefinite as to whom, other than parties to the receivership action, are required to receive notice of motions for relief from stay or motions to continue the stay. Presumably parties will argue by analogy to bankruptcy case law as to grounds for relief from the automatic stay.

Utility Services

Section 14 of the Act provides restrictions on discontinuance of utility service. These are not as extensive as the utility provisions of 11 U.S.C. § 366. Section 2(14) of the Act defines “utility” as “a person providing any service regulated by the Utilities and Transportation Commission.” This is more specific and presumably more narrow than the equivalent term used in 11 U.S.C. § 366. Section 14 of the Act is also more limited than 11 U.S.C. § 366. It prohibits a utility from discontinuing service without providing the receiver at least fifteen days notice of default. Section 14 stops short of enjoining utilities from termination of service, but instead states “[t]his section does not prohibit the court, upon motion by the receiver, to prohibit the alteration or cessation of utility service if the receiver can furnish adequate assurance of payment (for service to be provided after entry of the order appointing the receiver).” Section 14 applies to any utility providing service to receivership estate property regardless of whether it is a general or custodial receivership.

Executory Contracts and Unexpired Leases

Section 15 of the Act codifies, clarifies, and amends the common law power of a receiver to assume or reject executory contracts and unexpired leases. This section only applies to a general receiver. Section 15 allows a general receiver to assume or reject contracts after notice and opportunity for hearing. To assume a contract, as in bankruptcy, the receiver must cure defaults but does not have to cure financial condition or “ipso facto” clause violations. A receiver may assign executory contracts or unexpired leases after assuming them, but has no express power to override anti-assignment provisions. Additionally, contracts which are inherently non-assignable (such as personal service contracts, certain intellectual property license agreements, and certain governmental contracts), remain non-assignable in receiverships, absent the counterparty’s consent.

As in Section 365 of the Bankruptcy Code, the counterparties to certain kinds of executory contracts or unexpired leases are provided special protections in the event of contract rejection. These include buyers of real property in possession of the real property,
timeshare buyers, intellectual property licensees, and real property lessees. The protected parties are allowed to retain the benefits of their contracts, but must continue paying rent, royalties, or performing other obligations arising after rejection and may offset against such payments damages occurring as a result of rejection.

**Receivership Financing**

Section 16 clarifies that a receiver operating a business or managing a person’s property may obtain unsecured credit in the ordinary course of business without order of the court and may otherwise be authorized by court order to incur indebtedness on a secured or unsecured basis. There are no provisions authorizing priming of existing security interests by lenders to the receivership.

**Abandonment of Property**

Section 17 of the Act allows a receiver (whether a general or custodial receiver) to, after notice and hearing, abandon estate property that is burdensome or of inconsequential value. A receiver may not abandon property that is a hazard or potential hazard to the public in contravention of state statute. This is similar to the restriction on abandonment under 11 U.S.C. § 554, following the Supreme Court’s Midlantic Bank decision. *Midlantic Nat’l Bank v. New Jersey Dept. of Environmental Protection*, 106 S.Ct. 775 (1986).

**Personal Liability of Receiver**

Section 19 of the Act clarifies the standard for liability of a receiver. A receiver will only be liable if loss or damage is caused by a failure of the receiver to follow a court order or by an act or omission which would expose a member of a board of directors to liability, assuming such director’s liability is limited to the maximum extent permitted under RCW 23B.08.320. The range of persons to whom the receiver may be personally liable is also limited. Only the debtor or persons who would otherwise have valid claims against officers of a business corporation organized under the laws of the State of Washington under the same circumstances will have potential personal claims against the receiver. A receiver will have no personal liability to any person for acts or omissions specifically contemplated by an order of the court.

**Employment and Compensation of Professionals**

Section 20 of the Act specifically provides for appointment of professionals by the receiver after court approval. Such professionals must not “hold or represent an interest adverse to the estate” but are not disqualified by representation of or relationship with a creditor or other party in interest if the relationship is disclosed in the application and the court determines that there is no actual conflict of interest or inappropriate appearance of conflict. Section 20 also provides for notice and opportunity for hearing as to payment of the professionals’ bills. Fee applications must provide an itemized billing including the rates of persons performing the work to be compensated. In a custodial receivership in aid of foreclosure, the fees and expenses may be allowed by stipulation of the secured creditor affected by the appointment. If objections are filed, the receiver or professional seeking compensation may request a hearing on at least five days notice to persons having filed the objections.
Participation of Creditors and Parties in Interest in Receivership Proceeding; Effect of Court Orders on Non-Parties

Section 21 of the Act clarifies that a creditor or certain other parties in interest may participate in the receivership proceeding without formally joining as a party. Orders regarding sale free and clear of liens or other matters affecting real property are effective as to persons having actual knowledge of receivership whether or not they appear and participate in the receivership. Section 21 also provides certain notice periods, including a ten-day notice for receiver’s examination of the debtor referred to above and a thirty-day notice regarding claims allowance, abandonment, creditor distributions, dispositions of estate property, compromises, or settlements which may affect distributions to creditors, compensation of receivers and professionals, or applications for termination of the receivership or discharge of the receiver.

Submission of Claims in General Receiverships

Section 23 of the Act provides that, in a general receivership, creditors must file claims to receive a distribution. A general receiver must provide at least thirty days’ notice to creditors of a claims bar date except in the case of state agencies. State agencies must receive at least one hundred eighty days notice, equivalent to that required in the Bankruptcy Rules.

Priorities

Section 25 of the Act provides that claims in a general receivership shall receive distributions in a set priority generally equivalent to that under the Bankruptcy Code. Secured creditors are to be paid from the proceeds of their collateral, after payment of the “reasonable necessary expenses of preserving, protecting or disposing of the property to the extent of any benefit to the creditors.” This is a receiver’s equivalent of a bankruptcy trustee’s right to surcharge collateral under 11 U.S.C. § 506(c). The undersecured portion of a creditor’s claim is treated as an unsecured claim. Salary claims within ninety days of the appointment of the receiver or cessation of business are limited in priority to $2,000. Consumer deposit claims are limited in priority to $900. Support obligations, as defined in RCW 74.20A.020(10), receive a priority below wage and consumer deposit claims but above tax claims of governmental units. The priority for governmental unit tax claims is not limited as to the type of tax but is limited to unsecured claims.

Secured Claims Against After-Acquired Property

Section 26 of the Act clarifies that prepetition security interests which include an after-acquired property clause will attach to after-acquired property of the receivership. This is significantly different than the limitation on after-acquired property provided in 11 U.S.C. § 552.

Receiver’s Disposition of Property; Sales Free and Clear

Section 28 of the Act codifies the receiver’s common law right to sell assets of the receivership free and clear of liens. The court may authorize a general receiver to sell estate property free and clear of liens and rights of redemption whether or not sale proceeds would be sufficient to satisfy all secured claims. Absent consent of the owner, farm property and homestead property may not be sold by the receiver. Additionally, if the owner or a creditor secured by an interest in the property objects to the sale, the court must determine that “the
amount likely to be realized by the objecting person from the receiver’s sale is less than the person would realize within a reasonable time in the absence of the receiver’s sale.” Secured creditors are allowed to bid their debt but must provide for payment of senior secured creditors. This is the equivalent of 11 U.S.C. § 363(k).

The receiver is given the right as a co-owner to seek partition of property to the extent provided under applicable state or federal law but is not given the equivalent of a trustee’s right to force the sale of both a debtor and nondebtor’s jointly owned property as provided under 11 U.S.C. § 363(h). Section 28 also provides protection to a good-faith buyer from reversal or modification on appeal of the order of sale equivalent to that provided in 11 U.S.C. § 363(m).

Assignments for the Benefit of Creditors

Sections 36 and 37 of the Act replace RCW 7.08, et. seq. regarding assignment for the benefit of creditors. Section 36 provides that general assignments of the property of a person who is insolvent or “in contemplation of insolvency” for the benefit of the creditors must be for the benefit of all of the assignor creditors in proportion to their claims. Section 37 also provides that assignments must be in substantially the form provided which includes an articulation of the duties of an assignee to take possession of and administer estate assets, liquidate assets, and pay, to the extent of available funds, the costs of administration and debts due from the debtor/assignor. Through the assignment form, the assignor declares under penalty of perjury that the list of creditors and property is true and correct to the best of the assignor’s knowledge and the assignee accepts the assets in trust and agrees to faithfully carry out the assignee’s duties.

Section 37 provides that the assignee shall be appointed as a general receiver with respect to the assignor’s property by the superior court upon the filing of a petition by the assignor, assignee, or any creditor of the assignor with the clerk of the superior court. Venue is provided for in the county of the assignor’s residence or, for nonindividual assignors, the assignor’s principal place of business or registered office within the state. In effect, all ABCs must now be converted after the execution of the assignment into receivership actions. This also provides a clear avenue for debtors to initiate receiverships.

Once such an order is entered, the assignment proceeding is, in effect, converted to a general receivership. Two or more creditors may file a motion within thirty days of the mailing of a notice of assignment for benefit of creditors, directing the clerk of court to order a meeting of creditors to determine whether the assignee should be appointed as general receiver or whether an alternative party should be appointed as general receiver. These provisions are generally equivalent to those providing for election of trustees in bankruptcy.

Repealers; Elimination of Preference Statute

Various inconsistent or redundant provisions are repealed. Additionally, the state’s corporate voidable preference law found at RCW 23.72.030 is repealed. This will eliminate the use of RCW 23.72.030 in Washington corporate bankruptcies.
Section 47 of the Act provided for the repeal of three portions of the Non-Profit Corporations Act having to do with foreign corporations. These proposed repealers were in error (the intent was to repeal RCW 24.06.310, 315, and 320 which reference receiverships instead of RCW 24.03.310, 315 and 320 referenced in SSB 6189). This mistake was noticed after approval of the bill by the House and Senate but fortunately was corrected by Governor Locke’s use of the line item veto.

**Conclusion**

Hopefully, the Act will be easier for practitioners to utilize and provide greater certainty in judicial application. This greater clarity should make both judicial receiverships more attractive than prior law as an alternative to bankruptcy liquidations in appropriate circumstances. The changes to the ABC laws also should make the hybrid ABC/receivership procedure a viable alternative to bankruptcy liquidation.

The Act becomes effective on June 10, 2004. A copy of the final version of the Act can be found at both the Section’s web page on the WSBA website ([www.wsba.org](http://www.wsba.org)) or on the Washington State Legislature’s website ([www1.leg.wa.gov/legislature](http://www1.leg.wa.gov/legislature)).

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OREGON’S NEW RECEIVERSHIP LAW — WHAT YOU NEED TO KNOW

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On June 15, 2017, Governor Kate Brown signed Senate Bill 899, enacting the Oregon Receivership Code (“the Code”). This new Code is the result of hard work by the Oregon Law Commission Receivership Work Group, formed in January 2016 to clarify and improve the statutes and law related to receivership in Oregon in time to provide recommendations to the 2017 Legislative Assembly. The Work Group included judges, receivers, a professor, and lawyers. The group was ably assisted in its efforts by legislative counsel and staff of the Oregon Law Commission. The Work Group considered the law, prepared the text of Senate Bill 899, and submitted the bill in early 2017.

Purpose

The Code’s purpose is to bring clarity to receivership practice in Oregon. Historically, Oregon has had very few specific statutes and rules governing receivership which has, instead, primarily been governed by common law. The case law in this area is archaic, particularly for counsel and judges who do not specialize in receivership. As a result, receivership cases have been more expensive and less predictable for the parties and the legal system than they needed to be.

Philosophically, the Work Group saw its mission as bringing clarity to existing law, rather than attempting to make wholesale substantive changes to the law. Many of the proposed provisions are simply codifications of existing Oregon common law. While the Work Group needed to make some decisions if the law was silent or unclear, these decisions were made after considering the balanced input of judges, receivers, and lawyers representing all types of constituencies in receivership.

Starting Points

As part of its drafting process, the Work Group considered a number of receivership statutes, including the Washington receivership statutes (RCW 7.60 et seq.) and the Uniform Commercial Real Estate Receivership Act. Ultimately, the Work Group crafted its own statute, taking the best from each of the sources it considered, with its own additions, to make the Oregon Receivership Code consistent with Oregon’s legal culture and practice.

Scope of the Statute

The Oregon Receivership Code is generally not intended to be used in consumer cases, nor is it intended to be a substitute for residential foreclosure. For example, the
court's power to entrust property that is primarily residential to a receiver and for a receiver to sell that property is available only in very limited circumstances, such as those involving waste and destruction, or enforcement of domestic relations orders. The Code generally cannot be used for household goods, exempt property, or property held in trust, except in domestic relations cases.

The Code is also not intended to supplant existing law regarding specialized types of governmental receiverships, such as insurance company receiverships. When a state agency is authorized to commence a receivership for regulatory purposes, the agency is given its choice of using its own existing statutes or opting in to the provisions of the Code.

Defining the Scope of the Receivership

Under the Code, a receivership may be imposed over all or a portion of the defendant's property. If the party seeking appointment of the receiver does not reasonably describe specific limited property subject to the receivership, then the receivership will exist over all of the defendant's eligible property.

When Receivership is Allowed

The situations in which a receiver may be appointed have not substantially changed from prior Oregon law. A receiver may be appointed before judgment, if the property subject to the action is in danger of being lost or materially impaired. A receiver may also be appointed after judgment, to effectuate the judgment, to preserve property pending appeal, to dispose of property, or to aid in collection.

A receiver may be appointed in a fraudulent transfer action. If a creditor has attached property, a receiver is allowed if the property is perishable, is in danger of waste, impairment, or destruction, or is abandoned. A receiver may also be appointed over an entity that is dissolved or insolvent, to protect the interests of owners or creditors.

The Code includes broad authority for the appointment of a receiver if the court, in its discretion, believes a receiver is necessary to secure justice for the parties. Although the court may consider the existence of a contractual provision providing for the appointment of a receiver, the court is not bound by the provision.

Powers of the Receiver

Common law contains a distinction between custodial receivers and general receivers. In practice, the lines between these two types of receivers are very difficult to locate. The Oregon Receivership Code does not rely on this historical distinction. Instead, the Code takes the "menu approach." The menu approach is simple: the statute sets forth a nonexclusive list of powers that may be granted to a receiver. This list includes most of the powers that a party would typically seek to include in a comprehensive receivership order. The party requesting the receiver chooses what items off the menu that party believes the receiver should have under the facts of the particular case, and asks the court to include those powers in the order appointing the receiver. The party requesting the receiver may request items that are not on the menu. The opposing party or interested parties may object and ask that the powers be different or limited. The judge then has the authority to consider the facts and decide what powers the judge will grant to the receiver.

The advantage to this approach is that it forces the parties and the court to consider at the outset of the case what the receiver should be doing. This helps to avoid uncertainty during the case about whether the receiver really does or does not have authority to take certain actions.

Of course, the Oregon Receivership Code has preserved the possibility for any party, or the court on its own motion, to modify, expand, or limit the powers granted to the receiver as events in the case develop.

Participation and Service Rules

Under the Oregon Receivership Code, interested parties may appear and participate in a receivership without intervening to become formal parties to the case. This helps reduce costs for general creditors, potential purchasers, contract counterparties, and third parties who have an interest in how the case proceeds.

The Code also clarifies how notice must be given to various constituencies in the receivership case. The Work Group tried to balance the need to keep interested parties informed with the need to conserve limited estate resources.

At the outset of the case, the receiver is required by the Code to send a notice of the receivership to all known creditors by mail (or by another method approved by the court), as well as to publish notice in a newspaper. Otherwise, service of all interested parties is not required for every action in the receivership. The parties to the case (i.e., the entities in the caption) receive regular service of all pleadings as required by the Oregon Rules of Civil Procedure. Any interested person can file a request for special notice and indicate a preferred means of receiving notices. Notices must then be provided to the people and entities on the special notice list. Notice must be given to all known persons whose property interests may be directly affected by a proposed action. In addition, various provisions in the Oregon Receivership Code specify who must be served for particular purposes.

Automatic Stay

The Oregon Receivership Code provides for a six-month automatic stay, which can be extended by court
order. There are exceptions to the automatic stay for continuation of a foreclosure action by the party seeking appointment of the receiver, criminal actions against the owner, certain domestic relations proceedings, perfection of security interests, governmental pursuit of police and regulatory powers, and establishment of tax liability.

**Executory Contracts**

The Code adopts rules similar to those in the bankruptcy code regarding assumption and rejection of executory contracts. Contracts must be assumed in their entirety, with all benefits and burdens. Executory contracts specifically include contracts under which a party has an unexercised option to require the other party to perform. Actions taken in violation of the automatic stay are voidable (not void), and are subject to actual damages and sanctions for civil contempt.

**Receivership Sales**

A receivership sale is very different from a foreclosure sale. With a foreclosure sale, the property is sold at auction to the highest bidder on the courthouse steps. Bidders must pay cash on the date of the sale, have little to no opportunity to do due diligence, have limited information about the title to the property, and take ownership of the property with unknown risks. As a result, the typical bidder at a foreclosure sale is the lender who commenced the foreclosure. If others bid at a foreclosure sale, the price is often depressed because of uncertainty about the property.

By contrast, a receiver stands in the shoes of the owner of the property and can sell it as if the receiver were the owner. A receiver can hire regular commercial brokers (subject to employment by the court), can show the property, and can coordinate due diligence efforts. A buyer can propose a purchase and sale agreement with more traditional contingencies (such as financing and due diligence), and closing can occur in a more commercially reasonable time frame and manner. During the process, interested parties will have the opportunity to assert their ideas about how marketing should be done and to whom, in order to maximize the value obtained at sale. Ultimately, a receiver is an arm of the court, and the court will decide what sale process is fair under the facts of the case.

As a result of the differences between foreclosure and receivership sales, the Work Group deemed it logical to include language that a receiver's sales be made without rights of redemption. Often the sale price for a property is depressed if the borrower has a right of redemption, because the buyer does not have certainty that it will end up owning the property. In addition, the buyer may feel hampered in using the property until after the redemption period ends, which further depresses the price.

Since the purpose of a receiver's sale is to maximize the value of the property, and all interested parties are able to participate in the process of crafting the sale (subject to the court's oversight), the need for a redemption right to prevent the sale at an artificially low price is unnecessary.

**Claims**

The receiver may set a claims bar deadline and object to claims. The Code gives the receiver control over the process for submitting claims. The Code also contains a process for objecting to claims and for allowance or disallowance of claims. If the estate is insufficient to provide distributions to creditors, the receiver may give notice that no claims process will take place.

The Code further sets forth priorities for payment of claims. The order of priorities is as follows: (1) recovery of costs of preserving secured property in the estate; (2) secured claims; (3) administrative expenses; (4) claims under 31 USC §3713; (5) claims asserting liens that do not have to be perfected under applicable law; (6) unperfected secured claims to the extent of their collateral; (7) wages, salaries, and commissions, including vacation, severance, and sick-leave pay; (8) consumer deposits up to $2,850; (9) spousal or child-support obligations; (10) taxes; (11) general unsecured claims; and (12) interests.

**Recovery of Costs**

Under the Oregon Receivership Code, a receiver may seek to recover the costs and expenses of preserving property from the secured creditor's interest in property to the extent that the receiver's activities benefited the secured party.

**Protection of the Receiver**

In order to encourage the best-qualified people to serve as receivers, the Code provides that receivers should be protected from personal liability, except for their failure to follow court orders, instances of fraud, intentional misconduct, and similar bad acts. Parties wanting to sue the receiver must first obtain authority from the court that appointed the receiver.
Employment and Compensation of Receiver and Professionals

The Code sets forth the qualifications required for someone to serve as a receiver as well as the required disclosures by a proposed receiver. Under the Code, any person, whether or not a resident of Oregon, can be a receiver, unless the person or entity is not authorized to conduct business in Oregon, has been convicted of a crime, or (unless authorized by statute) is a sheriff of any county. A proposed receiver must disclose any conflicts of interest or affiliate relationships to any party to the receivership. The Code contains straightforward processes for employment and compensation of the receiver's professionals.

The court may appoint a successor receiver if a receiver resigns, dies, or is unable to serve, or if the court decides to remove the receiver for good cause.

General Administration

There are various options for providing bonds, security, or insurance for the receiver's actions, which the court can tailor to the needs of the case. There are also provisions governing receivership financing.

The Code requires the receiver to provide reports of the receiver's activities and the estate's financial condition. The reports must include a narrative description of the receiver's activities, as well as financial statements showing cash flow, receipts and disbursements, accounts receivable, tax status, and information on the estate's fees and expenses.

An owner of property is required to cooperate with the receiver. The receiver, with court approval, may apply to commence one or more ancillary receiverships if some property of the estate is located outside the boundaries of the state of Oregon.

Termination

The Oregon Receivership Code provides for the receiver to file a final report. Once the court approves the report, the court may discharge the receiver, exonerate the receiver's bond or any alternative security, and release the receiver from any further liability regarding the estate.

To learn more about this new Code, you may examine Chapter 358, 2017 Laws, or find it at https://olis.leg.state.or.us/liz/2017R1/Downloads/MeasureDocument/SB899/Enrolled. The Oregon Receivership Code will become effective on January 1, 2018.
Chapter 3B

363 Sales: Pertinent Issues and Alternatives—Overview of 363 Sales

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Section 363 of the Bankruptcy Code can be a powerful tool for selling assets. Under Section 363, the bankruptcy court may approve the sale of assets "free and clear of any interest in such property." 11 U.S.C. § 363(f). A 363 sale can be beneficial not only for the debtor, providing the quick sale of the property without resolving competing interests in the property as a condition of the sale, but also advantageous for the buyer by providing clear title to assets and protection from successor liability in most cases.

Sales of specific assets pursuant to section 363 of the Bankruptcy Code are common in both chapter 7 and chapter 11 bankruptcy cases. Section 363 sales provide prompt and efficient relief. Sales of all or substantially all of the assets of a chapter 11 debtor under section 363, however, are more complicated and occur less frequently, although it is becoming much more common in recent years. A primary advantage to a 363 sale of all assets is the timing, as such a sale can be completed in a much shorter time frame than going through the disclosure statement and plan of reorganization process. Such timing is often critically important in transferring ownership of the assets of an ongoing business.

**REASONS TO SEEK APPROVAL OF A 363 SALE**

There are several factors that might cause a debtor to conclude that it needs to sell all or substantially all of its assets in a 363 Sale. Some of the more common reasons are listed below and described briefly. These reasons are not intended as an exhaustive list, nor are they mutually exclusive.

In some cases the cash flow that a debtor can generate pursuant to a cash collateral order is sufficient to allow the debtor to continue its operations during the Chapter 11 case but is not adequate to permit the debtor to exit bankruptcy via a plan of reorganization. This could occur, for example, if the debtor lacks the funds to pay priority claims as required by the Bankruptcy Code. If the debtor is unable to find a source of adequate exit financing, then a sale may be the best alternative to maximize the value of the estate. Given that the debtor lacks the funds to confirm a plan, it is obviously impractical for the debtor to propose a sale through a plan.

In many other cases a debtor's cash flow is not only inadequate to implement a plan of reorganization, but projections (and common sense) show that the debtor will run out of cash during the course of the case. In such cases, the Chapter 11 plan confirmation process, with its
disclosure requirements, notice periods, and the need to resolve (or litigate) all of the debtor's contested issues, is simply too lengthy and costly for many debtors. In fact, secured creditors may require the debtor to move rapidly towards a 363 Sale as a condition of extending new financing and may limit the amount of that financing to that which is necessary to get to the closing of the sale.

Obviously, the lack of adequate capital and the "need for speed" can require a debtor to seek to complete a sale quickly. However, even debtors who are not confronting a cash crisis have reasons to proceed under 363 if the values of the business or its assets are deteriorating quickly (also known as the "melting ice cube" problem.). In those cases, the prospect of an imminent sale to a credible buyer may preserve the value of a business by convincing customers not to move their business to competitors and by keeping key employees from seeking, or leaving for, new jobs.

The 363 sale process has other advantages for debtors that have to move quickly. For example, negotiations regarding the terms of an asset purchase agreement can be simplified. Often debtors in chapter 11 cases will provide limited representations and warranties, provide few covenants and limited indemnities thereby avoiding the lengthy negotiations over these issues that frequently occur during negotiations about non-bankruptcy asset purchase agreements. Debtors also may be able to deliver free and clear title to their purchasers without extensive negotiations with secured creditors by including terms that provide that creditors' liens will be impressed on the proceeds of sale.

A potential ancillary benefit of 363 sales for debtors is that they might have two opportunities to get the best terms and price. A debtor can negotiate the terms and price with a buyer while retaining the ability to subject the terms to further competitive bidding at an auction.

Debtors may also be compelled to seek 363 Sales by prospective buyers. Both strategic and distressed asset buyers are generally interested in a quick and relatively predictable process to acquire the assets of a business, and buyers will, almost without exception, insist that the assets be sold free and clear of liens, encumbrances, claims and interests. In fact, prospective buyers will occasionally tell a debtor that they will withdraw from the sale process if a sale
cannot be closed expeditiously, or they may condition an offer on a closing date that can only be accomplished through a 363 Sale.

GETTING THE 363 SALE TO COURT

In most cases, 363 Sales involve the use of a "stalking horse" buyer. A debtor, either immediately prior to, or after, filing its bankruptcy petition will identify a prospective purchaser and negotiate the terms of an asset purchase agreement with that party. This prospective purchaser is the "stalking horse." In the ideal situation (from the debtor's perspective), there will be more than one party interested in becoming the "stalking horse" so that the debtor, in effect, will be able to conduct a mini-auction before selecting a "stalking horse."

Shortly after the debtor has entered into an agreement with the "stalking horse" (and the bankruptcy petition has been filed in those instances where the agreement was reached prior to the bankruptcy filing), the debtor will need to file several pleadings. One is a sale motion pursuant to which the debtor will seek authority to sell the assets (and usually to assume and assign specified executory contracts pursuant to section 365) to the "stalking horse," subject to receiving higher and better bids at an auction.

A second motion sets out the bidding procedures which provide the rules for the auction and for all parties seeking to bid against the "stalking horse" at the auction. The bidding procedure motion usually contains the protections for the "stalking horse," including the break up fee and overbid protection, and must be heard and approved by the court in advance of the auction. These two motions may be combined into one pleading.

There are also cases in which a debtor needs, or wants, to sell its assets, but hasn't entered into an agreement with a "stalking horse." In such cases, the debtor may file pleadings that schedule an auction, invite participants to bid, and establish procedures by which one becomes a qualified bidder and conducts due diligence, as well as the rules for the auction.

LOCAL RULES, FORMS AND GUIDELINES

The debtor must file and serve a notice summarizing the sale related motions. FRBP 2002(a)(2), (c)(i) and 6004. In Oregon the notice must be filed using Local Bankruptcy Form 760.5 or using a form that incorporates the requirements of Local Bankruptcy Rule 2002-1 (b)
(2). Since LBF 760.5 is not well suited to sales of all or substantially all of the assets of a business, most practitioners use a form incorporating the requirements of LBR 2002-1 (b) (2). In the Eastern District of Washington, Local Rule 6004-1 sets forth the process for 363 sales, including a sale free and clear of liens and interests. There are no special local rules for 363 sales in the Western District of Washington (although LBR 9013-1 would apply) but Judge Heston’s chambers procedures do provide an admonition to follow the Federal Rules of Bankruptcy Procedure on service in contested matters, which includes 363 sales free and clear.

In Oregon, the Bankruptcy Court has also adopted Local Form 363 "Guidelines Regarding Motions For Sale Of All Or Substantially All Assets And Sale Procedures Motions" (the "Oregon Guidelines"). The Oregon Guidelines provide a comprehensive outline of the issues that need to be addressed in the motions to be filed by the debtor. A number of these issues, such as bid protections for the buyer (including break-up fees), free and clear sales, insider releases and successor liability, have been the subject of extensive discussion and debate. The Oregon Guidelines assure that all relevant information regarding the proposed sale is fully disclosed as part of the sales process. A copy of the local rules, forms and guidelines for Oregon and Washington for sales under Section 363 are attached hereto.

LIMITATIONS ON THE 363 SALE OR THE SUB ROSA PLAN

Section I A (ii) of the Oregon Guidelines states that a copy of the form of sale order must be attached to the sale motion. Section I A (iv) requires the proponent to explain "[T]he reason and necessity for a sale of all or substantially all of the assets prior to or in lieu of confirmation of a plan and the benefits to the estate and the creditors from such a sale." On its face, these are not controversial requirements. However, these requirements are reflections of case law which imposes limitations on the scope of sale motions and orders.

A number of courts have said that a sale agreement cannot effect a "sub rosa" plan. What does that mean? In Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airlines, Inc.) 700 F.2d 935 (5th Cir. 1983). The Court of Appeals reversed the Bankruptcy Court's and District Court's approval of a 363 Sale (and other agreements) saying among other things that the agreements "had the practical effect of dictating some of the terms of any future reorganization plan." 700 F.2d at 940. The Court of Appeals noted that under the agreements a reorganization
plan would have to allocate certain consideration received by the debtor according to the terms provided in the agreements or that asset would be forfeited. The Court of Appeals also stated that under the agreements "the secured creditors were required to vote a portion of their deficiency claim in favor of any future reorganization plan approved by a majority of the unsecured creditors' committee." Id. The Court of Appeals observed that "such an action is not comprised by the term 'use, sell, or lease,' and it thwarts the Code's carefully crafted scheme for creditor enfranchisement where plans of reorganization are concerned." Id.

Shortly after the Court of Appeals for the Fifth Circuit decided *Braniff*, the Court of Appeals for the Second Circuit issued its opinion in *In re The Lionel Corporation*, 722 F.2d 1063 (2d Cir. 1983). In *Lionel*, the debtor filed a motion for authority to conduct a 363 Sale of "Lionel's most valuable single asset." 722 F.2d at 1065. Four days later Lionel filed a plan conditioned on the approval of the sale of that asset. At the hearing to consider the sale, Lionel's Chief Executive Officer testified that the only reason that the sale was being done outside of the plan process was that the Creditors' Committee had insisted on it. The bankruptcy judge confirmed the sale.

The Committee of Equity Security Holders objected to the order approving the sale. It argued that a sale outside of the reorganization process deprived the equity holders of the safeguards of the plan process including disclosure and solicitation and acceptance of the plan.

The Court of Appeals said the question before it was the extent to which a Chapter 11 debtor could sell an important asset under section 363 and outside of a plan of reorganization. The Court concluded that "[T]here must be some articulated business justification, other than appeasement of major creditors, for using, selling, or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b)." 722 F.2d at 1070. The Court went on to say, "The rule we adopt requires that a judge determining a §363(b) application expressly find from the evidence presented before him at the hearing a good business reason to grant such an application." 722 F.2d at 1071. The Court then stated that a bankruptcy court should review all "salient factors," and gave examples of the factors that a judge might consider. Id. Although the "sub rosa plan" objection was not raised in *Lionel*, the
business judgment test announced in that case has been cited in many subsequent cases to approve sales and dispose of objections that a particular 363 Sale constituted a subrosa plan.

The Bankruptcy Court in In re Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009), aff'd, 576 F.2d 108 (2d Cir. 2009), vacated sub nom. Indiana State Police Pension Trust v. Chrysler LLC. 130 S. Ct. 1015 (2009) utilized the holdings in both Braniff and Lionel in considering objections to the prosed 363 Sale of Chrysler's assets. In that case Chrysler and its affiliates, referred to as Old Chrysler, filed a motion to sell substantially all of their assets to a government backed purchaser known as New Chrysler, for $2 billion. All of the sale proceeds would go the holders of the first liens who were owed $6.9 billion. However, VEBA, an entity organized on behalf of retirees owed retirement benefits, would receive 55% of the equity in New Chrysler and the U.S. Treasury would receive 8% of that equity although both of those parties were essentially unsecured creditors.

The Court considered the Lionel standard and found that Old Chrysler had established good business reasons "...for the sale of their assets at the early stages of these cases." 405 B.R. at 96. The Court then considered the objection that approving the sale would constitute a subrosa plan of reorganization. The Court stated that the $2 billion being paid for the assets was a fair price because it exceeded the value that could be received in a liquidation which was the only other realistic alternative available to Old Chrysler. The Court also noted that all of the sale proceeds were going to the senior lien holders and thus were being distributed in a manner consistent with the priorities in the Bankruptcy Code.

The Bankruptcy Court then addressed the subrosa plan issue. The Court stated that neither VEBA nor the U.S. Treasury was getting anything on account of their prepetition claims. 405 B.R at 99. Even though one could easily argue that the UAW required that VEBA (which represented the interest of its retirees) receive equity as partial consideration for UAW 's willingness to enter into a new collective bargaining agreement, and that the Treasury, a prepetition creditor, received equity as a condition of approving the sale, the Court said that the allocation of equity was "an unrelated transaction that was negotiated between New Chrysler and the source of its funds, the Governmental Entities." 405 B.R at 100. In other words, the
purchaser was free to allocate its equity how it wished, and this equity issuance was not a distribution on account of prepetition unsecured claims.

The Court also offered another explanation as to why the allocation of equity to some, but not all, unsecured creditors was not prohibited. The Court stated that the consideration provided by New Chrysler was not value that was otherwise available to Old Chrysler. In other words, as the Court of Appeals put it, all of the equity in New Chrysler was attributable to new value, created by governmental loans, new technology, and new management, and these were not assets of Old Chrysler. The obvious response to the last point is that assets almost invariably have more value if sold as part of a going concern. Indeed, getting more value from assets is often a primary reason why debtors seek approval of 363 sales.

There are also many cases in which a 363 sale motion and proposed sale order describe the allocation of the proceeds of sale, and a particular allocation may be a condition of a secured creditor's consent to a sale free and clear of its' lien. In fact, section I B (xi) of the Oregon Guidelines requires the sale motion to "highlight any provision pursuant to which a debtor proposes to release sale proceeds on or after the closing without further Court order, or to provide for a definitive allocation of sale proceeds between or among various sellers or collateral."

In recent years, 363 sales of significant assets and businesses have become commonplace. Many debtors are using 363 sales prior to or in conjunction with a plan of reorganization. Many others are seeking to expand the scope of sale motions to resolve more and more of the issues in the bankruptcy case in conjunction with the sale. We are seeing more cases in which proponents seek to find legal justifications to achieve the desired economic outcomes. It appears that the economic realities of a melting ice cube and other exigencies of a case are prevailing with fewer and fewer parties objecting to a sale as a sub rosa plan. The need for speed in order to maximize the return to creditors is often persuasive.
UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

GUIDELINES REGARDING MOTIONS FOR SALE
OF ALL OR SUBSTANTIALLY ALL ASSETS
AND SALE PROCEDURES MOTIONS

Except as otherwise provided in the Local Rules, these Guidelines apply in Chapter 11 cases to (i) motions to sell all or substantially all property of the estate under section 363(b) of the Bankruptcy Code (each a "Sale Motion") and (ii) motions seeking approval of sale, bid or auction procedures in anticipation of or in conjunction with a Sale Motion ("Sale Procedures Motions"). These Guidelines also may be applied to other motions to sell property of the estate under section 363(b) of the Bankruptcy Code in Chapter 11 cases.

Definitions. As used herein, the following terms shall have the following meanings: (i) "highlight" means to provide text describing the existence, location and other required information concerning terms described in these Guidelines, and/or color, bold type or similar treatment in the exhibits; and (ii) “trustee” means the debtor in possession if a trustee has not been appointed. Other terms are defined in LBR 9001-1.

I. Sale Motions.

A. Contents of Sale Motion. Except as otherwise provided in the Guidelines, the Local Rules, the Bankruptcy Code, the Bankruptcy Rules or an Order of the Court, all Sale Motions shall attach or include all of the following:

(i) A copy of the proposed purchase agreement, or a form of such agreement substantially similar to the one the trustee reasonably believes it will execute in connection with the proposed sale. If there is no proposed purchase agreement, a copy of the term sheet shall be attached and parties shall be given sufficient time to review and object to the terms of the purchase agreement once it has been finalized.

(ii) A copy of a proposed form of sale order.

(iii) A request, if necessary, for the appointment of a consumer privacy ombudsman under Bankruptcy Code section 332.

(iv) The reason and necessity for a sale of all or substantially all of the assets prior to or in lieu of confirmation of a plan and the benefits to the estate and the creditors from such sale.

B. Provisions to be Highlighted. Any provisions of the type set forth below must comply with the requirements set forth therein. In addition, the Sale Motion must highlight material terms, including but not limited to (a) whether the proposed form of sale order and/or the underlying purchase agreement contains any provision of the type set forth below, (b) the location of any such provision in the proposed form of order or purchase agreement, and (c) the justification for the inclusion of such provision.
(i) **Purchase Price.** The Sale Motion shall identify the purchase price or the method by which the purchase price shall be ascertained.

(ii) **Sale to Insider.** If the proposed sale is to an insider, as defined in Bankruptcy Code section 101(31), or to an entity in which an insider holds or has a right to acquire an equity or other ownership interest, the Sale Motion must (a) identify the insider, (b) describe the insider's relationship to the debtor, and (c) set forth any measures taken to ensure the fairness of the sale process and the proposed transaction, such as an auction, advertisement, or other measures allowing access to competing purchasers.

(iii) **Agreements with Insiders or Management.** If the proposed buyer has entered into any agreement with an insider of the debtor or with an executive or other key employee of the debtor regarding compensation or future employment, or if the proposed buyer has engaged in discussions or intends to engage in discussions regarding any such agreement, the Sale Motion must disclose (a) the identity of each insider or key employee who is the subject of any such discussions or agreement, (b) the material terms of any such agreement or contemplated agreement, and (c) the measures that have been taken to ensure the fairness of the sale and the proposed transaction in the light of any such agreement or contemplated agreement. If such discussions are held or an agreement is entered into after the filing of but before the hearing on the Sale Motion, the trustee shall disclose the same at or before the hearing on the Sale Motion.

(iv) **Sales Free and Clear.** The Sale Motion must disclose whether the sale will be free and clear of liens and other interests, and if so, disclose the identity of each party that has a lien on or interest in the property to be sold and the nature of such interest, the total amount of the claims secured by liens on the property, and the subsections of section 363(f) of the Bankruptcy Code that permit the property to be sold free and clear of such interests. As used herein, “interest” includes any interest that is not a lien, such as a possessory leasehold interest, license or other right.

(v) **Assumption, Assignment and Rejection of Executory Contracts and Unexpired Lease.** The Sale Motion must disclose the trustee’s intentions with regard to the assumption, assignment and rejection of executory contracts and unexpired leases to which the debtor is a party and which are part of the sale. The Sale Motion shall either seek appropriate relief under section 365 of the Bankruptcy Code with regard to such contracts and leases or be accompanied by one or more separate motions seeking such relief.

(vi) **Releases and Insider Benefits.** The Sale Motion must highlight any provisions pursuant to which (a) any claim against an entity is to be waived or released, or (b) any insider of the debtor or any executive or other key employee of the debtor is to receive any economic benefit, directly or indirectly.
(vii) **Private Sale; No Competitive Bidding.** The Sale Motion must disclose whether an auction is contemplated and, if so, must include a summary of the sale procedures. The Sale Motion must disclose whether the proposed purchaser has met all the bid requirements that competing bidders must meet, and, if not, why such provision should not apply to the proposed purchaser, and highlight any provision in which the trustee has agreed not to solicit competing offers for the property or to otherwise limit shopping of the property.

(viii) **Closing, Other Deadlines and Contingencies.** The Sale Motion must highlight any deadlines for the closing of the proposed sale or deadlines that are conditions to closing the proposed transaction, and any contingencies to either party's obligation to close the proposed transaction.

(ix) **Good Faith Deposit.** The Sale Motion must highlight whether the proposed purchaser or any competing bidder has submitted or will be required to submit a good faith deposit and, if so, the conditions under which such deposit may be forfeited.

(x) **Interim Arrangements with Proposed Buyer.** The Sale Motion must highlight any provision pursuant to which a debtor is entering into any interim agreements or arrangements with the proposed purchaser, such as interim management arrangements (which, if out of the ordinary course, also must be subject to notice and a hearing under section 363(b) of the Bankruptcy Code) and the terms of such agreements.

(xi) **Use of Proceeds.** The Sale Motion must highlight any provision pursuant to which a debtor proposes to release sale proceeds on or after the closing without further Court order, or to provide for a definitive allocation of sale proceeds between or among various sellers or collateral.

(xii) **Record Retention.** The Sale Motion must identify what access the trustee will have to the debtor's books and records to enable the trustee to administer the bankruptcy case.

(xiii) **Sale of Avoidance Actions.** The Sale Motion must highlight any provision pursuant to which the trustee seeks to sell or otherwise limit its rights to pursue avoidance claims under chapter 5 of the Bankruptcy Code.

(xiv) **Requested Findings as to Successor Liability.** The Sale Motion must highlight any provision limiting the proposed purchaser's successor liability.

(xv) **Credit Bid.** The Sale Motion must highlight any provision by which the trustee seeks to limit credit bidding under section 363(k) of the Bankruptcy Code.

(xvi) **Standard for Approval.** The Sale Motion must state under what standard of approval the trustee is seeking approval of the Sale Motion, whether it be the
“business judgment” standard, “best interests of the estate” standard, or other standard.

(xvii) Relief from Bankruptcy Rule 6004(h). The Sale Motion must highlight any request for relief from the 14-day stay imposed by Bankruptcy Rule 6004(h) and the justification for such request.

(xviii) Solicitation Process. The Sale Motion shall identify to whom notice has been given or will be given and the efforts, if any, that have been or will be taken to publicize the sale to the debtor's competitors or other possible bidders.

II. Notice of Sale. Any party filing a Sale Motion shall provide notice of the sale either pursuant to LBF #760.5 or pursuant to a notice that includes the requirements of LBR 2002-1(b)(2).

III. Sale Procedures Motions. A trustee may file a Sale Procedures Motion seeking approval of an order (a "Sale Procedures Order") either as part of the Sale Motion or by a separate motion filed in anticipation of an auction and a proposed sale.

A. Provisions to be Highlighted. Any proposed Sale Procedures Order filed in conjunction with a Sale Procedures Motion must highlight the following provisions:

(i) Provisions Governing Qualification of Bidders. Any provision governing an entity's right to become a qualified bidder or defining what constitutes a qualified bidder, including but not limited to, an entity's obligation to:

(A) Deliver financial information by a stated deadline to the trustee and other key parties (ordinarily excluding other bidders).

(B) Demonstrate its financial wherewithal to consummate a sale.

(C) Maintain the confidentiality of information obtained from the trustee or other parties or execute a non-disclosure agreement.

(D) Make a non-binding expression of interest or execute a binding agreement.

(ii) Provisions Governing Qualified Bids. Any provision governing the nature, scope or quality of a bid or proposal, including, but not limited to:

(A) Any deadlines for submitting a bid and the ability of a bidder to modify a bid not deemed a qualified bid.

(B) Any requirements regarding the form of a bid, including whether a qualified bid must (a) be marked against the form of a “stalking horse” agreement or a template of the debtor's preferred sale terms, showing amendments and other modifications (including price and other terms), (b)
be for all of the same assets or may be for less than all of the assets proposed to be acquired by an initial, or “stalking horse,” bidder or (c) remain open for a specified period of time.

(C) Any requirement that a bid include a good faith deposit, the amount of that deposit, and under what conditions the good faith deposit is not refundable.

(D) Any other conditions for a bid to be considered a qualified bid or to permit a qualified bidder to bid at an auction.

(E) Whether the proposed purchaser has satisfied or is required to satisfy the above terms.

(iii) Provisions Providing Bid Protections to "Stalking Horse" Bidder. Any provisions providing an initial or "stalking horse" bidder a form of bid protection, including, but not limited to the following:

(A) No-Shop or No-Solicitation Provisions. Any limitations on the ability or right of the trustee or any official committee to solicit higher or otherwise better bids.

(B) Break-Up/Topping Fees and Expense Reimbursement. Any agreement to provide or seek an order authorizing a break-up or topping fee and/or expense reimbursement, and the terms and conditions under which any such fees or expense reimbursement would be paid. The court will not normally approve the following provisions:

(1) Approval of a breakup or topping fee in excess of the reasonable expenses actually incurred by the proposed purchaser in connection with the sale.

(2) The payment of a breakup or topping fee unless all professional reports (other than those subject to an applicable privilege, including information or reports prepared by attorneys), including but not limited to environmental reports, appraisals and title reports, are made available to all other potential bidders prior to the bid deadline.

(C) Bidding Increments. Any requirement regarding the amount of the initial overbid and any successive bidding increments.

(D) Treatment of Break-Up and Topping Fees and Expense Reimbursement at Auction. Any requirement that the “stalking horse” bidder receive a "credit" equal to the break-up or topping fee and/or expense reimbursement when bidding at the auction.
(iv) **Due Diligence Period.** Any provision that sets forth the period of time that competing bidders have to conduct due diligence and the requirements and method for obtaining access to the estate's records.

(v) **Modification of Bidding and Auction Procedures.** Any provision that would authorize the trustee, without further order of the Court, to modify any procedures regarding bidding or conducting an auction.

(vi) **Closing with Alternative Backup Bidders.** Any provision that would authorize the trustee to accept and close on alternative qualified bids received at an auction in the event that the bidder selected as the "successful bidder" at the conclusion of the auction fails to close the transaction within a specified period.

B. **Provisions Governing the Auction.** Unless otherwise ordered by the Court, the Sale Procedures Order shall:

(i) Specify the date, time and place at which the auction will be conducted, and the method for providing notice to parties of any changes thereto.

(ii) Provide that each bidder participating at the auction will be required to disclose, at or before the auction, (1) whether the bidder is bidding on its own behalf, on behalf of others, or on behalf of itself and others, (2) if the bidder is bidding other than on its own behalf, the identity of each entity on whose behalf the bidder is acting, and (3) whether the bidder is a party to any agreement limiting the bidders at the auction.

(iii) State that the auction will be conducted openly and that all creditors will be permitted to attend.

(iv) Provide that a record of bidding at the auction will be made.
OREGON LOCAL BANKRUPTCY FORM 760.5

UNITED STATES BANKRUPTCY COURT
DISTRICT OF OREGON

In Re

) Case No. ______________________
) Notice of Intent to Sell Real or
) Personal Property, Compensate Real Estate
) Broker, and/or Pay any Secured Creditor's Fees
) and Costs; Motion for Authority to Sell Property
) Free and Clear of Liens; and Notice of Hearing
) [Note: Do not use to sell personally identifiable
) information about individuals.]

Debtor(s) ________________________________________________________________________

NOTICE IS GIVEN THAT ________________________________, the ______________________ (i.e.,
debtor, trustee, etc.), intends to sell the property described below and moves for authority to sell
the property free and clear of liens pursuant to 11 U.S.C. § 363(f). The movant's name, address,
and telephone # are: ____________________________________________________________________
______________________________________________________________________________________.

If you wish to object to any aspect of the sale or fees disclosed in paragraph 7 or paragraph 15,
you must:

(1) Attend the hearing set in paragraph 16 below; and

(2) Within 21 days of the later of the date next to the signature below or the service date
in paragraph 17 below, file with the clerk at 1050 SW 6th Ave. #700, Portland OR 97204
or 405 E 8th Ave. #2600, Eugene OR 97401:

(a) a written response stating the specific facts upon which the objection is based, and

(b) a certificate of service of the response on the movant.

This document shall constitute the notice required by Local Bankruptcy Rule (LBR) 2002-1. All
sections must be completed.

1. The specific subsections of 11 U.S.C. § 363(f) movant relies upon for authority to sell the
property free and clear of liens are:

2. Buyer's name & relation to debtor:

3. General description of the property: [If real property, state street address here. Also attach
legal description as an exhibit to the notice filed with the court.]
4. A copy of the full property description or inventory may be examined or obtained at:

5. The property may be previewed at: [Include time and place.]

6. Other parties to the transaction and their relationship to the debtor are:

7. The gross sales price is: $______________.

   All liens on the property total $______________ , of which movant believes a total of $______________ need not be paid as secured claims (because the lien is invalid, avoidable, etc., the lienholder consents to less than full payment, or part or all of the underlying debt is not allowable).

   Secured creditor(s) also seek(s) reimbursement of $______________ for fees and costs.

   Total sales costs will be: $______________.

   All tax consequences have been considered and it presently appears the sale will result in net proceeds to the estate after payment of valid liens, fees, costs and taxes of approximately: $______________.

8. The sale is ☐ is ☐ is not (mark one) of substantially all of the debtor's assets. Terms and conditions of sale:

9. Competing bids must be submitted to the movant no later than ____________ (date), and must exceed the above offer by at least ____________, and be on the same or more favorable terms to the estate.

10. Summary of all available information regarding valuation, including any independent appraisals:
11. If paragraph 7 indicates little or no equity for the estate, the reason for the sale is:

and expenses and taxes resulting from the sale will be paid as follows:

12. (Ch. 11 cases only) The reason for proposing the sale in advance of approval of a plan of reorganization is:

13. The following information relates to lienholders (who are listed in priority order):

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<th>Name</th>
<th>Service Address (See FRBP 7004)</th>
<th>Approximate Lien Amount</th>
<th>Indicate Treatment at Closing (Fully Pd., Partially Pd., or Not P</th>
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14. Any liens not fully paid at closing shall attach to the sale proceeds in the same order of priority they attach to the property. Any proceeds remaining after paying liens, expenses, taxes, commissions, fees, costs or other charges as provided in this motion, shall be held in trust until the court orders payment.

15. (If real property) The court appointed real estate broker, ____________________________, will be paid ____________________________.

16. A hearing on this motion and any objections to the sale or fees is scheduled as follows:

Date: _______________ Time: _______________ Location: ____________________________

Testimony will be received if offered and admissible. If no timely objection is filed, the hearing may be cancelled, and an order submitted. Parties are encouraged to check the hearing calendar at https://www.orb.uscourts.gov after the objection deadline has passed.

17. I certify that on __________ this document was served, pursuant to FRBP 7004, on the debtor(s), trustee (if any), U.S. Trustee, each named lienholder at the address listed above, the creditors’ committee chairperson (if any), and their attorneys; and [unless movant is a chapter 7 trustee] that it was also sent on that date, pursuant to FRBP 2002(a), to all creditors and all parties as listed in the court’s records that were obtained on __________, a copy of which is attached to the document filed with the court.
18. For further information, contact: ________________________________

Date: __________  
Signature & Relation to Movant

(If debtor is movant) Debtor’s Address & Taxpayer ID(s)(last 4 digits)
Rule 6004-1
Sale of Estate Property

(a) Notice and Hearing Required

A sale pursuant to § 363(b) of the Code, including a sale free and clear of any interest of an entity other than the estate, is initiated by notice and hearing and is subject to LBR 2002-1. An action to determine the validity, priority, or extent of any interest of an entity other than the estate shall be brought separately as an adversary proceeding.

(b) Sale Free and Clear of Interests

(1) If the property is to be sold free and clear pursuant to § 363(f) of the Code, the notice of the motion shall so state and include the following information:

(A) The date and time of the hearing on the motion, which may be obtained from the court’s Web site;

(B) If no objection is timely filed and served, the moving party may strike the hearing and present ex parte a proposed order;

(C) The estimated fair market value of the property without deductions for interest of entities other than the estate;

(D) The amount of each lien or encumbrance claimed against the property and the paragraph of § 363(f) of the Code under which the sale is authorized;

(E) If the proceeds of the sale appear to be insufficient to pay all liens and encumbrances claimed against the property, the liens and encumbrances which may not be paid from the sale proceeds; and

(F) A statement specifying the necessity for the sale.

(2) All interests in property sold free and clear shall attach to the proceeds of the sale, unless otherwise provided in the notice.

(c) Service

Service of the notice shall be pursuant to FRBP 6004(c).

(d) Order

The proposed order shall be filed in accordance with LBR 9013-1(c).
Related Provisions

FRBP 2002(a)(2),(c)(1) Notices of Sale
FRBP 6004 Use, Sale, or Lease of Property
FRBP 7004 Service
FRBP 9014 Contested Matters

11 USC 363 Use, Sale, or Lease of Property
11 USC 1107 Rights and Duties of Debtor in Possession
11 USC 1206 Sales of Property
11 USC 1303 Rights and Powers of Debtor
28 USC 1746 Unsworn Declaration Under Penalty of Perjury

LBR 6004-1
DECEMBER 1, 2008
Chapter 3B—363 Sales: Pertinent Issues and Alternatives—Overview of 363 Sales

WESTERN WASHINGTON
JUDGE HESTON’S PROCEDURES

Notice/Service: If notice must be given to all parties in interest, notice is presumed adequate if mailed to all entities on the master mailing list, provided the list is current to within 21 days of mailing as evidenced by (1) the notation on the list showing the date it was extracted from ECF or PACER, or (2) counsel’s verification in the affidavit of service. See Local Rules W.D. Wash. Bankr. 2002-1(e); Fed. R. Bankr. P. 2002(a)(5).

Local Rules W.D. Wash. Bankr. 9013-1(d)(2)(B) requires that proof of any conventional (non-ECF) service of the notice and the motion be filed by the response date.

Service of a motion in a contested matter must be in compliance with Fed. R. Bankr. P. 7004, unless otherwise governed by the Federal Rules of Bankruptcy Procedure. Fed. R. Bankr. P. 9014 (b). This includes service of a motion to avoid a lien pursuant to 11 U.S.C. § 522(f), a motion to sell free and clear under 11 U.S.C. § 363(f), and a motion to strip a wholly unsecured mortgage lien and a request to value collateral in a Chapter 13 case.

When service in compliance with Fed. R. Bankr. P. 7004 is required, please pay attention to the rules for service upon specific parties. For instance, service upon a domestic or foreign corporation or upon a partnership or other unincorporated association must be to the attention of a specifically identified officer, managing or general agent, or agent authorized to receive service. Fed. R. Bankr. P. 7004(b)(3). Service on an insured depository institution shall be made by certified mail addressed to an officer of the institution.
Chapter 3C

363 Sales: Pertinent Issues and Alternatives—Successor Liability and Free and Clear Issues

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San Francisco, California

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It is a generally recognized principle of law that a company purchasing the assets of another company does not assume liability for the selling company’s debts. Under certain circumstances, however, this principle may be disregarded. Under the state law doctrine of successor liability, there are several different theories under which the selling company’s liabilities could be imposed upon the buying company. Because of this and other purchasing risks, buyers of assets of financially distressed companies have more and more frequently elected to steer sales through bankruptcy proceedings. In doing so, the sales are conducted pursuant to Section 363 of the Bankruptcy Code, which enables a “free and clear” transfer of the assets. But recent case law should put prospective purchasers of assets in bankruptcy sales on notice of the continued risk of potential successor liability claims, notwithstanding a sale order that absolves the buyer of any of the seller’s liabilities.

**Successor Liability Law**

Courts typically recognize four situations in which a purchasing company may be held liable for the debts of the selling company: 1) the existence of an express or implied agreement regarding the assumption of debt between the companies; 2) the transaction amounts to a “de facto merger”; 3) the purchasing company is a “mere continuation” of the selling company; or 4) the transaction is a fraudulent attempt by the selling company to escape liability for its debts. *Erickson v. Grande Ronde Lumber Co.*, 162 Ore. 556, 568 (1939); *Schmoll v. ACandS, Inc.*, 703 F.Supp. 868, 872 (D. Or. 1988).

**Express or Implied Agreement**

The existence of an express or implied agreement is fact specific and a matter of contract law and interpretation. Successor liability will be imposed if the purchase agreement and the intent/conduct of the parties reveal that the seller’s obligations were assumed by the buyer. Attentive drafting of the asset purchase agreement should ensure that unwanted liabilities are not transferred to the buyer.

**De Facto Merger**

Under the “de facto merger” exception, successor liability will be imposed if (i) the consideration for the acquisition does not adequately address the claims of the seller’s creditors or (ii) the stock of the purchaser is the only consideration distributed to the seller’s shareholders in conjunction with the seller’s liquidation. *Schwartz v. Pillsbury Inc.*, 969 F.2d 840, 846 (9th Cir. 1992) (citing *Ray v. Alad Corp.*, 19 Cal. 3d 22, 28 (Cal. 1977)).

Under this exception, courts generally consider five factors when determining whether the asset sale is a de facto merger or consolidation: (1) does the consideration paid for the assets
consist solely of stock issued by the purchaser or its parent; (2) did the purchaser continue the same enterprise after the sale; (3) did the shareholders of the seller become shareholders of the purchaser; (4) did the seller liquidate; and (5) did the buyer assume the liabilities necessary to carry on the business of the seller. *Marks v. Minnesota Mining and Manufacturing Company*, 232 Cal. Rptr. 594, 598 (Cal. Ct. App. 1986). “No single factor is necessary or sufficient to establish a de facto merger.” *ABC Developmental Learning Centers (USA), Inc. v. RCS Cap. Dev., LLC (In re RCS Cap. Dev., LLC)*, 2013 Bankr. LEXIS 4666 (9th Cir. B.A.P. July 16, 2013).

**Mere Continuation**

Under the “mere continuation” theory of successor liability, “[a] successor corporation is merely a continuation of the predecessor corporation, despite a business transformation, if it is substantially the same as the predecessor corporation.” *Alicki v. Intratec USA, Inc.*, 769 F.Supp. 336, 340 (D. Or. 1991). “The theory of the exception is that if a corporation goes through a mere change of form without substantial change in substance, then it should not be allowed to thereby avoid liability.” *Estey & Assocs., Inc. v. McCullough Corp.*, 663 F.Supp. 167, 171 (D. Or. 1986). Under the traditional application of the “mere continuation” exception, a corporation will not be considered a continuation of a predecessor unless only one corporation remains after the transfer of assets and there is an identity of stock, stockholders and directors between the two corporations. *Id.* (quoting *Groover v. West Coast Shipping Co., Inc.*, 479 F.Supp. 950, 951 (S.D.N.Y. 1979)). The “mere continuation” and “de facto merger” exceptions are very similar and, as such, are often applied almost interchangeably. *Cargo Partner AG v. Albatrans, Inc.*, 352 F.3d 41, 45 n.3 (2d Cir. 2003); *Franklin v. USX Corp.*, 87 Cal.App.4th 615, 625 (2001); *In re Acushnet River & New Bedford Harbor Proceedings*, 712 F.Supp. 1010, 1019 n. 15 (D. Mass. 1989) (distinction between “de facto merger” and “mere continuation” seems more apparent than real). With respect to successor liability cases brought under the Comprehensive Environmental Response Compensation and Liability Act (CERCLA), some courts apply an expanded version of the “mere continuation” exception known as the “continuity of enterprise” or “substantial continuity” exception. *Washington v. United States*, 930 F.Supp. 474, 480 (W.D. Wash. 1996).

**Fraud**

A determination that the transaction is a fraudulent effort to avoid liabilities of the predecessor will result in successor liability being imposed upon the buyer. Under the Uniform Fraudulent Transfer Act (UFTA), any transfer made with “actual intent to hinder, delay or defraud” any present or future creditor is a fraudulent transfer. It has routinely been recognized that an asset transfer that is not made for adequate consideration and that is not made in good faith constitutes a fraudulent transfer. In general, to avoid being labeled a fraud, the asset sale transaction should be at arm’s length and the assets should be sold for as close to fair market value as possible under the circumstances.

**Bankruptcy and Section 363 Sales**

Classic Chapter 11 reorganizations are few and far between. But where a reorganization may not be plausible, Section 363 of the Bankruptcy Code provides an opportunity for distressed companies to sell their assets and for buyers to purchase those assets at a fair price and with
many other benefits that may not be available in a sale conducted outside of bankruptcy. Principal of the benefits being obtaining a court order that the sale is free and clear of all claims, interests and other debts arising in any way or in connection with the actions of the debtor, including claims based on theories of successor liability.

Section 363(f) of the Bankruptcy Code provides that a sale of assets may be approved free and clear of liens and other interests if one of five statutory conditions is met. The conditions are:

1. Applicable nonbankruptcy law permits a sale free and clear of interests;
2. The interest holder consents to the sale;
3. The interest is a lien and the sale price exceeds the total value of all liens on the property;
4. The interest is in bona fide dispute; or
5. The holder could be compelled in a legal or equitable proceeding to accept money satisfaction of its interest in the property.

Section 363 sales are typically governed by local court rules or pre-approved sale procedures. The procedures are ultimately intended to maximize the sale price, but they also serve the equally important role of providing notice to interested parties, including those that may have claims against the seller. In the end, the buyer wants to obtain the best deal possible with the greatest protections permitted by the bankruptcy court. The sale price will be whatever the sale process produces, but the sale order will frequently contain provisions expressly providing, among other items, (i) that the sale is “free and clear,” and (ii) that the liabilities that can be asserted against the purchaser are limited and preclude creditors from asserting claims based on theories of successor liability. Recent opinions, however, serve as a reminder to buyers of distressed assets that the risk of successor liability claims may never be truly extinguished even if a sale order has been entered that clears the buyer of any of the seller’s liabilities. On the other hand, case law continues to teach claimants that they must pay particular attention to sales conducted under Section 363 and be active in protecting their claims from being cut off by a sale order.

The bankruptcy court’s power to sell assets free and clear of successor liability claims has received a major boost from the U.S. Court of Appeals for the Third Circuit. In United States v. Knox-Schillinger (In re Trans World Airlines Inc.),¹ the Third Circuit joined the Fourth Circuit² in holding that a debtor-in-possession (DIP) can sell its assets free and clear of successor liability claims when selling assets as an ongoing business under Bankruptcy Code §363(f). That section provides that the trustee can sell assets free and clear of “any interest in such property,” so long as the holder of the interest could be compelled to take a money satisfaction.³

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¹ 322 F.3d 283 (3d Cir. 2003).
³ 11 U.S.C. §363(f) (2000) provides, “The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than an estate only if...(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all such liens on such property...or
The Third Circuit held that successor liability claims are interests in property within the meaning of §363(f) and that the claims were of the type that can be satisfied by monetary payment. However, although the claims were of the type that could be satisfied by monetary payment, they remained general unsecured claims with no priority claim to the sale proceeds. The Third Circuit determined that the phrase “any interest in such property” should be broadly construed to include interests that could otherwise travel with the property being sold even if the asserted interest is a general unsecured claim.

Thereafter, the Seventh Circuit cited Knox-Schillinger with approval for the proposition that the term “any interest in such property” should be given an expansive definition.4 Perhaps this signals that Knox-Schillinger will overcome the Seventh Circuit’s earlier doubts as to whether the term “any interest in such property” would include unsecured claims, such as successor-liability claims.5 And perhaps Knox-Schillinger will be persuasive to the First Circuit, which, noting the Seventh Circuit’s earlier doubts, declined to express an opinion as to whether successor claims would be included as “any interest in such property.”6

Allowing sales free and clear of successor liability under §363(f) is important because that section is resorted to by most debtors who sell their ongoing businesses. Most debtors who need to sell their businesses are unable to keep their businesses going for the often lengthy periods required for reorganization plans or liquidation to be developed, negotiated and confirmed. While the bankruptcy court’s power to sell assets free and clear of successor claims may be clearer when the sale is pursuant to a plan,7 that power is practically unavailing in most cases because of most debtors’ need to sell quickly.

**In re Grumman Olson Ind., Inc., 467 B.R. 694 (S.D.N.Y. 2012)**

Grumman Olson Industries designed, manufactured and sold products for the truck body industry. On December 9, 2002, Grumman filed chapter 11 in the Bankruptcy Court for the Southern District of New York. On July 1, 2003, the Bankruptcy Court entered an order approving the sale of certain assets of Grumman to Morgan Olson, LLC, which was also engaged in the manufacture of products for the truck body industry. The sale order contained

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4 Precision Industries Inc. v. Qualitech Steel SBQ LLC, 327 F.3d. 537, 545 (7th Cir. 2003) (holding that a sale free and clear of liens would divest the possessory interest of a real estate tenant whose lease was rejected and who elected to remain in possession as provided in 11 U.S.C. §365(h) (2000)).

5 See Zerand-Bernal Group Inc., 23 F.3d 159 (7th Cir. 1996) (citing with approval, in dicta, the discussion in Mooney Aircraft Inc. v. Foster (In re Mooney Aircraft Inc.), 730 F.2d 367 (5th Cir. 1984), to the effect that unsecured claims were not interests in property under the Bankruptcy Act).

6 See Western Auto Supply Co. v. Savage Arms (In re Savage Industries Inc.), 43 F.3d 714, 723 (1st Cir. 1994) (Cyr, C.J.) (citing Zerand-Bernal as generally contrary to the notion that §363 enables the extinguishment of state-law based successor product-line liability claims).

7 11 U.S.C. §1141 (2000) (providing that property dealt with by a reorganization plan can be “free and clear of all claims and interests of creditors); see, also, Piper Aircraft Corp. v. Calabro (In re Piper Aircraft Corp.), 169 B.R. 766, 779 (Bankr. S.D. Fla. 1994) (stating, in dicta, that a product liability claimant would be bound by a plan treating the claim and prohibiting the claimant from asserting successor liability against a purchaser that purchased the debtor’s manufacturing assets pursuant to the plan); Volvo White Truck Corp. v. Chambersburg Beverage Inc. (In re White Motor Credit Corp.), 75 B.R. 944, 950-51 (stating that 11 U.S.C. §1141(c) (2000) can preempt successor liability claims against purchaser of debtor’s manufacturing assets).
several provisions that purported to limit Morgan’s potential liability for tort claims based on allegedly defective products manufactured and sold by Grumman prior to the sale to Morgan. In particular, the sale of assets was ordered “free and clear of all ... claims ... and other interests ...and all debts arising in any way in connection with any acts of [Grumman].” In addition, the sale order provided that the purchase of the assets by Morgan would not subject Morgan to “any liability for claims against [Grumman] or the assets, including, but not limited to, claims for successor or vicarious liability.”

On October 8, 2009, some six years after the sale order was entered, Denise and John Frederico brought a personal injury action against Morgan and others in New Jersey Superior Court. The complaint alleged that Ms. Frederico, an employee of FedEx, sustained injuries when the FedEx truck she was driving struck a telephone pole on October 15, 2008. The complaint also alleged that the truck she was driving was manufactured, designed, and/or sold by Grumman in 1994 and was defective for several reasons.

On March 24, 2010, Morgan filed an adversary proceeding in the Bankruptcy Court seeking declaratory and injunctive relief barring the Fredericos from bringing their claims against Morgan in New Jersey state court. Morgan’s complaint alleged that the sale order and accompanying Asset Purchase Agreement “provided that the assets of the debtor would be sold and purchased without liability for products manufactured prior to the sale.” The truck involved in the accident was manufactured by Grumman, not Morgan, and so, the complaint alleged, Morgan could not be held liable for any damage caused by any alleged defects in the truck.

In dismissing Morgan’s case, the Bankruptcy Court explained that the straightforward, threshold legal question was, does the sale order exonerate Morgan from liability to the Fredericos? The Bankruptcy Court answered this question in the negative, leading to Morgan’s appeal.

In affirming the Bankruptcy Court’s decision, the United States District Court for the Southern District of New York held that claims of parties who cannot possibly be identified as of the time of the bankruptcy and, thus, cannot be provided notice of the bankruptcy, cannot be discharged by bankruptcy court orders for due process reasons. The District Court reasoned that the requirement of notice is the cornerstone of bankruptcy code procedure and that notice requirements of bankruptcy law are “founded in fundamental notions of procedural due process.” Therefore, because the Fredericos did not receive adequate notice of their potential claim in Grumman’s bankruptcy proceedings (because, at the time of the bankruptcy, there was no way for anyone to know that the Fredericos would ever have a claim), enforcing the sale order against the Fredericos and taking away their right to seek redress under a state law theory of successor liability, when they did not have notice or an opportunity to participate in the bankruptcy proceedings, would deprive them of due process.

In re Old Carco LLC, 492 B.R. 392 (Bankr. S.D.N.Y 2013)

Plaintiffs attempted to rely on Grumman to prevent a 363 sale order from cutting-off of their successor liability claims against the purchaser, but were unsuccessful. The debtors, who manufactured and sold vehicles, had sold substantially all their assets free and clear of all claims and liabilities, other than expressly assumed liabilities, to purchaser. The purchaser expressly
assumed liabilities were for certain warranty/repair claims and state Lemon Law claims. Although the sale order did not prevent the plaintiffs’ claims that arose under the expressly assumed liabilities or their claims concerning vehicles manufactured or sold by the purchaser after the sale, the court found that the sale order barred all other claims that arose prior to the closing date. The court further found that issues of due process were not implicated because the plaintiffs had a “pre-petition relationship” with the debtor and the design flaw existed pre-petition. Accordingly, the court determined that the plaintiffs’ claims existed prepetition and were barred by the sale order.

*In re Emoral, Inc., 740 F.3d 875 (3d Cir. 2014).*

In *Emoral*, the Third Circuit was faced with the question of whether personal injury causes of action arising from the alleged wrongful conduct of a debtor corporation, asserted against a third-party non-debtor corporation on a “mere continuation” theory of successor liability under state law, are properly characterized as “generalized claims” constituting property of the bankruptcy estate. The Third Circuit determined that the claims were “generalized claims” and, therefore, could only be asserted by the bankruptcy trustee.

In August of 2010, Aaroma Holdings LLC (“Aaroma”) purchased certain assets and assumed certain liabilities of Emoral, Inc. (“Emoral”), a manufacturer of diacetyl, a chemical used in the food flavoring industry. At the time of the transaction, the parties were aware of potential claims against Emoral arising from exposure to diacetyl, although those individuals who came to be known in the litigation as the “Diacetyl Plaintiffs” apparently had never themselves been employed by Emoral. The Asset Purchase Agreement specifically provided that Aaroma was not assuming Emoral’s liabilities related to the Diacetyl Litigation, and that it was not purchasing Emoral’s corresponding insurance coverage.

When Emoral filed for bankruptcy protection in June of 2011, disputes arose between the bankruptcy trustee (the “Trustee”) and Aaroma, including, the Trustee’s claim that Emoral’s sale of assets to Aaroma constituted a fraudulent transfer. On September 21, 2011, the Trustee and Aaroma entered into a Settlement Agreement (the “Agreement”) resolving the claims. As part of the Agreement, Aaroma agreed to pay $500,000 and take certain specific actions, and the Trustee agreed to release Aaroma from any “causes of action ... that are property of the Debtor’s Estate” as of the date of the Agreement.

At a hearing before the Bankruptcy Court regarding approval of the Agreement, the Diacetyl Plaintiffs objected to the releases contained in the Agreement to the extent that those releases might bar them from bringing claims against Aaroma, as a successor to Emoral, for personal injuries related to diacetyl. Counsel for Aaroma argued, however, that whether or not the Diacetyl Plaintiffs’ causes of action were property of the estate (and therefore covered by the release) was not an issue before the Bankruptcy Court at that time. Ultimately, the parties added the following language to the order approving the settlement to address concerns expressed by the Diacetyl Plaintiffs: “Nothing contained in this Order or in the Aaroma Settlement Agreement will operate as a release of, or a bar to prosecution of any claims held by any person which do not constitute Estate’s Released Claims as defined in the Aaroma Settlement Agreement.”
Shortly thereafter, the Diacetyl Plaintiffs filed complaints against Aaroma in the Superior Court of New Jersey, alleging personal injury and product liability claims and asserting that Aaroma was a “mere continuation” of Emoral and, therefore, liable. Aaroma filed a motion to enforce the Settlement Agreement and compelling the dismissal of the state court actions. The Diacetyl Plaintiffs opposed the motion, arguing that it was the understanding of the parties that their claims were not released and, in any event, the claims did not constitute property of the estate. The bankruptcy court denied the motion, holding that the personal-injury causes of action were not property of the estate because they alleged a particular injury, not generalized injury suffered by all Emoral shareholders or creditors. The District Court reversed, finding that the cause of action was a “generalized” claim belonging to the estate.

The Third Circuit affirmed the District Court, finding that the Diacetyl Plaintiffs’ causes of action against Aaroma constituted property of Emoral’s estate and were therefore released by the Trustee in the Settlement Agreement. The panel noted that, because Aaroma was a third party which is not alleged to have caused any injury to the plaintiffs, the plaintiffs were required to show that Aaroma was a “mere continuation” of Emoral which therefore succeeded to all of Emoral’s liabilities. But a finding that Aaroma succeeded to all of Emoral’s liabilities would benefit all of Emoral’s creditors — not just the plaintiffs claiming harm from Diacetyl — and would serve to increase the pool of assets available to all creditors. Therefore, the successor liability aspect of the plaintiffs’ claim was a generalized one, and the claims were property of Emoral’s estate.


Kelley Williamson Co. ("Williamson"), the purchaser of two gas station/convenience stores previously owned by the Debtor, filed a motion seeking the issuance of a rule to show cause against the Illinois Department of Revenue (the “Department”) for the alleged violation of the court’s order that authorized the sale of the stores.

After the closing of the sale, the Department issued a Bulk Sales Stop Order on account of alleged unpaid tax liabilities of the Debtor. Upon failing to release the Stop Order, Williamson filed the motion. Williamson argued that a contempt ruling was appropriate because (i) the sale order covered Williamson’s potential transferee liability, (ii) the Department failed to contest the sale motion and could not now collaterally attack the sale order, and (iii) the transferee liability under Illinois law was an interest subject to the Section 363(f) relief granted by the sale order. The court agreed on all fronts and issued an order to the Department to show why it should not be held in contempt.

_Teed v. Thomas & Betts Power Solutions, LLC, 711 F.3d 763 (7th Cir. 2013)._

In _Teed_, the Seventh Circuit held that a purchaser that acquired substantially all of a company’s assets through a state court receivership sale was subject to successor liability for claims arising under the Fair Labor Standards Act (FLSA)—notwithstanding provisions in the sale order that precluded successor liability.

Several months after the lawsuits were filed against the seller for overtime pay under the FLSA, the seller’s parent company defaulted on its secured bank loan. To pay as much of the
debt to the bank as it could, the parent company assigned its assets—including its stock in the seller, which was its principal asset—to an affiliate of the bank. The assets were placed in a receivership under Wisconsin law and auctioned off, with the proceeds going to the bank. Thomas & Betts was the high bidder at the auction, paying approximately $22 million for the seller’s assets. One condition specified in the transfer of the assets to Thomas & Betts pursuant to the auction was that the transfer be “free and clear of all Liabilities” that the buyer had not assumed, and a related but more specific condition was that Thomas & Betts would not assume any of the liabilities that seller might incur in the FLSA litigation. After the transfer, Thomas & Betts continued to operate the seller in much the same manner as prior to the sale, and indeed offered employment to most of the seller’s employees.

Following the purchase, the FLSA lawsuit plaintiffs (presumably, former employees of the seller and current employees of the buyer Thomas & Betts) sought to substitute Thomas & Betts as the defendant in the action. Thomas & Betts objected to their substitution as a defendant, but the trial court overruled the objection. Thomas & Betts appealed the decision to the Court of Appeals for the Seventh Circuit. Finding that no good reason existed to withhold successor liability, Seventh Circuit (Posner, J.) affirmed the trial court’s ruling. In arriving at its decision, the Seventh Circuit found that when liability is based on a violation of federal labor or employment law (such as the FLSA), a federal common standard of successor liability applies.

The court acknowledged that had the matter been governed by state law, a different result would likely have been obtained as Wisconsin state law, like Massachusetts and New Hampshire law, limits successor liability claims in most instances. Here, however, the broader standard was applied and the court analyzed the matter by reviewing the five factors under the federal test:

1. Whether the successor had notice of the pending lawsuit.
2. Whether the predecessor would have been able to provide the relief sought in the lawsuit before the sale.
3. Whether the predecessor could have provided relief after the sale.
4. Whether the successor can provide the relief sought in the suit.
5. Whether there is continuity between the operations and work force of the predecessor and the successor.

In reviewing the factors as applied to the purchase transaction, the court held that “there is no good reason to reject successor liability in this case.” Without such a ruling, the court was concerned that employers and purchasers could circumvent federal employment statutes and liability by structuring a purchase of assets and disclaiming liabilities.

**Lessons Learned:**

1. Give notice of all possible claimants of the asset sale - due process.

2. However, even the best efforts to give possible claimants notice may not be sufficient and purchasers must be mindful that potential liability to unidentifiable future claimants may persist despite the “free and clear” language of section 363(f). Purchasers must therefore consider these potential liabilities when determining a fair price for the assets.
Federal Laws

Many federal statutes assign successor liability automatically or with a relatively low threshold. Among the issues that arise are whether the right to payment is an “interest” from which assets are sold free and clear, or whether the right to payment arises under a contract which is subject to assumption or rejection.

A. Employment Claims.

The general rule under 11 U.S.C. § 363(f) is that assets can be sold free and clear of “any interest in such property” and “any interest” in property has been broadly construed to include employment related interests and claims. See In re Leckie Smokeless Coal Co., 99 F.3d 573 (4th Cir. 1996) (approving a court order authorizing a sale free and clear of debtors’ financial obligations to fund a benefit plan under the Coal Industry Retiree Health Benefit Act of 1992); In re Trans World Airlines, Inc., 322 F.3d 283 (3d Cir. 2003) (sale free and clear of employment discrimination claims and travel voucher program to certain flight attendants pursuant to a settlement of a gender discrimination action); Rubinstein v. Alaska Pac. Consortium (In re New England Fish Co.), 19 B.R. 323 (Bankr. W.D. Wash. 1982) (Bankruptcy court approved sale free and clear over objections of employee claimants of 2 class actions suits before the National Labor Relations Board, finding claimants to be general unsecured creditors who lacked an interest in the property to be sold).

Cases in the Seventh and Third Circuits, however, may have implications on the general rule of “free and clear” with respect to claims arising under the Fair Labor Standard Act (“FLSA”). Specifically, in Teed v. Thomas & Betts Power Solutions LLC, 711 F.3d 763 (7th Cir. 2013), the Seventh Circuit held that a buyer of substantially all a company’s assets pursuant to a state court receivership sale was subject to successor liability for FLSA claims despite the “free and clear” of successor liability provisions in the sale order. In doing so, the Seventh Circuit adopted the federal standard in determining liability under the FLSA, which has a lower bar to relief than under most state laws.

In April 2014, the Third Circuit joined the Seventh Circuit in adopting the federal standard for determining liability under the FLSA in Thompson v. Real Estate Mortgage Network, 12-3828 2014 U.S. App. LEXIS 6150, 2014 WL 1317137 (3d. Cir. Apr. 3, 2014). In Thompson, the Third Circuit similarly held that federal common law standard should apply to determine whether a successor entity may be liable for federal wage and hour violations under the FLSA.

Although the facts in both Teed and Thompson did not involve a bankruptcy section 363(f) sale of assets, the holdings do call into question the general rule relied upon by buyers that, unless expressly assumed, successors are not responsible for the liabilities of their predecessors.

Case to Watch: Plange v. Christ Hosp., Civil Case No. 13-6852 (FSH) 2014 U.S. Dist. LEXIS 62220 (Distr. NJ May 5, 2014) A district court in New Jersey recently stayed an employee’s action for claims arising under the Family and Medical Leave Act of 1993 so that the bankruptcy court could interpret its 363 sale order as to whether defendant purchaser purchased assets out of bankruptcy free and clear of plaintiff’s claims.
B. Medicare Liability.

A change of ownership in entity or assets results in the automatic assignment of an existing provider agreement to the new owner, unless the new owner declines to accept the assignment. 42 U.S.C. § 1395g(a); 42 CFR 489.18(c). Assignment includes both assets and liabilities of the former provider, including the responsibility of repaying accrued Medicare payments. Medicare is currently taking an aggressive approach to rejection, announcing, among other things that “If the new owner rejects assignment, the facility must be treated as an initial applicant if it seeks to participate in Medicare. Like all initial applicants the facility will experience a period (of uncertain duration) with no Medicare payments.” See, Acquisitions of Providers/Suppliers with Rejection of Automatic Assignment of Medicare Provider Agreement: Implications for Timing of Surveys and Participation Effective Date, dated September 6, 2013, a copy of which is attached hereto.


The issue in bankruptcy is whether a provider number can be sold free and clear of recoupment rights. Courts are split on this issue. Compare In re Vitalsigns Homecare, Inc., 396 B.R. 232, 241 (Bankr. D. Mass 2008)(provider agreement executory and assignment comes with recoupment) and In re BDK Helath Management, Inc., 1998 Bankr. LEXIS 2031 (Bankr. M.D. Fla 1998)(provider agreement not executory and could be sold free and clear).

Takeaway: Determine whether the acquirer can withstand the application process, or carve-out a reserve for recoupment if the provider number is being assumed or sold subject to recoupment.

C. Are Environmental Liabilities Considered “Interests” for Bankruptcy Purposes?

There are numerous federal, state and local laws governing the exposure, liability and obligations related to environmental harms. The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) is one of the primary federal environmental laws, and is frequently encountered in bankruptcy cases. See 42 U.S.C. §§ 9601-9675. CERCLA, imposes strict, joint and several liability upon parties deemed responsible for environmental harms. Id. A party may be a “responsible party” simply for owning an asset, regardless of its participation in the actual contamination. Id. Another prevalent federal environmental law is the Resource Conservation and Recovery Act (RCRA), which regulates the

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8 Under CERCLA, the EPA is authorized to either direct responsible parties to clean contaminated sites or the EPA can remedy the harm itself, and then seek recovery of costs against the responsible parties. CERCLA also permits private parties to remediate the contaminated sites and pursue other responsible parties for contribution. 42 U.S.C. §§ 9607(a)(4)(B) and 9613(f).
treatment, storage, and disposal of hazardous waste. 42 U.S.C. §§ 6901-6991. In addition to federal laws, many states, such as Massachusetts, have broad environmental laws (often modeled after CERCLA) that provide additional remedies for environmental harms. See Mass. Gen. L. Ch. 21E.

Consistent with the growing trend to recognize in personam claims within the scope of section 363(f), several cases involving environmental liabilities have also recognized this broadening definition of “interests.” See e.g., In re GMC, 407 B.R. 463, 499-506 (Bankr. S.D.N.Y. 2009) (analyzing “any interest” and concluding that it included successor liability claims, both environmental cleanup obligations and future claims); see also Ninth Ave. Remedial Group, 195 B.R. at 721; In re Heldor Industries, Inc., 131 B.R. 578 (Bankr. D.N.J. 1991) (vacated on other grounds).

Our analysis of whether environmental liabilities are “interests” begins with an analysis of whether they are “claims” under the Bankruptcy Code. Courts often review the scope of the term “claim” and the extent those claims can be discharged in the bankruptcy. See e.g., In re Grumman Olson Indus., 467 B.R. at 703-04 (analyzing whether future claims are “claims” which can be discharged in bankruptcy to assist the court in determining whether future claims could be asserted against a section 363 sale purchaser); In re Ninth Ave. Remedial Group, 195 B.R. at 7433, n. 9 (explaining that successor liability may not apply to a section 363 sale purchaser if the creditor could have brought a claim against the predecessor in a bankruptcy proceeding). Generally, “claim” is broadly defined under the Bankruptcy Code as a right to payment.10 Indeed, it is understood that “all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy court.” US v. LTV (In re Chateaugay Corp.), 944 F.2d 997, 1003 (2nd Cir. 1991).

Because environmental liabilities vary significantly, courts struggle with determining whether environmental liabilities fall within the definition of “claim.” Some environmental statutes are limited to equitable remedies, which require the issuance of cleanup injunction orders directing the responsible persons to remediate the contamination and do not expressly provide for money damages. See e.g., RCRA, 42 U.S.C. § 6901 et. seq. These remedies would not be considered “claims” under section 101(5), despite the fact that money must typically be spent to comply with the injunction. See Chateaugay Corp., 944 F.2d at 1008 (if it only imposes injunctions, cleanup order is not a “claim”). Other environmental laws, including CERCLA, contain both equitable and legal remedies. Certain CERCLA violations may lead to either a cleanup injunction order or, alternatively, the government could perform the cleanup and seek reimbursement from any and all responsible persons. Given the wide breadth of potential environmental remedies, defining which environmental liabilities are “claims” is often a fact-

9 Under RCRA, the EPA can seek injunctive relief to require the cleanup of sites maintained in violation of RCRA’s requirements, issue corrective action orders to owners and operators of such sites, and bring civil and criminal enforcement actions against RCRA violators. I d. at §§ 6973, 6928(h).

10 Claim is defined to mean: “(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.” 11 U.S.C. § 101(5).
intensive analysis. Adding to this complexity, are situations involving unknown and future claims.

The seminal case of Ohio v. Kovacs, 469 U.S. 274 (1985) considered the scope of environmental “claims.” In Kovacs, the state of Ohio obtained an injunction ordering the defendant to cleanup a hazardous waste site. *Id.* The Court determine that, because a receiver had been appointed and the debtor no longer had the ability to cleanup the property on its own, “the cleanup order ha[d] been converted into an obligation to pay money, an obligation that was dischargeable in bankruptcy.” *Id.* at 283. Notably, for issues of successor liability, *Kovacs* acknowledged that all subsequent owners would still need to comply with environmental laws after the sale closed; in fact, the Court plainly stated that a successor owner “may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions.” *Id.* at 285.

Since the Kovacs decision, courts have struggled to apply the Supreme Court’s general framework to various complicated facts and scenarios. One bankruptcy court from the Southern District of New York has recently attempted to develop a three-factor test for determining whether an environmental obligation is a “claim” for bankruptcy purposes. *See In re Mark IV Indus.*, 438 B.R. 460 (Bankr. S.D.N.Y. 2010). This test required a court to consider: (i) is the debtor capable of executing the equitable decree, or can it comply only by paying someone else to do it?; (ii) is the pollution ongoing; and (iii) does that statute imposing the equitable obligation permit the environmental agency the option of cleaning up the pollution on the debtor’s behalf and seeking reimbursement? *Id.* at 467-70. This test provides a helpful starting point when analyzing potential environmental liabilities. However, it has not been widely adopted, thus a more detailed examination of the most common scenarios is useful.11

**Conclusion**

These decisions remind purchasers of distressed assets to conduct comprehensive due diligence and to closely analyze the liabilities of the seller, including both existing and potential claims. Regardless of these court decisions, purchasers of distressed assets should still insist on sale orders with clear and unequivocal language authorizing the transfer of assets “free and clear” of claims and precluding any assertions of successor liability. If a purchaser is aware of potential liabilities that may not be discharged notwithstanding a broad sale order, the purchase price should be adjusted accordingly.

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11 In *Mark IV Indus.*, the court applied the factors and found that the debtor’s environmental obligations were not dischargeable because, though the debtor no longer owned the site, it had access to it for purposes of complying with the environmental order. *Id.* at 469. Further, no alternative monetary remedy for breach of the cleanup order existed. *Id.*
Chapter 4

Ninth Circuit Case Review

THE HONORABLE FRANK KURTZ
U.S. Bankruptcy Court, Eastern District of Washington
Yakima, Washington

THE HONORABLE PETER MCKITTRICK
U.S. Bankruptcy Court, District of Oregon
Portland, Oregon

ANN CHAPMAN
Vanden Bos & Chapman LLP
Portland, Oregon

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**In re Taggart, 888 F.3d 438 (9th Cir. 2018)**

The Ninth Circuit reiterated its holding in *Zilog*, 450 F.3d 996, 1007 (9th Cir. 2006), that, where a creditor possesses a good faith belief that the discharge injunction is inapplicable to the creditor’s claim, the creditor is not liable for civil contempt penalties or sanctions. The case came before the Ninth Circuit after lengthy litigation between the parties and tours through both federal and state courts below.

Once a debtor receives a bankruptcy discharge, it “operates as an injunction against the commencement or continuation of an action . . . to collect, recover or offset any such debt as a personal liability of the debtor.” 11 U.S.C. § 524(a)(2). Generally, a creditor will be held in contempt of the for violation of the discharge injunction if “the creditor (1) knew the discharge injunction was applicable and (2) intended the actions which violated the injunction.” *In re Taggart*, 888 F.3d at 443 (quoting *In re Bennett*, 298 F.3d 1059, 1069 (9th Cir. 2002).

In *Taggart*, the creditors sued the debtor in state court. The debtor moved to be dismissed out of the litigation due to his pending bankruptcy, but that motion was denied on the basis that the debtor was an indispensable party. However, the state court ruled that no monetary judgment would be entered against debtor. Following the state court trial at which the creditors prevailed, debtor objected to the form of the judgment supplied by a creditor. The creditors sought attorney fees against debtor incurred post-discharge claiming that debtor had “returned to the fray.” Without ruling whether the creditors’ action to recover attorney fees constituted a discharge injunction violation, the Ninth Circuit held that, because creditors “acted pursuant to their good faith belief that, due to [debtor’s] ‘return to the fray,’ the discharge injunction did not apply to their claims.” In support of it’s ruling, the court reasoned that “knowledge of the applicability of the injunction must be proved as a matter of fact and may not be inferred simply because [a] creditor knew of the bankruptcy proceeding. . . .
Additionally, [a] creditor’s good faith belief that the discharge injunction does not apply to [a] creditor’s claim precludes a finding of contempt, even if [a] creditor’s belief is unreasonable.”

While the Ninth Circuit did not address caselaw from other circuits, the debtor cited cases from the First, Fourth, and Eleventh Circuits in support of his position that a creditor’s good-faith mistake is not a valid defense and contrary to the Ninth Circuit’s ruling. See IRS v. Murphy, 892 F.3d 29 (1st Cir. 2018); Bradley v. Fina (In re Fina), 550 Fed. App’x. 150, 154 (4th Cir. 2014); In re Hardy, 97 F.3d 1384 (11th Cir. 1996). Cert was recently granted in this case. Taggart v. Lorenzen, 2019 WL 98543 (No. 18-489).

**Goudelock v. Sixty-01 Ass’n of Apartment Owners, 895 F.3d 633 (9th Cir. 2018)**

The Bankruptcy Court for the Western District of Washington granted summary judgment in favor of a condominium association which filed an adversary proceeding to determine the dischargeability of a debtor’s personal obligation to pay condominium association (“CA”) assessments that accrued between the date the debtor filed her Chapter 13 bankruptcy petition and the date the condominium unit was foreclosed upon. The bankruptcy court decided that the CA assessments “were not dischargeable because they arose at the time of their assessment and were an incidence of legal ownership of the burdened property.” The district court affirmed the bankruptcy court’s decision. The Ninth Circuit Court of Appeals reversed and remanded the district court’s decision.

The Ninth Circuit panel disagreed with the Bankruptcy and District Courts’ reasoning and, instead, found the reasoning of Matter of Rosteck, 899 F.2d 694 (7th Cir. 1990) (a Chapter 7 case) and In re Coonfield, 517 B.R. 239 (Bankr. E.D. Wash. 2014)(a Chapter 13 case) persuasive. The panel held that in personam condominium association assessments that become due after a debtor has filed for bankruptcy under Chapter 13 are dischargeable under 11 U.S.C. § 1328(a). The panel concluded that the claim arose prepetition and was not among the exceptions listed
in § 1328(a), finding that the debtor’s personal obligation to pay the CA assessments was not a “result of a post-petition transaction but was created when she took title to the condominium.”

Referring back to the definitions of both “claim” and “debt”, the court pointed out that a debt is defined as “liability on a claim.” A claim is defined as “right to payment, whether or not such right is contingent, matured, legal, equitable, secured or unsecured.” The definition of claim is very broad, encompassing all of debtor’s obligations, “no matter how remote or contingent.” Future assessments arising after the Chapter 13 bankruptcy filing would be considered a matured form of debt that arises from a pre-petition claim.

Noting that, unlike §§ 727 (Chapter 7), 1141 (Chapter 11), 1228(a),(b) (Chapter 12), and 1328(b) (Chapter 13 cases where the debtor is discharged without completing her payments), § 1328(a) did not include a reference to § 523(a)(16), the only provision which excepts post-petition association assessments from discharge, the court concluded the in personam obligation was dischargeable in Chapter 13. Thus, according to the rule of statutory construction of *expression unius est exclusio alterius*, Congress’s decision to exclude a reference to § 523 was purposeful and that if it was actually an error in statutory drafting, then it should be remedied by Congress and not the courts.

The panel further held that the Takings Clause was not implicated because the condominium association retained its *in rem* interest. The panel also concluded that equitable arguments did not override the express provisions of the Bankruptcy Code.

In *re Mastro*, 585 B.R. 587 (9th Cir. BAP 2018)

**Holding:** The Ninth Circuit remanded the case to the bankruptcy court, after ruling that the court had authority to issue “consent directives,” in order to compel an absconded debtor’s financial institutions to provide information regarding the debtor’s assets.

**Facts:** After his creditors filed an involuntary bankruptcy petition, Mastro and his spouse fled from the United States to France. The trustee in his involuntary case and his
creditors believe that Mastro is concealing substantial assets. During the pendency of his bankruptcy case, Mastro has resided in France and efforts to compel his return to the United States have proven fruitless. Likewise, the trustee’s efforts to reach his assets or even information about his assets have proven unsuccessful because financial institutions are reluctant to divulge information about the debtor’s assets, absent the debtor’s consent.

Consequently, the trustee sought an order from the bankruptcy court allowing the issuance of a “consent directive,” by the terms of which the trustee, purporting to act in the debtor’s name, is empowered to demand financial information from the debtor’s banks and brokerages. In the absence of express authority to issue such an order, the bankruptcy court declined to issue the order, but the Ninth Circuit BAP reversed.

**Reasoning:** In its opinion, the BAP addressed two issues raised by Mastro, which are whether the issuance of a “consent directive” violated his right against self-incrimination and whether the bankruptcy courts have authority to issue such an order.

Mastro contended that the issuance of a consent directive by its very nature violates his 5th amendment right against self-incrimination. The BAP rejected this argument, noting that Supreme Court authority on point rejected it, stating consent directives do not constitute an admission by the debtor that any specific asset exists but instead compel third party institution to disclose information about accounts that may or may not exist.

Mastro next contended that the issuance of a consent directive was beyond the authority of bankruptcy courts, an argument that was accepted by the bankruptcy court. In response, the BAP stated that other courts have authorized issuance of consent directives in non-bankruptcy cases and those cases typically involve investigatory or regulatory agencies seeking information from uncooperative parties. The court further noted that “like these agencies the trustee has a statutory duty and authorization to require production of documents in the furtherance of an investigatory duty.” The court further noted that the debtor has a
statutory duty to provide the information requested by the trustee. The court held that bankruptcy courts have authority under § 105(a) and Rule 2004 to issue consent directives in furtherance of the trustee’s obligations under § 704(a)(1) and (a)(4) and the debtor’s obligation under § 521(a)(3) and (a)(4). The BAP noted that the issuance of a consent directive is entirely consistent with the broad inquiry into the debtor’s financial affairs authorized by the code. It remanded the case to the bankruptcy court, stating the court should determine whether a consent directive was appropriate in Mastro’s case.

**Easley v. Collection Serv. of Nev., 910 F.3d 1286 (9th Cir. 2018)**

This case continues to clarify the Ninth Circuit’s decision in *In re Schwartz-Tallard*, 803 F.3d 1095 (9th Cir. 2015)(en banc) which reversed *Sternberg v. Johnston*, 595 F.3d 937 (9th Cir. 2010). *Sternberg* had construed 11 USC 362(k) as a limitation on the nature of attorneys fees that could be awarded to a Debtor after a willful violation of the stay had been found. *Sternberg* held that 362(k) allowed a debtor to recover only those fees incurred to end the stay violation itself, not the fees incurred to prosecute a damages action. *Schwartz-Tallard* reversed that decision and made it clear that 362(k) would allow recovery of attorneys fees reasonably incurred in seeking a remedy to prosecute a damages action, including successfully opposing a creditor’s appeal of an initial award to the Debtor. The issue resolved in Easley by the Ninth Circuit panel held that, in addition to authorizing the court to award reasonable attorneys’ fees and costs incurred on appeal in defending a judgment rendered pursuant to § 362(k), § 362(k) also authorizes an award of attorneys’ fees and costs that the debtor incurred on appeal in successfully challenging an initial award made pursuant to § 362(k). The court determined that it stands to reason that a “party who violated the stay should continue to pay for its harmful behavior by compensating the debtor for its appellate attorneys’ fees and costs.” The court then cited a number of Ninth and Tenth Circuit cases in support of its conclusion stating that it
was an “established principle” that attorneys fees can be awarded for defending appeals of or challenges to a district court’s award of attorney fees.

The panel reiterated that the provision for attorneys’ fees and costs are of critical importance for the “very class of plaintiffs authorized to sue – individual debtors in bankruptcy.” The court thus found that § 362(k) seeks to make debtors whole, as if the violation never occurred, and that this “reasonably includes awarding attorney’s fees and costs on appeal to a successful debtor, even when a debtor must bring the appeal.”

The panel also held that the district court abused its discretion in denying the motion for attorneys’ fees on the alternative ground that the debtors failed to comply with a local rule requiring the filing of points and authorities. The panel concluded that the memorandum of points and authorities filed with the district court sufficiently clarified the attorneys’ fees and costs sought in debtors’ motion.

The panel reversed the order of the district court and remanded to the district court with instructions to remand to the bankruptcy court to calculate appellate attorneys’ fees and costs.

**In re Point Center Financial**, 890 F.3d 1188 (9th Cir. 2018)

**Holding:** The Ninth Circuit reversed the district court order dismissing the appeal of the bankruptcy court order for lack of standing.

**Facts:** Point Center Financial was a real estate loan originator and servicer. The business invested in real estate properties and provided its investors with fractionalized interests in the note and the deed of trust. In the event of default, Point Center foreclosed on the property and transferred the property to a newly created entity, in which the investors received a membership interest. Dillon Avenue 44 LLC was the entity created by Point Center to hold title to property upon which it had foreclosed.
Point Center filed a chapter 7 petition. On the petition date, the debtor had an operating agreement with Dillon. The deadline for the chapter 7 trustee to assume or reject executory contracts passed without the trustee assuming the operating agreement designating Point Center as Dillon’s manager. The trustee subsequently filed an untimely motion to assume the operating agreement, asserting that the failure to timely assume the executory contract was due to the trustee’s reliance on misrepresentations made by Dillon’s principals. At the hearing on the trustee’s motion, Dillon was unrepresented, and the bankruptcy court orally granted the trustee’s unopposed motion. One week later Dillon filed a motion for reconsideration which the bankruptcy court denied, even though it had not yet entered the order granting the motion.

Dillon appealed to the district court. The trustee moved to dismiss the appeal on the grounds that the appellants lacked standing to appeal because they did not file an objection to the motion or attend the hearing. The district court granted the trustee’s motion. The Ninth Circuit reversed and remanded.

**Reasoning:** In order to appeal an order, the litigant must have standing. Typically, this means that the litigant must be a “person aggrieved” by the appealed order. Here, the issue is whether Dillon’s failure to appear and to object to the relief requested by the chapter 7 trustee, despite having been given appropriate notice of the hearing, meant that Dillon could not satisfy the “person aggrieved” standard. In its ruling the court observed that there was no Ninth Circuit case law on the issue, but other circuits had addressed the issue with divided results. The district court had relied on dicta from a Ninth Circuit opinion stating that attendance and objection at bankruptcy court proceedings should usually be prerequisites to meeting the prudential standing rule. The Ninth Circuit did follow the dicta from its earlier decision and ruled that the failure to attend the bankruptcy court hearing of which a litigant had notice and the failure to object to the court’s ruling may result in a waiver or forfeiture of the right to...
make certain arguments or object to certain claims, but it does not constitute a jurisdictional standing issue. In other words, Dillon was a “person aggrieved” by the bankruptcy court order allowing the trustee to assume the management contract but it entered the appellate fray in a weakened condition, having failed to present evidence and make arguments to the bankruptcy court. In summary, the failure to appear and object violates a procedural rule that implicates the interest of judicial economy but not of standing.

In re Lee, 889 F.3d 639 (9th Cir. 2018)

The Ninth Circuit affirmed the bankruptcy and district court rulings that FRBP 4003(b), unlike some other bankruptcy rules, prescribes no particular form for objections to exemption claims, and its purpose is to “provide the debtor with timely notice that the trustee or other interested party objects to a debtor’s claimed exemption.” In re Lee, 889 F.3d 639, 644 (9th Cir. 2018).

Three years prior to filing his chapter 7 bankruptcy petition, debtor transferred two pieces of real estate into a tenancy by the entirety for the purpose of “exemption planning” at some future time. Following debtor’s petition, the trustee brought an adversary proceeding seeking to set aside the transfers. The trustee filed this proceeding within the time period required under Rule 4003(b) for objecting to claimed exemptions but neither the trustee nor the bankruptcy court addressed the issue of debtor’s claimed exemptions during the course of the adversary proceeding. Following a ruling in the trustee’s favor, the trustee filed a motion for turnover of the properties. Debtor objected on the grounds that the trustee had not timely objected to his claimed exemptions. The bankruptcy court overruled debtor’s objections on the grounds that the adversary complaint satisfied the requirements of 4003(b). The district court affirmed.

In rejecting a formalistic approach to interpreting Rule 4003(b) and determining that the fraudulent transfer complaint satisfied the notice requirements of Rule 4003(b), the Ninth
Circuit also cited favorably In re Grosslight, 757 F.2d 773, 777 (6th Cir. 1985), a case wherein creditor’s adversary proceeding asking that the automatic stay be lifted was adequate for purposes of giving notice to a debtor of creditor’s objections to debtor’s claimed exemption.

**Wilson v. Rigby, 909 F.3d 306 (9th Cir. 2018)**

The Bankruptcy Court for the Western District of Washington refused to permit a Chapter 7 debtor to amend her bankruptcy schedules to exempt a post-petition increase in the value of property that was the subject of a homestead located in Washington and exempted under the federal bankruptcy exemptions. The district court affirmed the decision. The Ninth Circuit Court of Appeals affirmed the district court’s ruling, though there was a vigorous dissent.

The Ninth Circuit panel held that the debtor’s claimed exemption was limited to the amount to which she was entitled to exempt under Washington law as of the petition date, whether claiming federal or state law exemptions, because the value of the exemption under the Washington statute is fixed as of the date of the petition to the value of the homestead rather than tied to a fixed dollar amount. Declining to decide whether the definition of the value of exemptions in 11 U.S.C. § 522(a)(2) applies to state law exemptions as well as to federal ones, the panel concluded that § 541(a)(1) makes clear that the debtor’s interests in property transfer to the bankruptcy estate as of the commencement of the bankruptcy action. Following this transfer, any appreciation inures to the bankruptcy estate. Distinguishing cases involving California’s homestead statute, the panel held that, under Washington law, the debtor’s exemption was limited to her equity in the property as of the date of her bankruptcy petition.

Washington’s ARCW § 6.13.030 states that the homestead exemption amount “shall not exceed the lesser of (1) the total net value of the lands, manufactured homes, mobile home, improvements, and other personal property...or (2) the sum of one hundred twenty-five thousand dollars...” Thus, in Washington, a debtor’s exemption is tied to their equity and the
debtor must have $125,000 in equity in the property on the date of filing in order to take the full exemption amount allowed under Washington law. As a result, the Washington statute limits a debtor to the net value in their homestead on the date of petition. Due to arguments presented by counsel, the Washington statute was compared to the California exemption statute, California’s Code of Civil Procedure § 704.730, which ties the allowed exemption amount to demographic information (e.g. a person 65 years of age or older is entitled to an exemption of $175,000) and does not limit the exemption amount to the amount of net value, i.e. equity, possessed by a debtor in their homestead. (Note the Oregon homestead exemption also is tied to an amount rather than the value of the property).

Dissenting, District Judge Huck wrote that binding Ninth Circuit precedent mandates that when a homestead appreciates in value post-petition, a debtor is entitled to amend her homestead exemption claim to include a portion of that appreciation in order to exempt from the bankruptcy estate the maximum amount permitted by state or federal law applicable on the petition date. Judge Huck wrote that the only property subject to exemptions is that which becomes part of the estate. Because post-petition appreciation is an estate asset, it is subject to the maximum applicable homestead exemption irrespective of the amount of the exemption initially claimed by the debtor.

For Oregon Practitioners: ORS § 18.395. Oregon’s homestead exemption statute, like that of California, is not limited by the amount of equity a debtor has in their property. ORS § 18.395(a) allows for a $40,000 exemption for a single filer and $50,000 for joint filers regardless of the amount of equity held in the property. Thus, practitioners in Oregon, unlike those in Washington, are able to take the full amount of the exemption at the commencement of the bankruptcy action without consideration of their client’s equity in the property or any appreciation in value. Moreover, if an Oregon practitioner did not take the full exemption amount, they could later increase said exemption to the maximum allowed as they would have
been allowed to do so at the commencement of the bankruptcy case. This is contrasted with a Washington debtor whose exemption amount is limited to the amount of equity the debtor possessed at the commencement of the case.

**Practice Tip:** Washington practitioners should opt to use the highest value for their client’s homestead property that can be justified, for obvious reasons.

**Query:** If appreciation in a homestead is a post-petition asset that inures to the benefit of the bankruptcy estate, couldn’t a practitioner, using the wild card “pourover” exemption under federal law (as opposed to utilizing the Washington state law exemption in a homestead) amend Schedule B, claiming as a separate asset “post petition appreciation in homestead” and use whatever remaining “pourover” from the homestead exemption (“amplifying the wild card exemption available) that might be available to claim this appreciation? Could this approach get around the Ninth Circuit’s conclusion that the **homestead** exemption (vs. the wild card exemption) is fixed as of the date of filing?

**Bank of New York Mellon v. Lane (In re Lane),** 589 B.R. 399 (9th Cir. BAP 2018)

**Holding:** The Ninth Circuit BAP reversed the bankruptcy court order voiding the bank’s first position lien on the debtor’s residence.

**Facts:** Richard Lane filed a chapter 13 petition, scheduling his residence, valuing it at $420,000.00, and stating it was subject to two debts owed to Bank of America. Regarding these two debts, Lane asserted that the first debt in the approximate amount of $700,000 was disputed because it was no longer held by a “real party in interest,” and the second debt of approximately $74,000.00 was not disputed but wholly unsecured. Lane proposed a chapter 13 plan providing that payment theoretically would be made to Bank of America for its first lien position but actually not paid until its real party in interest status was resolved.

The Bank of New York Mellon (BONY) filed a secured proof of claim, indicating that the original lender was Countrywide Home Loans and BONY held its endorsed in blank note and
deed of trust. Lane objected to BONY’s claim, challenging its standing. On that basis, he filed a motion asking that its claim be disallowed. For some reason, BONY failed to object to the motion and/or appear at the hearing, resulting in a default order disallowing its claim. Because its claim had been disallowed, BONY did not participate in the confirmation process. Lane’s plan was confirmed, and he made no payments on BONY’s claim during the plan’s five year term. The plan was completed, a discharge order entered, and the case closed.

Thereafter BONY obtained an order reopening the case and asked the court to reconsider its order disallowing its claim. The motion was denied. Then Lane filed an adversary proceeding against BONY seeking to void the deed of trust under § 506(d). The bankruptcy court ruled on summary judgment that the lien was void, basing its ruling upon § 506(d), its prior order disallowing the claim, and HSBC Bank USA N.A. v. Blendheim (In re Blendheim), 803 F.3d 477 (9th Cir. 2015). The BAP reversed the bankruptcy court holding that it erred in voiding the lien under § 506(d).

Reasoning: The BAP rejected BONY’s argument that lack of standing was not a substantive objection under § 506(d) and likewise rejected its reliance upon Blendheim. In that case, the circuit held that the bankruptcy court properly avoided the secured creditor’s lien under § 506(d) based upon a prior court order that disallowed the secured claim on the substantive ground of forgery. The court emphasized that in Blendheim the bankruptcy court had actually adjudicated the validity of the lien and the underlying note in its claim disallowance order. Here, the BAP noted, the bankruptcy court never ruled the lien to be invalid but simply held that BONY lacked standing to enforce the note. Section 506(d) provides that a lien is void to the extent that it secures a claim against the debtor that is not an allowed secured claim. The provision applies only when a claim disallowance addresses the merits of the underlying claim, which an objection based on standing does not.
In re Fagerdala, USA-Lompoc Inc., 891 F.3d 848 (9th Cir. 2018)

The Ninth Circuit held in Fagerdala that creditors may purchase claims in defense of their economic interests in bankruptcy without necessarily running afoul of the good faith requirement in § 1126(e), even if such purchase is detrimental to other creditors.

A chapter 11 debtor moved to designate votes on the basis that a creditor acted in bad faith by 1) offering to purchase a subset of available claims to block a plan of reorganization; and/or 2) that blocking the plan would adversely impact the remaining creditors. The bankruptcy court granted the motion on the basis that the creditor’s conduct resulted in an unfair disadvantage to other creditors. The district court affirmed.

The Ninth Circuit reversed the bankruptcy and district courts on the basis that bad faith requires “some evidence that a creditor is seeking ‘to secure some untoward advantage over other creditors for some ulterior motive.’” Fagerdala, 891 F.3d at 852. The court determined that a creditor merely pursuing its own self-interest, even if it yields a detrimental result to other creditors, is not sufficient for a finding of bad faith. The court specifically held that failing to make an offer to purchase all claims in a particular class is not, by itself, sufficient evidence of bad faith. It also held that the bankruptcy court must look to the motivations of the creditor in order to determine bad faith. Merely looking to whether a particular action creates a negative effect for other creditors is not sufficient.

Schnitzel, Inc. v. Sorensen (In re Sorensen), 586 B.R. 327 (B.A.P. 9th Cir. 2018)

The Bankruptcy Court for the Northern District of California entered an order denying a pawn-shop creditor’s Motion to Dismiss an adversary proceeding for injunctive and declaratory relief which granted the debtor a preliminary injunction preventing the creditor from disposing of jewelry the creditor held as security for a pawn loan. The creditor argued that the jewelry never became part of the bankruptcy estate under 11 U.S.C. § 541(b)(8) and that if the debtor wished to include the jewelry in the bankruptcy estate, she was required to redeem it pursuant
to §§ 541(b)(8)(C) and 108(b). The bankruptcy court disagreed and found that the 10-day notice required before the redemption period was terminated, as required by California statute, could not be given without first obtaining relief from stay. Since relief had not been sought prior to giving the notice, the notice given was void as a matter of law. Thus, since no valid notice was issued as required by California law under § 108(b), the jewelry was not excluded from the estate under § 541(b)(8) as the redemption period never began to run due to the invalid notice. The Ninth Circuit Bankruptcy Appellate Panel subsequently affirmed the bankruptcy court’s order.

The B.A.P. agreed with the bankruptcy court’s reasoning and distinguished the instant case from the 11th Circuit’s ruling in In re Northington, 876 F.3d 1302, 1314-15 (11th Cir. 2017), which held that, under Georgia law, title automatically vested in the pawnbroker at the end of the redemption period and that the pawned property “dropped out” of the estate pursuant to § 541(b)(8). The 9th Circuit B.A.P. noted that there was no notice requirement under Georgia law as there was under California law. California law does not vest title in pawned property until 10 days after proper notice is given to the pledgor of the pawned property. Because the notice was found to be an act to “exercise control over property of the estate,” as it was an act to “enforce a lien that secures a claim” and an act “to collect, assess, or recover a claim against the debtor.”, relief from stay was required before the notice could be given. Thus, as the notice was issued post-petition, it violated the automatic stay provided by § 362 and was therefore void.

For Oregon Practitioners: ORS § 726.400. Like California law, Oregon law allows a pawnbroker to deem a pledge to be forfeited (on transactions in excess of $500) if they have given proper notice to the pledgor that their pledged property is at risk of forfeiture and the pledgor has had an opportunity to redeem the pledged property. Section (4) of that statute requires written notice before the redemption period expires. Thus, like the law being
discussed in Sorenson, Oregon law would require relief from the automatic stay before giving notice.

For Washington Practitioners: RCW § 19.60.061. Unlike Oregon and California law, and similar to Georgia law, there is no notice requirement under RCW § 19.60.061. Under Washington law, a pawnbroker only needs to wait for the loan period of ninety days to expire before the rights, title, and interest in the pledged property automatically vests in the creditor. Therefore, if this case had been analyzed under Washington law, the interest in the pledged property would have vested in the pawnbroker immediately after the redemption period ran, without the need to seek relief from the automatic stay.

In re City of Stockton, 909 F.3d 1256 (9th Cir. 2018)

Holding: In a split decision, the Ninth Circuit held that the appellant’s appeal from the bankruptcy court order denying his objection to the chapter 9 plan was equitably moot.

Facts: Michael Cobb’s deceased father owned land in Stockton, CA that was taken by the city of Stockton for a road easement by means of California’s “quick take” condemnation process. Essentially this process allowed Stockton to deposit $90,000.00 with the state treasurer as compensation for the taking based upon its appraiser’s estimate of just compensation. If the condemnee took the deposited money, the condemnee waived all defenses to the eminent domain lawsuit, except for the amount of just compensation. Here, Cobb took the money. Ultimately the city’s eminent domain lawsuit was dismissed for failure to prosecute. Thereafter Cobb filed an inverse condemnation lawsuit against Stockton, asserting that the city’s action amounted to an unconstitutional taking of his property without just compensation in violation of the 5th amendment.

Stockton filed for chapter 9 relief in 2012. In its bankruptcy, Cobb filed a proof of unsecured claim for $4.2 million. Stockton’s proposed plan treated Cobb’s claim, affording it the same treatment as other unsecured claims. Cobb objected to confirmation of the plan of
reorganization, asserting that his constitutional claim could not be impaired by a plan of reorganization confirmed by a bankruptcy court. The bankruptcy court disagreed, reasoning that Cobb had only a monetary claim and not a property rights claim.

Significantly Cobb did not seek a stay of the confirmation process and consequently the chapter 9 plan became effective. A split panel of the Ninth Circuit dismissed Cobb’s appeal as equitably moot, with a dissent seeing merit in his argument that his claim was protected by the 5th amendment and beyond the authority of a bankruptcy court to impair.

**Reasoning:** The Ninth Circuit agreed with the bankruptcy court that Cobb had only an unliquidated and unsecured monetary damage claim. The majority noted that he had waived all his defenses and claims arising out of the eminent domain action and that his remaining claim was simply a claim for more money. The court further noted that his claim for increased compensation should have been brought as a counterclaim in the city’s dismissed condemnation lawsuit. In the end the majority affirmed the bankruptcy court order overruling his objection to the city’s reorganization plan and dismissed his appeal as equitably moot because he never sought a stay. In the court’s words, “if there is a confirmed plan that deserves finality- for employees, retirees, creditors, taxpayers and the future of the city- it is Stockton’s…”

The dissenting judge agreed with Cobb that his claim was a constitutional takings claim that could not be discharged through a chapter 9 bankruptcy.

**Hunsaker v. United States, 902 F.3d 963 (9th Cir. 2018)**

The Ninth Circuit held that sovereign immunity does not operate as a bar to emotional distress damages for willful violation of the automatic stay. The bankruptcy court below ruled that 11 USC §§ 106(a) and 362(k) operated to waive sovereign immunity for the purpose of recovering emotional distress damages in the case of stay violations. On the IRS’s appeal, the
district court concluded that Congress had not waived sovereign immunity for emotional distress damages. The Ninth Circuit reversed.

Debtors filed for chapter 13 bankruptcy protection. Following the petition, the IRS sent four notices to them demanding payment and threatening to levy their social security benefits. Debtors filed an adversary proceeding seeking damages for violation of the automatic stay.

Section 362(k) establishes that “an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages.” The Ninth Circuit observed that these damages include damages for emotional distress. Hunsaker, 902 F.3d at 966. Once establishing that this category of damages is appropriate under § 362(k), the Ninth Circuit focused the bulk of its decision on the scope of the waiver in § 106(a), rejecting the government’s argument that the waiver only extends to funds “unlawfully in the government’s possession.” Id. at 968-69. The court ultimately concluded that “Congress has waived sovereign immunity for nonpunitive monetary damages under the waiver’s enumerated provisions, including Section 362(k).” Id. at 969. In so doing, the Ninth Circuit also rejected the approach taken by the First Circuit in In re Rivera Torrez, 432 F.3d 20 (1st Cir. 2005), creating a circuit split on the question of the scope of the waiver under § 106(a).

**Aldana v. Stadtmueller (In re De Jesus Gomez), 592 B.R. 698 (B.A.P. 9th Cir. 2018)**

The debtor failed to disclose a 2012 Chevrolet Malibu, which he had purchased two weeks before filing, in his initial petition and also failed to disclose the Malibu during two subsequent § 341(a) meetings of creditors. The debtor finally amended his schedules to include the Malibu and listed it as being subject to a secured claim held by a dealership. The Trustee discovered that the dealership’s security interest was perfected post-petition and obtained a default judgment against the dealership for avoidance and recovery of a post-petition transfer under § 549 and was granted a release of the security interest. The trustee filed a motion for
turnover of the vehicle. Only then, did the debtor amend his Schedule C to claim an exemption in the Malibu, but did not oppose the Motion to Compel Turnover.

The trustee filed an objection to the claim of exemption on the basis that the debtor could not assert an exemption under 11 USC section 522(g)(1) which provides that the debtor cannot exempt transferred property recovered by the trustee when 1) said transfer was voluntary; and 2) the debtor concealed such property. In addition, the trustee argued he should be awarded his fees and costs. No opposition to the objection was filed but the debtor’s attorney appeared at the hearing. He argued that he could amend his exemptions until the close of the case and filed a declaration of another bankruptcy attorney who stated that the debtor could modify his claimed exemptions on property in Schedule C until the close of the bankruptcy. The declaration did not state that the advising attorney was aware that the property had been recovered by the Trustee under § 549 and was thus considered inapplicable and was not considered in the bankruptcy court’s ruling. Ultimately, the bankruptcy court found that bad faith appeared to exist due to the apparent reckless conduct of the debtor’s attorney coupled with frivolous argument and actions including disregard of the court’s scheduling requirements. As a result, the Bankruptcy Court sanctioned the debtor’s attorney for asserting the meritless claim of exemption in the Malibu.

On appeal, the Ninth Circuit Bankruptcy Appellate Panel affirmed the bankruptcy court’s sanctions against the debtor’s attorney and held that the Trustee was entitled to fees and double costs due to the debtor’s frivolous appeal.

The Panel agreed with the bankruptcy court’s rulings and further held that the arguments the debtor’s attorney continued to offer on appeal that ignored § 522(g)(1), (which states that the debtor cannot exempt transferred property recovered by the trustee when said transfer was voluntary and the debtor concealed such property) were frivolous and reckless and not a mere “difference of opinion.” In defending his arguments, the debtor’s attorney
argued that his “subjective good faith belief in his course of conduct should insulate him from punishment.” The panel wholeheartedly disagreed and stated that Rule 8020(a), by which the sanctions were levied, was not susceptible to a “pure heart, empty head” defense.

**In re Swintek**, 906 F.3d 1100 (9th Cir 2018)

**Holding**: In a split decision, the Ninth Circuit held that the expiration of a state statutory ORAP lien was tolled by 11 U.S.C. § 108(c).

**Facts**: In 2001 two law firms were granted money judgements totalling approximately $300,000.00 against Swintek, a former certified public accountant, for unpaid legal fees. They assigned the judgments to another entity for collection. Approximately nine years later, the creditor obtained from state court an Order for Appearance and Examination (ORAP). The service of the order upon Swintek created a one-year ORAP lien encumbering Swintek’s personal property. Consequently, the creditor was able to levy upon approximately $67,000.00 in bank deposits. Swintek did not appear for the examination, electing instead to file a chapter 7 bankruptcy. The bank funds were turned over to the chapter 7 trustee.

Approximately three years after the petition was filed, the creditor filed an adversary complaint seeking a determination that its ORAP lien entitled it to the bank funds held by the trustee. The chapter 7 trustee took the position that the ORAP lien had expired during the pendency of the bankruptcy because the creditor had failed to renew it at the end of its one-year term. The creditor countered that the ORAP lien was tolled under § 108(c). The bankruptcy court granted summary judgment to the trustee, holding that the tolling provision of §108(c) was not applicable to an ORAP lien. The BAP reversed, citing Spirton v. Moreno (In re Spirton), 221 F.3d 1079 (9th Circuit 2000) wherein the Ninth Circuit held that § 108(c) tolls the period for renewing a judgment.

**Reasoning**: The Ninth Circuit majority agreed with the BAP. The pivotal issue was whether an order authorizing the examination of the debtor and the creation of a lien was the
continuation of the lawsuit or enforcement of the judgment. Section 108(c) encompasses the former but not the latter. In Swintek, the court stated that the period in which a creditor may enforce a judgment by executing on a lien constitutes the continuation of the original action that resulted in the judgment. In this regard the court observed that California appeared to regard an Order for Appearance and Examination as part of the original lawsuit that gave rise to the judgment.

The dissent questioned whether an ORAP lien is the commencement or continuation of a civil action. Rather, the dissent argued that it was enforcement. Additionally, the dissent characterized an ORAP lien as a secret lien because a creditor would have to examine the original state court law file in order to determine whether the lien existed.

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

The Bankruptcy Appellate Panel held that an executive’s employment contract does not establish a presumptive post-petition compensation rate.

The debtor’s plan rejected its executive chairman’s employment contract as of confirmation. The chairman claimed post-petition salary as an administrative expense from the date of the petition to confirmation at his contractual rate. The bankruptcy court awarded him far less than the prorated amount of salary that would have been due under the employment contract, reasoning the chairman “had not proved that the reasonable value of the benefit to the estate of his post-petition services was equal to the amount claimed.” The BAP affirmed.

The BAP reasoned that, pursuant to Burlington Northern Railroad Co. v. Dant & Russell, Inc. (In re Dant & Russell, Inc.), 853 F.2d 700 (9th Cir. 1988), § 503(b)(1)(A) requires that administrative priority claims are to be construed narrowly “so as to keep fees and administrative costs at a minimum” in service of the “overwhelming concern of the Code: Preservation of the estate.” Moreover, the BAP observed that the burden of persuasion by a preponderance of the evidence for any administrative claim is born by the claimant. The BAP
also held that a debtor is not bound to the contract rate simply because the contract has not yet been rejected.

In examining whether the claimant met his burden, the BAP ruled that “although the rate for payment under a rejected executory contract has some baring on the court’s discretionary determination of the benefit of post-petition services to the estate, such rate is not presumptive as the reasonable value, and a debtor in possession need not rebut it. The burden falls upon the applicant to prove the value.” In re Cook Energy LLC, 583 B.R. at 502-03.
Chapter 5

Student Loans and Bankruptcy

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Chapter 5—Student Loans and Bankruptcy

Student loans: beyond Undue Hardship

Northwest Bankruptcy Institute
April 5, 2019

Ed Boltz, Durham NC
Latife Neu, Seattle WA

The Starting Point

Presumption of non-dischargeability—

Student loans are presumed to be nondischargeable...

11 USC §523(a)(8) : “unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and debtor’s dependents...”
Chapter 5—Student Loans and Bankruptcy

Uses of bankruptcy, absent dischargeability

- Chapter 7: eliminate dischargeable debt so that student loan payments are manageable.
  - Can student loans underlie a non-consumer filing?
- Chapter 13 may include:
  - Best effort Plan payments control outflow
  - Co-debtor stay (§1301)
  - Preferential payment on co-signed loans (§1322)
  - Stop garnishment & collection activity
  - Remain on IDR/PSLF (w/ goal of eventual forgiveness) if no detriment to other creditors (“Buchanan provisions”)
  - Direct application of disbursements to principal.

Adversary Proceeding in Bankruptcy

- Within a chapter 7 or 13
- File an Adversary Proceeding (AP) asking for ruling that certain loans are dischargeable
  - Undue Hardship
  - Declaratory action that certain loans are not subject to §523(a)(8) nondischargeability
Understanding the Undue Hardship Standard

• Generally, debtor must show “Undue Hardship” to discharge student loans under the Brunner test adopted by 9th Cir. through In re Pena, 155 F.3d 1108 (9th Cir. 1998). Three prong test looks at:
  • Current inability to pay and maintain “minimal” standard of living (scrutinize bank statements, Sch. I&J)
  • Future inability to pay (age, health, family situation, payment options)
  • Past good faith efforts to deal with student loans
Nys Factors in Undue Hardship

*In re Nys* set out 12 factors for courts to consider:

1. Serious mental or physical disability of debtor prevents employment or advancement.
2. Debtor’s obligation to care for dependents.
3. Lack of or limited education
4. Poor quality of education
5. Lack of usable job skills
6. Underemployment

Continued...

Nys Factors Con’t

7. Maximized income potential in the chosen field, no more lucrative job skills
8. Limited number of years in work life
9. Factors that prevent retraining or relocation
10. Lack of assets that could be used to pay the loan
11. Potentially increasing expenses
12. Lack of better financial options elsewhere.
What does Undue Hardship mean?

- “Mere financial adversity is insufficient.” *Id*.
- “Minimal Standard of living... does not equate to a middle class standard of living.” *In re Howe*, 319 B.R. 886 (9th Cir. BAP 2005).
- “In defining undue hardship, courts require more than temporary financial adversity, but stop short of requiring utter hopelessness.” *Id*.

Partial discharge

- Through *In re Saxman*, 325 F.3d 1168(9th Cir. 2003), the 9th Circuit made it possible for the bankruptcy court to grant partial discharge of student loans on finding that the Brunner factors had been satisfied as to the discharged portion of the loan.
- Can support an adverse result for debtor. See *In re Morrison*, AP no. 13-80034-FPC, EDWA 2014.
Application of Undue Hardship

_In re Coplin_, AP no. 16-04122-MJH, WDWA 2017.
Single mother of five children, three of whom are disabled, has approximately $500,000 in student loans. Though she has a J.D., she works as a waitress at a casino, and lives with boyfriend, who pays for most living expenses. DOE and ECMC (guarantor on federal loans) take case to trial. Loans reduced to $222,000 on the theory that due to boyfriend’s support, borrower can repay part of her loans without undue hardship.

_In re Williams_, AP no. 16-01114-CMA, WDWA 2017.
Discharge granted on over $250,000.00 in private student loans. Current and future inability to pay are established (minimal standard of living shown by partially-disabled 44 year old woman with multiple health problems and low income). Past good faith found despite debtor never making payments on the loans at issue, based on evidence that debtor never earned enough to make the contractual payments on the loans.
**In re Mitchell**, AP13-04415-PBS, WDWA 2014. A disabled young woman’s private student loans are found to be largely dischargeable. However, the ruling provides that when debtor receives an expected modest PI settlement, funds left over after repair of her home’s failing electrical and plumbing systems should be paid to the loans. Any remaining student loan balance to be discharged.

**In re Hedlund**, 718 F. 3d 848 (9th Circuit, 2013). Oregon law school grad who can’t pass the Bar holds a modest job in local government. Debtor’s wife is a stay at home parent. All but $30,000.00 of debtor’s student loans discharged despite the fact that debtor and his wife may not have made all possible efforts to maximize income, such as seeking paid employment for wife.

Bankruptcy court ruling reversed by District Court, upheld at 9th Cir.
Healthy, employed 30-somethings with $148,000 in combined federal student loans found to fail on inability to maintain a reasonable standard of living and pay student loans. Availability of income-driven payment options was persuasive in denial of discharge.

Undue hardship takeaways

- The Department of Education & federal loan guarantors (ECMC) continue to aggressively oppose discharge efforts
- Income-Driven Payment options on federal loans are often considered, effectively making federal loans more difficult to discharge; be prepared to counter this argument by the DOE/ECMC
- Even a sympathetic Debtor faces an uphill battle to discharge, based on current case law.
Chapter 5—Student Loans and Bankruptcy

Consider Administrative Remedies Instead of OR In Conjunction With Bankruptcy

Student Loans: 3 cases

A: Teacher’s wages are being garnished but he was never sued. Garnishment is revealed to be for student loans.

B: 65 year old woman with MS owes $80K in federal student loans. Her spouse works part time, and they have equity in their home.

C: Psychologist has six-figure balances on federal loans and also on private loans. Feels paralyzed and is near default on both batches of debt.
Federal Loan Programs and Discharges

- Approx. 80% of student loans are Federal Loans
  - FFEL (phased out by 2010) – private lenders, guarantors, backed by the federal government
  - Direct Loans (phased in to by 2010) – Gov’t is lender
  - Several types, including:
    - Direct Stafford Subsidized & Unsubsidized
    - Parent PLUS and Graduate PLUS loans
  - All subject to the same/similar treatment & programs

Are these federal loans?

- Federal loans are listed in the National Student Loan Data System
  - NSLDS.ED.GOV
  - 1-800-4FED-AID
- NLDS will show dates, default status, principal & interest
- Detailed instructions for accessing NSLDS system in materials
### NSLDS Loan Summary Example

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<th>Type of Loan</th>
<th>Loan Amount</th>
<th>Loan Date</th>
<th>Disbursed Amount</th>
<th>Cancelled Amount</th>
<th>Outstanding Principal</th>
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### Utility of info from NSLDS

- Know what loan IS and ISN’T a federal loan
- If it’s not on the report: private loan
- Approximate amounts owed
- Status RE: default
- Where is the loan? Click down on the loan number (left column) to find out

Note: Phone access to NSLDS information possible at 1-800-4FED-AID
Managing Federal Loan Payments with Income Driven Repayment

- Balances may be huge, but payments can be limited to a percentage of income: 10% to 20% of disposable income (DI)
- Income Driven Repayment Plans (IDR)
  - Pay as you Earn (PAYE) 10% of DI
  - Revised Pay as you Earn (REPAYE) 10% of DI
  - Income Based Repayment (IBR) 15%* of DI
  - Income Contingent Repayment (ICR) 20% ** of DI

Debt will be discharged after 20 or 25 years of payments.

*Newer borrowers have slightly different terms under IBR
** Parent Plus borrowers are forced into ICR, to their detriment

Calculating Income Driven Payments (IDR)

- Customizable loan calculator and comparison of IDR plans at www.studentaid.ed.gov
- How To Repay Your Loans
  - Repayment Estimator: enter loan type, amount, income
Public Service Loan Forgiveness

Three requirements must all be met to qualify:

1. Direct Loans: Check the NSLDS loan summary
2. In an IDR plan (or 10 year standard repayment)
3. Qualifying employment: government, 501(c)(3), or “other qualifying public service” s/t limitations

120 payments made with all three in place =
tax free loan forgiveness

Federal Loan Default

Broad Collection Powers and Adverse Effects of Default

- Defined as: 270 days of non-payment
- No more student loan borrowing
- Tax refund offset
- Administrative wage garnishment w/o judgment
- Offset of SSA and SSDI benefits
- “Collection costs” up to 25% added to balance
- Lawsuit – very rare
- Small effect on settlement options (90% of P&I)
Getting out of default

Stop adverse collection activity through one of two mechanisms:

- Consolidation
- Loan Rehabilitation

Information available at www.studentaid.ed.gov and www.studentloanborrowerassistance.org

Each can only be done once per loan – next stop, chapter 13.

Total & Permanent Disability Discharge

Offers tax free discharge of federal student loan. Show disability by:

- Certification by an MD or OD
- Social Security Administration finding of full disability, maximum review period
- VA finding of full service related disability

See: Total & Permanent Disability Discharge Application, studentaid.ed.gov
Federal loan management mechanisms

- Deferment & forbearance
  - Economic hardship / unemployment
  - Active Cancer Treatment forbearance
  - Active duty military / national guard
- Discharge
  - Death of borrower (or student w/r/t Parent PLUS loans)
  - Closed school
  - Fraud, false certification, forgery, etc.

Private Student Loans

- Similar to federal loans w/r/t non-dischargeability
- Different
  - SOL applies – use it
    - Chapter 13 allows claims objections
    - Disallowance of a Proof of Claim is res judicata in subsequent actions
  - No garnishment without judgment
  - No IDR, though ad-hoc arrangements may be possible
  - Co-signer obligation is common
Dealing with Private Loans

- Utilize legal process to assert defenses
- Lenders do not always pursue judgment
- Favorable settlement may be possible after default
  - Co-signer buy out possible after default
- Unlike federal loans, fraudulent and closed schools do not result in discharge of private loans
  - ... but lenders may not have the appetite to sue on debt from compromised schools.
- Far fewer tools to help Private Loan borrowers.

Another look at 3 cases--

A: School teacher's wages are being garnished but he was never sued. Garnishment is revealed to be for student loans.

Resolve default through loan rehabilitation. Subsequently seek IDR; counsel client on avoiding default and recertify IDR annually to avoid future problems. Look into loan forgiveness options once out of default.

B: 65 year old woman with MS owes $80K in federal student loans. Her spouse works part time, and they have equity in their home.

Avoid filing bankruptcy. Total & Permanent Disability Discharge will avoid the risk to the home from a bankruptcy, and the stress & expense of a discharge action.

C: Psychologist has six-figure balances on federal loans and also on private loans, which are co-signed by her father. Feels paralyzed and is near default on both batches of debt.

Evaluate for PSLF and apply for IDR for federal loans. If private lender is intractable, consider Chapter 13. Craft a plan that allows her to accrue time toward loan forgiveness on her federal loans.
Making Chapter 13 Work for the Student Loan Debtor

The Problem:
- Student loans are generally not dischargeable in a bankruptcy proceeding.
- In Chapter 13 bankruptcies, Debtors can emerge from discharge with a large increase in the amount owed and classification of the debt (in default).

Solutions:
- IDR’s in Chapter 13.
- Cure of student Loan arrears in a Chapter 13 plan.
- Revisiting separate classification for student loans in chapter 13 plans.
- Direct application of disbursements to principal balance.
- Solutions outside of bankruptcy.
Problem: Dramatic Increase in Amounts owed on Student Loans following Discharge

- Previously the Department of Education, its Guaranty Agencies and Student Loan Servicers would place all student loans for Chapter 13 Debtors in administrative forbearance.
- This meant that no collection actions were taken, but interest continued to accrue.
- Accordingly, $100,000 of student loans at 8% interest will grow to $148,984.57 at the end of a 60-month Chapter 13 Plan.
- The “fresh start” becomes a “false start.”

Dept. of Education refused IDR Participation during a Chapter 13 bankruptcy

- The Department of Education had refused to allow Chapter 13 Debtors to participate in the various income driven repayment plans.
- When pressed with the argument that 11 U.S.C. § 525(c) prohibited such discrimination, the Department of Education consented to allowing Chapter 13 Debtors to participate in IDRs if Chapter 13 Plans contained the following provisions from the Buchanan case:
Options for Chapter 13 Allowance of IDR

- Separate Classification
- Co-Sign Protection
- Above-median debtor pays student loan from discretionary income, i.e. Social Security or belt-tightening, earned in excess of PDI
- Below-median debtor extends plan to five years
- Pro Rated Distribution to Other General Unsecured Claims
- Chapter 20

Solution 1: Include Buchanan Provisions in Chapter 13 Plans

- The Debtor is not seeking nor does this Plan provide for any discharge, in whole or in part, of her student loan obligations.
- An over-arching concern by the Department of Education appears to be that, following United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260 (2010), “unscrupulous debtors [will] abuse the Chapter 13 process by filing plans proposing to dispense with the undue hardship requirement in the hopes the bankruptcy court will overlook the proposal and the creditor will not object.” Id. at 16.
- It is best to address this concern directly, both by specifically disavowing any present attempt at discharge and by asking that the Plan be specially set for a Confirmation Hearing.
Buchanan Provisions, con’t

- The Debtor shall be allowed to seek enrollment in any applicable income-driven repayment (“IDR”) plan with the U.S. Department of Education and/or other student loan servicers, guarantors, etc. (Collectively referred to hereafter as “Ed”), without disqualification due to her bankruptcy.

- This is a fundamental change in practice by Ed. and its servicers, which previously refused to consider applications by Chapter 13 debtors for IDRs, instead placing student loans into an “administrative forbearance.”

- The basis for this provision is the prohibition in 11 U.S.C. § 525 (c) which provides that a “A governmental unit that operates a student grant or loan program ... may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title ... because the debtor ... is ... a debtor under this title....”

Buchanan Provisions, con’t

- Ed shall not be required to allow enrollment in any IDR unless the Debtor otherwise qualifies for such plan.

- This is meant to prevent the debtor from asserting the confirmation of the plan on its own enrolled the Debtor in an IDR or that the Debtor was given any special preference.
Buchanan Provisions, con’t

- The Debtor may, if necessary and desired, seek a consolidation of her student loans by separate motion and subject to subsequent court order.

- Consolidation of several student loans may be necessary for enrollment in a specific IDR or if the debtor was in default on her student loans. The plan provides that this will be approved by separate motion.

- 11 USC 362(b)(16) provides that it is not a stay violation to determine the eligibility of a debtor to participate in student loan programs, including repayment plans.

Buchanan Solution: Allow review and objection of the IDR by the Chapter 13 Trustee

- Upon determination by Ed of her qualification for enrollment in an IDR and calculation of any payment required under such by the Debtor, the Debtor shall, within 30 days, notify the Chapter 13 Trustee of the amount of such payment. At such time, the Trustee or the Debtor may, if necessary, file a Motion to Modify the Chapter 13 Plan to allow such direct payment of the student loan(s) and adjust the payment to other general unsecured claims as necessary to avoid any unfair discrimination.

- This provides that once the monthly payment under an IDR is determined, the debtor will notify the Chapter 13 Trustee, who would then have an opportunity to decide whether that requires a higher dividend to unsecured creditors and if the IDR should be made directly or by “conduit.”
Buchanan Solution: Allow review and objection of the IDR by the Chapter 13 Trustee

- The Debtor shall re-enroll in the applicable IDR annually or as otherwise required and shall, within 30 days following a determination of her updated payment, notify the Chapter 13 Trustee of such payment. At such time, the Trustee or the Debtor may, if necessary, file a Motion to Modify the Chapter 13 plan to allow such direct payment of the student loan(s) and adjust the payment to other general unsecured claims as necessary to avoid any unfair discrimination.

- This provides a bit of a “carrot” for the Chapter 13 Trustee in consenting to the plan, in that the debtor will annually notify the Trustee of changes in the monthly IDR, which could result in a higher dividend to other unsecured creditors.

Buchanan Solution: Re-enrollment during a chapter 13 and the Automatic Stay

- During the pendency of any application by the Debtor to consolidate her student loans, to enroll in an IDR, direct payment of her student loans under an IDR, or during the pendency of any default in payments of the student loans under an IDR, it shall not be a violation of the stay or other State or Federal Laws for Ed to send the Debtor normal monthly statements regarding payments due and any other communications including, without limitation, notices of late payments or delinquency. These communications may expressly include telephone calls and e-mails.

- The second greatest concern by Ed appears to be that this plan is a devious attempt to trick student loan servicers into violating the automatic stay. The communications allowed are patterned on those with mortgage servicers, but stop short of allowing non-bankruptcy garnishment or other involuntary collection.
**Buchanan Solution:**

**Provides for monitoring of payments**

- **In the event of any direct payments that are more than 30 days delinquent, the Debtor shall notify her attorney, who will in turn notify the Chapter 13 Trustee, and such parties will take appropriate action to rectify the delinquency.**
- This is to allow for monitoring of the IDR payments if made directly by the debtor.
- It is important to remember that in regards to student loans, “delinquent” may not be the same as “default, which requires that no payments have been made for more than 270 days. See 34 C.F.R. 685.102

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**Buchanan Solution:**

**Compensation of Attorneys**

- **The Debtor’s attorney may seek additional compensation by separate applications and court order for services provided in connection with the enrollment and performance under an IDR.**
- This clearly is an important provision, allowing separate and additional compensation for services above and beyond standard representation of a debtor in a chapter 13 plan.
Getting Paid In Chapter 13 Cases for Student Loan Representation

- Another advantage to student loan litigation and representation in Chapter 13 is that attorneys fees can be paid through the plan.
- See *In re Coleman*, 560 F.3d 1000 (9th Cir. 2009), which recognized that even an “Attorney Fee Only” plan can be appropriate as a debtor often “cannot finance ... undue hardship litigation up-front, she would have to proceed with the undue hardship litigation pro se, if at all.”

Failure to Comply

- The failure/refusal by a student loan servicer to apply payments made to an IDR pursuant to a Chapter 13 plan can be sanctionable.
- See *In re Berry*, 2019 U.S. Dist. LEXIS 34554 (D.S.C. 2019) where the district court upheld an award of $16,317.30 in attorneys fees under the Equal Access to Justice Act (EAJA) due to PHEAA failing to apply payments towards an PSLF.
Solution 2: Cure Defaults on Student Loan Through Bankruptcy Plan

- 11 U.S.C. § 1322(b)(3) provides that “the plan may ... provide for the curing or waiving of any default.” (Emphasis added.)
- “Any default” should include student loan or even a default under a rehabilitation.
- “Curing”, which generally means catching up on missed payments, must mean something different from “waiving”, which implies forgiving of missed payments.
- 11 U.S.C. § 1322(b)(5), which routinely is used to allow the cure and maintenance of mortgage payments, specifically allows the same treatment for “any unsecured claim ... on which the last payment is due after the date on which the final payment under the plan is due”, which would include non-dischargeable student loans.
- Such a cure or waiver could avoid the assessment of collection costs of up to 18.5% of the outstanding principal and interest.
- It should be expected that such a plan would face vigorous opposition from the Department of Education and heightened judicial scrutiny.

Solution 3:
Separate Classification in Chapter 13

§ 1322. Contents of plan
* * *

(b) Subject to subsections (a) and (c) of this section, the plan may—

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;
Reasons for Separate Classification

- Reasons for classifying student loan creditors separately from other unsecured creditors in chapter 13 plan:
  - Stay current on IDR.
  - Make progress towards 20/25 year cancellation or 10 year PSLF.
  - Maximize payment toward non-dischargeable debt.

Judicial Standards

- In re Leser, 939 F.3d 669 (8th Cir. 1991):
  1. whether the discrimination has a rational basis;
  2. whether classification is necessary to debtor’s rehabilitation under chapter 13;
  3. whether the discrimination is proposed in good faith; and
  4. whether there is meaningful payment to class discriminated against
Separate Classification Allowed

- Permitting Public Service Forgiveness eligibility advances debtor’s fresh start
- Less discriminatory approach would leave the debtor or creditors worse off
- Concurrent payment of student loans and secured debts, followed by payment in full of unsecured debt
- Unsecured creditors receive at least as much as they would in chapter 7 proceeding

Separate Classification Not Allowed

- Nondischargeability, by itself, does not justify discrimination
- Public policy favoring student loan repayment or debtor’s fresh start is not reasonable justification
- Avoiding harm to the debtor is not a reasonable basis for discrimination
- No proof that discrimination is necessary or reasonable
Solution 4:
Co-Signer Protection in Chapter 13

- Does the co-debtor stay under § 1301 protect parents or other family members who may have co-signed the debtor’s student loan?

- Does the “however clause” eliminate or qualify the fairness requirement?

- Do student loans co-signed by parents for children fall into the § 1322(b)(1) consumer debt exception, permitting separate classification?

Solution 5:
Application of disbursements to principal balance

- Finding that “non-dischargeability does not immunize the student loan claim from modification,” the bankruptcy court confirmed the chapter 12 debtors’ plan under which their payments would go to the principal on their student loan debt with accumulated post-petition interest to be paid post-discharge. In re Duensing, No. 18-10201, 2019 Bankr. LEXIS 598 (Bankr. D. Kan. Feb. 22, 2019)
When is a student loan not a student loan?

§523(a)(8)(A)(i)-(ii)

Consider the statute—
§ 523 Exceptions to discharge
(a) a discharge... does not discharge an individual from any debt—
(8) Unless [nondischargeability] would impose undue hardship to debtor or debtor’s dependents, for—
§523(a)(8)(A)(i)-(ii)

(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) An obligation to repay funds received as an educational benefit, scholarship, or stipend; or

§523(a)(8)(B)

(B) Any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by the debtor who is an individual.

So-- the interpretation of §523(a)(8)(A)(ii) drives the breadth of §523(a)(8)(B).
Unpacking §523(a)(8)

“four types of educational claims”

(1) Loans made, insured, or guaranteed by a gov’t unit, (2) loans made under any program partially or fully funded by gov’t or non-profit inst., (3) claims for funds received as educational benefit, (4) any “qualified educational loan” as defined in the Internal Revenue Code.

_Institute for Imaginal Studies v. Christoff_, 527 B.R. 624, 632 (9th Cir. BAP 2015).

What is NOT in (A)(ii)?

- _Christoff v. Institute for Imaginal Studies_, 527 B.R. 624 (9th Cir. 2015) debtor receives a tuition credit to attend a non-Title IV school. BAP rules that a tuition credit does not constitute “funds received,” so §523(a)(8)(a)(ii) does not apply; §523(a)(8)(B) applies.

- _Kashikar v. Turnstile Capital Mgmt_., 567 B.R. 160 (9th Cir. 2017): debtor borrowed to study medicine in the Cayman Islands (not Title IV school). “§523(a)(8)(A)(ii) is not a catch all provision to include every type of credit transaction that bestows an educational benefit on a debtor.” Remanded to consider (A)(i).
§523(a)(8)(B)

If §523(a)(8)(A)(ii) is not a catch-all, then §523(a)(8)(B) is given greater effect.

Analysis under §523(a)(8)(B) may offer opportunity--

§523(a)(8)(B)

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;
§221 of the Internal Rev. Code

(d) Definitions...

(1) Qualified education loan
The term "qualified education loan" means any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses—

(A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,

(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

(C) which are attributable to education furnished during a period during which the recipient was an eligible student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term "qualified education loan" shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or to any person by reason of a loan under any qualified employer plan (as defined in section 72(p)(4)) or under any contract referred to in section 72(p)(5).

§221 of the Internal Rev. Code 2

(d)(2) Qualified higher education expenses

The term "qualified higher education expenses" means the cost of attendance (as defined in sec. 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) at an eligible educational institution, reduced by the sum of—

(A) the amount excluded from gross income under section 127, 135, 529, or 530 by reason of such expenses, and

(B) the amount of any scholarship, allowance, or payment described in section 25A(g)(2).

For purposes of the preceding sentence, the term "eligible educational institution" has the same meaning given such term by section 25A(f)(2), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.
Cost of Attendance (COA)

- Defined at length in sec 472 of the Higher Education Act.
- Summary: a figure, determined by the school, representing the cost of tuition, room, board, transportation, and necessary supplies to attend a year at the school.
- Current COA is published on most schools’ websites.
- A qualified education loan is used solely to pay qualified education expenses, which means it is limited to cost of attendance.

Eligible Education Institution

- Internal Revenue Code § 25A(f)(2)
- From the IRS website:
  “An eligible educational institution is a school offering higher education beyond high school. It is any college, university, vocational school, or other post secondary educational institution eligible to participate in a student aid program run by the U.S. Department of Education. This includes most accredited public, nonprofit and privately-owned—for-profit postsecondary institutions.”
- Eligible to participate in student aid program run by US DOE = Title IV schools.
  See the “School Codes List” to determine whether a school is an eligible educational institution.
Dischargeable? Why/why not?

- Debtor took out a second mortgage to pay tuition and also pay for a home remodel.

- Elderly debtor co-signed on a private student loan with her son in law so that he could pursue technical training.

- Debtor borrowed money from his sister to attend university.

Dischargeable? Why/why not? 2

- Debtor took all of the loans offered to him by the financial aid office. Later, he saw an ad by a well-known lender in the student loan industry, placed in a student magazine. That lender offered to loan him up to $40,000.00 directly. He borrowed all he wanted, and spent the money to buy dorm furniture, a nice bike, and a top of the line computer and laptop.
Dischargeable? Why/why not? 3

- Debtor borrowed money to send her wayward son to “boot camp”
- Debtor went into debt so his kids could attend an elite private high school
- Debtor took out a bar study loan after finishing law school
- Debtor attended a not-Title IV flight school
- Debtor borrowed to pay for a bad education from a for-profit, Title IV school that later closed amid scandal.

Questions?
11 U.S.C. § 523 (a)(8)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

. . .

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for—

(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

26 U.S.C. § 221(d)

(d) Definitions. For purposes of this section—

(1) Qualified education loan. The term “qualified education loan” means any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses—

(A) which are incurred on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,

(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

(C) which are attributable to education furnished during a period during which the recipient was an eligible student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term “qualified education loan” shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or to any person by reason of a loan under any qualified employer plan (as defined in section 72(p)(4)) or under any contract referred to in section 72(p)(5).

(2) Qualified higher education expenses. The term “qualified higher education expenses” means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) at an eligible educational institution, reduced by the sum of—

(A) the amount excluded from gross income under section 127, 135, 529, or 530 by reason of such expenses, and

(B) the amount of any scholarship, allowance, or payment described in section 25A(g)(2).

For purposes of the preceding sentence, the term “eligible educational institution” has the same meaning given such term by section 25A(f)(2), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded
by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

**20 U.S.C. § 1087ll. Cost of attendance**

For the purpose of this subchapter, the term “cost of attendance” means—

1. tuition and fees normally assessed a student carrying the same academic workload as determined by the institution, and including costs for rental or purchase of any equipment, materials, or supplies required of all students in the same course of study;

2. an allowance for books, supplies, transportation, and miscellaneous personal expenses, including a reasonable allowance for the documented rental or purchase of a personal computer, for a student attending the institution on at least a half-time basis, as determined by the institution;

3. an allowance (as determined by the institution) for room and board costs incurred by the student which—
   - shall be an allowance determined by the institution for a student without dependents residing at home with parents;
   - for students without dependents residing in institutionally owned or operated housing, shall be a standard allowance determined by the institution based on the amount normally assessed most of its residents for room and board;
   - for students who live in housing located on a military base or for which a basic allowance is provided under section 403(b) of title 37, shall be an allowance based on the expenses reasonably incurred by such students for board but not for room; and
   - for all other students shall be an allowance based on the expenses reasonably incurred by such students for room and board;

4. for less than half-time students (as determined by the institution), tuition and fees and an allowance for only—
   - books, supplies, and transportation (as determined by the institution);
   - dependent care expenses (determined in accordance with paragraph (8)); and
   - room and board costs (determined in accordance with paragraph (3)), except that a student may receive an allowance for such costs under this subparagraph for not more than 3 semesters or the equivalent, of which not more than 2 semesters or the equivalent may be consecutive;

5. for a student engaged in a program of study by correspondence, only tuition and fees and, if required, books and supplies, travel, and room and board costs incurred specifically in fulfilling a required period of residential training;

6. for incarcerated students only tuition and fees and, if required, books and supplies;

7. for a student enrolled in an academic program in a program of study abroad approved for credit by the student’s home institution, reasonable costs associated with such study (as determined by the institution at which such student is enrolled);
(8) for a student with one or more dependents, an allowance based on the estimated actual expenses incurred for such dependent care, based on the number and age of such dependents, except that—

(A) such allowance shall not exceed the reasonable cost in the community in which such student resides for the kind of care provided; and

(B) the period for which dependent care is required includes, but is not limited to, class-time, study-time, field work, internships, and commuting time;

(9) for a student with a disability, an allowance (as determined by the institution) for those expenses related to the student’s disability, including special services, personal assistance, transportation, equipment, and supplies that are reasonably incurred and not provided for by other assisting agencies;

(10) for a student receiving all or part of the student’s instruction by means of telecommunications technology, no distinction shall be made with respect to the mode of instruction in determining costs;

(11) for a student engaged in a work experience under a cooperative education program, an allowance for reasonable costs associated with such employment (as determined by the institution);

(12) for a student who receives a loan under this or any other Federal law, or, at the option of the institution, a conventional student loan incurred by the student to cover a student’s cost of attendance at the institution, an allowance for the actual cost of any loan fee, origination fee, or insurance premium charged to such student or such parent on such loan, or the average cost of any such fee or premium charged by the Secretary, lender, or guaranty agency making or insuring such loan, as the case may be; and

(13) at the option of the institution, for a student in a program requiring professional licensure or certification, the one-time cost of obtaining the first professional credentials (as determined by the institution).

26 U.S.C. § 25A(f)

(f) Definitions

For purposes of this section—

(1) Qualified tuition and related expenses

(A) In general

The term “qualified tuition and related expenses” means tuition and fees required for the enrollment or attendance of—

(i) the taxpayer,

(ii) the taxpayer’s spouse, or

(iii) any dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151,

at an eligible educational institution for courses of instruction of such individual at such institution.

(B) Exception for education involving sports, etc.
Such term does not include expenses with respect to any course or other education involving sports, games, or hobbies, unless such course or other education is part of the individual’s degree program.

(C) Exception for nonacademic fees

Such term does not include student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual’s academic course of instruction.

(D) Required course materials taken into account for American Opportunity Tax Credit

For purposes of determining the American Opportunity Tax Credit, subparagraph (A) shall be applied by substituting “tuition, fees, and course materials” for “tuition and fees”.

(2) Eligible educational institution

The term “eligible educational institution” means an institution—

(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this section, and

(B) which is eligible to participate in a program under title IV of such Act.
# Student Loan Questionnaire

**CLIENT INFORMATION**

<table>
<thead>
<tr>
<th>Name:</th>
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<td>Former Names (if any):</td>
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| Street Address: | |

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<th>State:</th>
<th>Zip:</th>
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| Date of Birth: | Social Security Number (SSN): | |
|----------------|--------------------------------| |

| Driver's License State: | Driver's License Number: | |
|-------------------------|---------------------------| |

| Home Phone: | Cell Phone: | |
|-------------|-------------| |
| (________) | (________) | |

| Work Phone: | |
|-------------| |
| (________) | |

| Email: | |
|--------| |
|       | |
### FAMILY INFORMATION

#### Marital Status:

- Single
- Married
- Married, but separated
- Married, but cannot access spouse’s income info

*If married, provide the following:*

- **Spouse Name:** ____________________________________________________________________________
  *(Last, First, Middle)*

- **Spouse Date of Birth:** ____________________________________________________________________

- **Spouse Social Security Number (SSN):** _______________________________________________________

- **Does your Spouse have Federal Student Loans too?**
  - Yes
  - No
  - Amount: $__________

- **Does your Spouse have Private Student Loans too?**
  - Yes
  - No
  - Amount: $__________

#### People Supported by You:

- **How many children receive more than half of their support from you?** __________________________

- **How many other people receive more than half of their support from you?** ______________________
  *(Do NOT include spouse)*

*NOTE: Family and IRS dependent status are NOT relevant.*

*The only relevant factor is if child or person receives more than 50% of their support from Client.*

- **Do your children or dependents have Federal Student Loans too?**
  - Yes
  - No
  - Amount: $__________

- **Do your children or dependents have Private Federal Student Loans too?**
  - Yes
  - No
  - Amount: $__________
### EMPLOYMENT INFORMATION

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<table>
<thead>
<tr>
<th>Third Employer Name:</th>
<th>_________________________________________________________________________________________</th>
</tr>
</thead>
<tbody>
<tr>
<td>Street Address:</td>
<td>_________________________________________________________________________________________</td>
</tr>
<tr>
<td>City:</td>
<td>_________________________________________________________________________________________</td>
</tr>
<tr>
<td>State:</td>
<td>__________________________________________</td>
</tr>
</tbody>
</table>
SPECIAL QUESTIONS FOR TEACHERS

Teachers may be eligible for special loan forgiveness programs. If you are (or were) a teacher, answer the questions below:

Are you currently (or have you been) a full-time teacher?

Yes  No

Have you taught full-time for at least five (5) consecutive, complete academic years (with at least one of those years being AFTER the 1997-98 academic year)?

Yes  No

Was your teaching service performed at an eligible school listed on the Teacher Cancellation Loan Income List?  (www.tcli.ed.gov)

Yes  No

Were any federal student loans originated before the end of your 5-year teaching service?

Yes  No

SPECIAL QUESTIONS FOR GOVERNMENT AND NON-PROFIT EMPLOYEES

Employees working in the public and non-profit sectors may be eligible for special loan forgiveness programs. If you work in the public or non-profit sectors, answer the questions below:

Is your employer a governmental organization?  Yes  No

Is your employer tax-exempt under Section 501(c) (3) of the Internal Revenue Code?  Yes  No

Is your employer a non-profit organization?  Yes  No

Is your employer a partisan political organization?  Yes  No

Is your employer a labor union?  Yes  No

Indicate the service(s) Client’s employer provides:

- Emergency Management
- Public Service for The Elderly
- Military Service
- Public Health
- Public Safety
- Public Education
- Law Enforcement
- Public Library Services
- Public Interest Legal Services
- School Library Services
- Early Childhood Education
- Other School-Based Services
- Public Service for Individuals With Disabilities
- None of The Above
DISABILITY INFORMATION

Are you currently disabled? □ Yes □ No (If No, please skip to the next page)
Have you been declared disabled by _________? □ Yes □ No
Do you have a disability claim pending? □ Yes □ No

If you are disabled, describe the extent of your disability:
___________________________________________________________________________________________________________
___________________________________________________________________________________________________________

Are you receiving SSDI? □ Yes □ No
Are you receiving VA Disability? □ Yes □ No
Are you receiving private or another form of disability? □ Yes □ No
Were you disabled when you received the student loans? □ Yes □ No
Are able to work for pay? □ Yes □ No

SPECIAL INSTRUCTIONS REGARDING DISABILITY DISCHARGE

Total and Permanent Disability Discharge

If you are totally and permanently disabled, this may be shown in one of three ways:

1. Documentation from the U.S. Department of Veterans Affairs (VA) showing that the VA has determined that you are unemployable due to a service-connected disability.

2. Certification from a physician that you are totally and permanently disabled.

3. A Social Security Administration (SSA) notice of award for SSDI or SSI benefits stating that your next scheduled disability review will be within five to seven years from the date of your most recent SSA disability determination. This document is called a Benefits Planning Query (BPQY). There are two ways to obtain a copy of your BPQY:
   a. We can obtain the BPQY for you. Please sign two copies of Form SSA-3288 Consent for Release of Information. The cost for this additional service is $250.00.
   b. You can get a copy of your BPQY:

      Step 1: Gather one or two forms of identification that provide your date of birth and social security number (Driver’s License, Photo ID, Social Security Card, etc.).

      Step 2: Go to your local Social Security Administration office and ask for a BPQY form number SSA-2459. (We can provide a sample).

      OR

      Call the Social Security Administration at 1-800-772-1213 between 7 a.m. and 7 p.m. and ask them to mail your BPQY to you.

      Step 3: Check to see that the information you are given says “Benefits Planning Query” and that your name is at the top.
## INCOME INFORMATION

**INSTRUCTIONS:** If your annual taxable income has not decreased significantly since your last tax return, enter the Adjusted Gross Income amount (AGI) from your last tax return.

- **Married Filing Jointly** - enter household Adjusted Gross Income (AGI)
- **Married Filing Separately or Head of Household** - must provide spouse’s AGI

### Current Adjusted Gross Income: $ ______________

| Did AGI change significantly from last year? | Yes | No |
| Did actual income change significantly from last year? | Yes | No |

**Married borrowers, filing separately ONLY**

| Spouse’s Current Adjusted Gross Income: $ ______________ |
| Did AGI change significantly from last year? | Yes | No |
| Did actual income change significantly from last year? | Yes | No |

### Alternative Documentation of Income

If your Income is substantially different from the AGI on your last tax return, please complete:

#### Taxable Income

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Monthly Average Amount</th>
<th>Please Provide The Following Proof:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
<td>Spouse</td>
<td></td>
</tr>
<tr>
<td>1. Employment Income</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>2. Worker’s Compensation</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>3. Unemployment Benefits</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>4. Alimony</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>5. Other Taxable Income</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

#### Non-Taxable Income

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Monthly Average Amount</th>
<th>Please Provide The Following Proof:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
<td>Spouse</td>
<td></td>
</tr>
<tr>
<td>6. Child Support</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>7. Social Security</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>8. Other Non-Taxable</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

☐ Check this box if you have no income and are entirely supported by someone other than a spouse. Please explain how you are supported in the space below and on the back if necessary: ________________________________________________________
STUDENT LOAN STATUS AND COLLECTION ACTIVITY

Payment Status:
- Are you currently repaying your student loans?  
  Yes  No
  If yes, circle all of the repayment plans in which you are enrolled:
  - Standard
  - Graduated Standard
  - Extended
  - Graduated Extended
  - Income Contingent
  - Income Based
  - PAYE
  - REPAYE
  Not Sure

- What is your total monthly payment: $_______________________

- Are you in a forbearance or deferment agreement?  
  Yes  No

- Are you behind on your payments?  
  Yes  No
  If yes, how far behind are you?  
  <30 days  >30 Days  >180 Days  >270 Days  Not Sure

- Have or are your loans in default?  
  □ Yes  □ No  □ Not Sure

Bankruptcy Status:
- Are you in an active bankruptcy?  
  Yes  No
  If yes, provide the following:
  - Bankruptcy Jurisdiction: _________________________
  - Case Number: ____________________________
  - Filing Date: _____________________________
  - Chapter: 7  11  12  13

Collection Actions:
- Are your wages being garnished?  
  Yes  No
- Are your Social Security, Veteran’s or other benefits being garnished?  
  Yes  No
- Has your tax refund been seized?  
  Yes  No

NOTE: You will need the Bankruptcy Court’s permission to make changes to your student loans. If not, the bankruptcy could be dismissed.
Chapter 5—Student Loans and Bankruptcy

- **Are your Federal student loans the subject of a lawsuit or judgment?**
  
<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

  When were you sued? ____________________  Where was the lawsuit filed? ________________________________

  Who was the lawyer for the student loans? ________________________________________________________________

  Did you have a lawyer?  Yes  No  Name (and telephone #): ________________________________

- **Is the suit still going on? ** List any court deadlines and hearing dates:

  __________________________________________________________

  __________________________________________________________

  __________________________________________________________

  __________________________________________________________

**NOTE:** If Client’s student loan lender is suing Client or has obtained a judgment, Client must first resolve the lawsuit/judgment before proceeding. Bankruptcy automatically stays any lawsuits.

### Debt Collection

- Has a debt collector ever contacted you about your student loans?  □ Yes  □ No
- Has any debt collector:
  - Sent you inappropriate, unfair, or inaccurate letters?  □ Yes  □ No
  - Made inappropriate, unfair, or inaccurate telephone calls?  □ Yes  □ No
  - Visited you personally?  □ Yes  □ No
  - Contacted anyone other than you or a co-debtor about your student loans?  □ Yes  □ No
  - Contacted you using a false name?  □ Yes  □ No
  - Threatened to sue you, garnish your wages, or damage your credit score?  □ Yes  □ No

If yes, please provide details about that contact:

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

### Student Loan Settlement

- Have you sought help from any other attorney regarding your student loans?  □ Yes  □ No
- Have you sought help from any debt settlement company for your student loans?  □ Yes  □ No

  *If yes to either*, please provide the name, address, and contact information:

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

How much did you pay?  $________________________

When were you enrolled in this program? _____________________________

**NOTE:** We will need copies of all contracts, letters, emails, promotional materials, etc., to determine whether to pursue recovery of these amounts.
**GOVERNMENT STUDENT LOANS**

**PLEASE FILL OUT THE FOLLOWING FORM FOR EVERY**
**GOVERNMENT STUDENT LOAN YOU HAVE OR MIGHT HAVE**

Attach latest bill or statement for each loan.
(If you need more pages, please ask.)

<table>
<thead>
<tr>
<th>Name of Creditor:</th>
<th>Amount of Debt: $</th>
<th>Monthly Payment: $</th>
<th>Last payment date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mailing Address:</td>
<td>Account Number:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Include Zip code)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>When was this loan incurred:</td>
<td>From:</td>
<td>To:</td>
<td>Years</td>
</tr>
<tr>
<td>Original Lender:</td>
<td>Co-Signers:</td>
<td>□ Yes □ No</td>
<td>Did anyone co-sign this loan?</td>
</tr>
<tr>
<td>Which school did you use the loan to attend?</td>
<td>Name and Address of co-signer:</td>
<td>Relationship to you:</td>
<td></td>
</tr>
<tr>
<td>Did you use some or all of the loan for living expenses?</td>
<td>□ Yes □ No</td>
<td>Do you care if the creditor goes after the Co-signer for payment?</td>
<td></td>
</tr>
<tr>
<td>If yes, please describe:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do you have copies of your loan documents?</td>
<td>□ Yes □ No</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Servicer Selection for Consolidation:**
You may be able to select your loan servicer going forward. Select from the list below:

- Nelnet
- Navient
- FedLoan Servicing
- CornerStone
- OSLA Servicing
- Great Lake
- MOHELA
- HESC/EdFinancial
- Granite State
- I don’t care

**NSLDS Data:**
You will need to provide your Federal student loan information from the National Student Loan Data System (NSLDS). This can be done one of two ways:

**Option 1**
Provide your NSLDS text file (see attached instructions)

**Option 2**
Provide your FSA ID and Password.

Client’s FSA ID: ________________________________

FSA Password: ________________________________

**IMPORTANT:** Client will NOT be able to proceed without providing NSLDS data.
SPECIAL INSTRUCTIONS REGARDING LOAN CANCELLATIONS

Review the available discharges/cancellations below. If you believe any of these discharges apply, complete questions below:

**False Certification of Ability to Benefit Discharge**
If you didn't have a high school diploma or GED when you enrolled and the school did not properly assess or certify your ability to benefit from the education paid for with the loan.

**False Certification - Disqualifying Status Discharge**
When the school certified your eligibility, but because of a physical or mental condition, age, criminal record, or other reason, you would have been disqualified from employment in the occupation in which you were being trained.

**False Certification - Unauthorized Signature Discharge**
The school signed your name on the application or promissory note without authorization or the school endorsed your loan check or signed your authorization for electronic funds transfer without your knowledge. Does NOT apply if the proceeds of the loan were delivered to you or applied to charges you owed to the school.

Closed School Discharge
If you attended a school that closed while enrolled or if you withdrew 120 days before the school’s closure.

Unpaid Refund Discharge
You withdrew from school, but the school didn’t pay a refund that it owed to the U.S. Department of Education or to the lender, as appropriate. Only the amount of the unpaid refund will be discharged.

Defense to Repayment
The school, through an act or omission, violated state law directly related to your federal student loan or to the educational services for which the loan was provided.

Discharge Due to Death
If original borrower or the student borrower in a Parent PLUS loan has died.

LOAN CANCELLATIONS DUE TO IMPROPER LENDING PRACTICES

**False Certification of Ability to Benefit Discharge**
- Did you sign private student loans before you were 18? □ Yes □ No □ Not Sure
- Do you have a high school diploma or a GED? □ Yes □ No
  If you do have a diploma or GED, when was it earned and awarded?
- Did you enroll in any school(s) before you had your diploma or GED? □ Yes □ No
  If so, did the school give you any kind of test before you enrolled? □ Yes □ No
  If the school gave you any tests, please provide all the details you can about each test, how it was administered, including the number of times you took it:

**False Certification - Disqualifying Status Discharge**
- When you enrolled in school were you disqualified from employment in the occupation for which you were training due to physical or mental condition, age, criminal record, or other reason? □ Yes □ No
  If yes, please explain:

**False Certification - Unauthorized Signature Discharge**
- Are any of the student loans not yours or are there any that you did not sign for? □ Yes □ No □ Not Sure
  If yes, please explain:

**Closed School Discharge**
- Did any of your schools close while you attended or soon after you left? □ Yes □ No
  If yes, please describe, including whether you completed the program through a “teach out” or a transfer of credits to another school:
Unpaid Refund Discharge

- Did you withdraw from any school before completing your program? □ Yes □ No
  *If yes, please provide more information about your withdrawal:
  ______________________________________________________________________
  ______________________________________________________________________

- Did you receive a refund? □ Yes □ No □ Not Sure

Client Defense to Repayment

- Did any of your schools make any false promises or statements to you? □ Yes □ No
  *If yes, please describe the promises/statements and why they were false.
  ______________________________________________________________________
  ______________________________________________________________________

- Did you experience any other problems with the school(s) you attended? □ Yes □ No
  *If yes, please describe:
  ______________________________________________________________________
  ______________________________________________________________________

Discharge Due to Death

- Has the original borrower died? □ Yes □ No
  *If yes, please provide the original borrower’s name and date of death:
  ______________________________________________________________________
  ______________________________________________________________________

- Is the loan a Parent PLUS loan where the student has died? □ Yes □ No
  *If yes, please provide the student borrower’s name and date of death:
  ______________________________________________________________________
  ______________________________________________________________________
### PRIVATE STUDENT LOANS

**PLEASE FILL OUT THE FOLLOWING FORM FOR EVERY PRIVATE STUDENT LOAN YOU HAVE OR MIGHT HAVE**

Attach latest bill or statement for each loan.
(If you need more pages, please ask.)

<table>
<thead>
<tr>
<th>Name of Creditor:</th>
<th>Amount of Debt: $</th>
<th>Monthly Payment: $</th>
<th>Last payment date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mailing Address:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Include Zip code)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>When was this loan incurred:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(Years)</td>
<td></td>
</tr>
<tr>
<td>From:</td>
<td></td>
</tr>
<tr>
<td>To:</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Original Lender:</th>
<th>Co-Signers:</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Which school did you use the loan to attend?</th>
<th>Did anyone co-sign this loan?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>☐ Yes ☐ No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Did you use some or all of the loan for living expenses?</th>
<th>Name and Address of co-signer:</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes ☐ No</td>
<td>Relationship to you:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>If yes, please describe:</th>
<th></th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Do you have copies of your loan documents?</th>
<th>Do you care if the creditor goes after the Co-signer for payment?</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes ☐ No</td>
<td>☐ Yes ☐ No</td>
</tr>
</tbody>
</table>

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**Student Loan Questionnaire**

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**32nd Annual Northwest Bankruptcy Institute**
Downloading Your NSLDS File

Step 1:
Navigate your web browser to nslds.ed.gov.

Step 2:
Click the My Student Data Download button.

Step 3:
If the Privacy Statement screen is displayed, read the statement and click the Accept button.

Step 4:
You will be required to have a valid FSA ID email address and password to continue to the next steps. If you do not have an FSA ID and need to create one, click the Create an FSA ID tab. Follow the onscreen directions and provide the information required to create your FSA ID.

The following step-by-step video tutorials will assist you in creating or resetting your FSA ID:
- Learn to Create a New FSA ID - https://youtu.be/fIpBwdO4NK8
Step 5: Login to NSLDS by clicking the Log in to NSLDS tab and entering your FSA ID email address and password.

![Login to NSLDS](image)

Step 6: Read the Disclaimer and click the Accept button.

![Disclaimer](image)

Step 7: If the password recovery feature page is displayed, skip this step by clicking Skip and Remind Me Later.
Step 8:

On the My Student Data Download Confirm page, click the Confirm button.

Step 9:

Clicking the Confirm button will download your NSLDS .txt file to your computer.

**NOTE:** Your internet browser and computer settings will determine where the file is saved.

Please take note of where the file was saved. You will need to return to www.studentloanify.com to upload the file and complete your analysis and application.

TIP: The fastest way to view your recent downloads on Internet Explorer, Firefox and Chrome is to press CTRL+J
Student Loan Bankruptcy and the Meaning of Educational Benefit

Jason Iuliano

Student loans hold a special status in the Bankruptcy Code. Unlike any other consumer debt, they are not dischargeable through the normal bankruptcy process. Specifically, for any student loan that satisfies one of three statutory criteria, a court may only grant a discharge if the borrower proves “undue hardship.” This requirement presents a significant hurdle that discourages the vast majority of bankrupt debtors from ever pursuing a student loan discharge. Given the high deterrent effect of the undue hardship standard, it is, therefore, imperative that courts accurately determine which educational debts are nondischargeable. In this Article, I argue that bankruptcy courts have misinterpreted the statutory criteria. The ultimate consequence of this judicial error has been to misclassify billions of dollars of student loan debt and to prevent many borrowers from obtaining the bankruptcy relief to which they are entitled.

One phrase, in particular, has been the source of this problem: “educational benefit.” In their rulings, judges have held that this term includes any debt used for educational purposes. Under any of the prevailing interpretive frameworks, however, that reading is indefensible. The statutory text, legislative history, and policy considerations all indicate that the phrase educational benefit can only be read to refer to a narrow type of debt—namely, conditional educational grants. If courts adopt the interpretation set forth in this Article, they will not only be expressing fidelity to the statute and to congressional intent but also will be acting to provide financial relief to many debtors who have been hit hardest by the student loan crisis.

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Introduction

America is barreling towards a student loan crisis. From politicians\(^1\) and journalists\(^2\) to scholars\(^3\) and judges\(^4\) and even to celebrities,\(^5\) it seems almost everyone is in agreement that educational debt is out of control.\(^6\)


\(^2\) See, e.g., Kevin Carey, Student Debt Is Worse Than You Think, N.Y. TIMES, Oct. 7, 2015, https://www.nytimes.com/2015/10/08/upshot/student-debt-is-worse-than-you-think.html (discussing data from the Department of Education that suggests “that the system is failing and that, at some colleges, the saddling of students with loans they cannot afford to pay down is far more dire than anyone knew”); Editorial Board, Four Years on Campus Might Be One Too Many, BLOOMBERG BUSINESSWEEK, Nov. 17, 2017 (proposing that colleges reduce the time it takes to earn a bachelor’s degree by one year in order to rein in the “student-loan crisis”).

\(^3\) See, e.g., Adam Levitin, Is There a Student Loan Debt Crisis?, CREDIT SLIPS, June 23, 2015, http://www.creditslips.org/creditslips/2015/06/is-there-a-student-loan-debt-crisis.html (hesitating “to call student loan debt a crisis, [but observing that] what is clear is that if current trends continue it will become one”); Michael Stratford, Income-Based Loans Made Simple, INSIDE HIGHER ED, Oct. 22, 2013, https://www.insidehighered.com/news/2013/10/22/new-report-calls-income-based-repayment-system-operates-payroll-taxes (quoting Susan Dynarski) (“We have a repayment crisis because student loans are due when borrowers have the least capacity to pay.”); but see SANDY BAUM, STUDENT DEBT RHETORIC AND REALITIES OF HIGHER EDUCATION FINANCING (2016) (noting that “[t]he idea of a student loan crisis has taken hold in the media, in the blogosphere, and in the political arena. But the reality is that borrowing for college is opening doors for many students. It is helping far more people than it is hurting.”).


\(^6\) Some of the most prominent financial institutions have expressed similar views. See, e.g., Chelsey Dulaney, Student Loan Debt: the Bubble Goldman Thinks You Should Buy, WALL ST. J., Dec. 5, 2017, https://blogs.wsj.com/moneybeat/2017/12/05/student-loan-debt-the-bubble-goldman-thinks-you-should-buy (noting that Goldman Sachs has described the student loan market as a “bubble”).
The widespread concern over this issue is easy to understand. At present, Americans owe more than 1.5 trillion dollars in student loan debt—an amount that has tripled in the last decade and now exceeds both automotive and credit card debt. Despite the troubling increase, however, there is an even more pressing issue: the low repayment rate. Only sixty percent of student loans are in active repayment, and a full eleven percent are in default. All told, these bleak statistics make it impossible to deny that educational debt is a significant problem in the United States. Disagreement arises, however, over the potential remedies.

If student loans were like any other consumer debt, a first-pass solution to the problem would be obvious; individuals in need of relief could simply file for bankruptcy. Student loans, however, are not like any other consumer debts. Instead, they are subject to a number of restrictions that preclude courts from granting discharges through the normal bankruptcy process. Specifically, if a student loan satisfies one of three statutory criteria, a borrower can only discharge it through a showing of “undue hardship.”

In reviewing how bankruptcy courts have implemented this statutory scheme, lawyers and scholars alike have advanced two propositions: (1) that the criteria for exemption are so broad as to encompass all educational debts and (2) that virtually no one is able

---

7 See Current Student Loan Debt in the United States, COLLEGE DEBT, http://collegedebt.com (keeping a running tally of the total outstanding student loan debt); See also Board of Governors of the Federal Reserve, Consumer Credit – G.19, Jan. 8, 2018, https://www.federalreserve.gov/releases/g19/current/default.htm (showing the increasing student loan trend over the past five years).


9 Although a substantial portion of loans not in repayment are in deferment or forbearance, it is important to keep in mind that such loans generally continue to accrue interest and ultimately yield significantly heavier debt burdens.


11 See, e.g., Rana Foroohar, The US College Debt Bubble is Becoming Dangerous, FINANCIAL TIMES, https://www.ft.com/content/a272ce4c-1b83-11e7-bcac-6d03d067f81f (quoting NY Federal Reserve president Bill Dudley as describing educational debt as a “headwind to economic activity”).

12 See Steve Rhode, Here is Why Your Private Student Loan May Able to Be Eliminated in Bankruptcy, Dec. 29, 2016, https://getoutofdebt.org/100708/private-student-loan-may-able-eliminated-bankruptcy (lamenting “the vast number of people who continue to believe that student loans are not dischargeable in bankruptcy, yet many are. Even large swathes of bankruptcy attorneys continue to believe this urban myth . . . [A] blanket belief that student loans are not dischargeable is just not a true fact.”); Michael J. Tremblay, I Thought All Student Loans could not be Discharged in Bankruptcy,
to prove undue hardship. Through my research, however, I challenge this prevailing view of the student loan bankruptcy system.

In a previous article, I refuted the second claim by showing that many debtors are able to satisfy the undue hardship standard. Drawing on a nationwide sample of student loan bankruptcy filings, I found that approximately forty percent of those who seek to discharge their student loans through bankruptcy are successful. The central problem, I concluded, is that so few student loan debtors in bankruptcy take the necessary steps to request an undue hardship determination. Many more would be successful if they tried.

In this Article, I shift focus to the first claim—namely, that the student loan discharge exceptions encompass all educational debts. Upon reviewing the cases, I find that this statement does capture the reading advanced by a majority of bankruptcy courts. However, that is not the full story. Drawing upon the textual

http://attorneytremblay.com/category/bankruptcy-2 (noting that “[t]here is a common misunderstanding that all student loans are not dischargeable in bankruptcy”).

13 As one consumer bankruptcy attorney wrote:

Student loans are not dischargeable in bankruptcy under almost any circumstances. There is such a thing as a hardship discharge of student loan debt, but to get one of those you need to be over the age of eighty, have no hearing, and have a serious mental illness that prevents you from ever being able to earn a dime or receive a social security payment, and not have any family that can assist you.


15 See id. at 523 (concluding that “[t]he data dispel the myth that it is nearly impossible to discharge educational debt. Thirty-nine percent of debtors who filed an adversary proceeding received a full or partial discharge.”).

16 See id. (finding that “99.9 percent of student loan debtors in bankruptcy fail to ask for” a student loan discharge). Ultimately, I concluded that “[c]ourts are willing to grant discharges. The problem is that few people are asking for them.” Id. at 525. To put numbers on the magnitude of the shortfall, consider the following: Each year, approximately two hundred fifty thousand people with student loan debt file for bankruptcy. Of those individuals, only about five hundred file an adversary proceeding—a process that is necessary to request a student loan discharge from the court. This places the filing rate around 0.2%. In other words, more than ninety-nine percent of individuals go through the bankruptcy process without even trying to discharge their student loans. Based on my estimates, tens of thousands of debtors each year could prove undue hardship if they only took the necessary legal steps. See id. at 523–24.
language, the provision’s legislative history, and the policy consequences, I argue that all the prevailing interpretive methodologies preclude such an interpretation of the statute.

The primary source of the problem is the misreading of one short phrase: “educational benefit.” Whereas all factors indicate that this phrase should be understood in a narrow, semi-technical sense, a majority of courts have read it expansively to mean any loan that an individual uses for educational purposes. By adopting this broad reading, courts have done much to prevent honest debtors from utilizing the protections of bankruptcy. All manner of student loans which should have been discharged—such as loans for unaccredited schools, loans for tutoring services, and loans beyond the cost of attendance for college—have been swept up in this interpretation. The magnitude of this problem is, in fact, rather large and has led billions of dollars of student loan debt to be misclassified as nondischargeable.

This Article proceeds in two parts. In Part I, I lay out the three student loan exceptions contained in the Bankruptcy Code and discuss how they have been interpreted by courts. In Part II, I argue that the broad reading of “educational benefit” is incorrect and present an alternative, narrower reading that is supported by the statutory text, the legislative history, and policy considerations. If courts adopt this narrow reading, they will not only be exhibiting fidelity to the text and congressional intent but will also be providing many individuals the bankruptcy relief to which they are entitled under the law.

I. The Three Exceptions to Student Loan Discharge

The current iteration of the law governing student loan discharges was enacted as part of the 2005 Bankruptcy Abuse and Consumer Protection Act. The relevant statutory language reads as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for—

(A) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or
made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.17

There is a lot to parse in this excerpt. For current purposes, however, the most important point is that not all student loans are excepted from discharge. Instead, there are three categories: (1) government and non-profit backed loans and educational benefit overpayments, (2) obligations to repay funds received as an educational benefit, scholarship, or stipend, and (3) qualified education loans.18 Unless an educational debt falls within one of these classifications, it is dischargeable through the normal bankruptcy process.19

I discuss the scope of these exceptions later in this Part, but for now it is worth mentioning two procedural features that bear on the determination of whether a student loan is excepted from discharge. First, at the initial stage, the creditor has the burden of proving both the existence of the debt and that the debt qualifies under one of the statutory exceptions to discharge.20 Courts uniformly agree that “the initial burden is on the lender to establish the existence of the debt and to demonstrate that the debt is included in one of the . . . categories enumerated in § 523(a)(8).”21 Not until the creditor has satisfied these burdens does the burden of proving undue hardship fall upon the debtor.22 Too often, however, debtors simply concede that their student loan debt is nondischargeable absent a showing of undue hardship.23 This action relieves creditors of a significant burden and, in doing so, exempts many loans from discharge that otherwise are entitled to discharge.

The second issue worth highlighting with respect to the interpretation of this statute is that the exceptions to discharge must be

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18 Some courts have identified four exempt categories. In these cases, the court merely chose to break the first provision into two separate categories.
19 See In re Corbin, 506 B.R. 287, 291 (Bankr. W.D. Wash. 2014) (noting that “the creditor bears the initial burden of proving the debt exists and that the debt is of the type excepted from discharge under the discharge exception for student loan debt”).
20 See In re Roth, 490 B.R. 908, 916–17 (B.A.P. 9th Cir. 2013) (“the lender has the initial burden to establish the existence of the debt and that the debt is an educational loan within the statute’s parameters . . . ”).
22 In re Renshaw, 222 F.3d 82, 86 (2d Cir. 2000) (citing Grogan v. Garner, 498 U.S. 279, 287, 291 (1991) (holding that the Bankruptcy Code requires “the creditor to prove by a preponderance of the evidence that its claim is one that is not dischargeable”).
23 U.S. v. Wood, 925 F.2d 1580, 1583 (7th Cir. 1991) (noting that the “burden of challenging th[e] presumption [of nondischargeability] falls on the debtor.”)
construed narrowly. Courts have repeatedly held that such a construction of the statute is necessary “in order to preserve the Bankruptcy Act’s purpose of giving debtors a fresh start.” If judges were to read the exceptions broadly, they would “frustrate this fundamental policy.” Therefore, to avoid this problem, “[t]he reasons for denying a discharge . . . must be real and substantial, not merely technical and conjectural.” In the remainder of this Part, I explore the manner in which courts have interpreted these three provisions.

A. § 523(a)(8)(A)(i)

Section 523(a)(8)(A)(i) excepts from discharge any “educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution.” As you can see, there are two different discharge exceptions in this provision: “loans” that are backed by the government or non-profit institutions and “educational benefit overpayments” that are backed by the government or non-profit institutions.

With regard to the former, courts have held that “[t]his language applies to all situations of student loans funded by the government or nonprofit institutions,” and that “for there to have been a loan ‘there must be (i) a contract, whereby (ii) one party transfers a defined quantity of money, goods, or services, to another, and (iii) the other party agrees to pay for the sum or items transferred at a later date.’” This is a straightforward exception and is designed to protect American taxpayers and non-profit organizations from bearing the burden of widespread student loan defaults.

With regard to the second exemption, courts have concluded that the phrase “educational benefit overpayments” applies to benefit payments that an individual receives for schooling but subsequently

24 See In re Bullock, 670 F.3d 1160, 1164 (11th Cir. 2012) (citing In re Mitchell, 633 F.3d 1319, 1327 (11th Cir. 2011) ("exceptions to discharge . . . must be construed narrowly").

25 In re Jackson, 184 F.3d 1046, 1051 (9th Cir. 1999) (citations omitted).


27 In re Miller, 39 F.3d 1046, 1051 (9th Cir. 1999) (internal quotations omitted); see In re Corbin, 506 B.R. 287, 291 (Bankr. W.D. Wash. 2014) (noting that “[c]ourts construe exceptions to discharge strictly against a creditor and liberally in favor of the debtor")


29 See, e.g., In re Johnson, 222 B.R. 783, 786 (Bankr. E.D.Va. 1998) (labeling these as two separate categories).


uses for alternative purposes.\textsuperscript{32} For one example, consider the Servicemen's Readjustment Act of 1944 (colloquially known as the G.I. Bill). This Act provides educational assistance to veterans. Any individuals who participate in this program must use the funds for approved educational purposes, and any funds not used in such a manner must be paid back to the government. By exempting “educational benefit overpayments” from discharge, the Bankruptcy Code ensures that individuals who exploit programs—such as the one in the G.I. Bill—by using the money for unauthorized purposes cannot discharge their debt obligations in bankruptcy.

B. § 523(a)(8)(A)(ii)

Section 523(a)(8)(A)(ii) excepts from discharge “an obligation to repay funds received as an educational benefit, scholarship, or stipend.”\textsuperscript{33} Most courts to consider the issue have interpreted the clause to include any loans that facilitated a debtor’s education.\textsuperscript{34} Specifically, they read “obligation to repay funds received” as synonymous with “loan” and “educational benefit” as synonymous with “advancing an individual’s education.”\textsuperscript{35}

By interpreting the clause in this broad manner, courts have swept every loan that is used for any educational purpose within the ambit of the statute. \textit{In re Belforte} presents an illustrative example.\textsuperscript{36} In this case, the debtor (Patricia Belforte) took out a general, unsecured loan in the amount of ten thousand dollars from her credit union (Liberty Bay).\textsuperscript{37} A number of years later, Patricia submitted a handwritten letter requesting that the credit union “rewrite [her] personal loan to $14,000 . . . for tuition [and] books for [her] children’s schools.”\textsuperscript{38} Liberty Bay agreed and advanced the funds.

Several years passed, and Patricia filed for bankruptcy, seeking to discharge the loan she had obtained from Liberty Bay. The credit union attempted to block the discharge by arguing that the debt was “an obligation to repay funds received as an educational benefit” and, as such,

\begin{footnotes}
\footnotetext{32}{See, e.g., \textit{In re Moore}, 407 B.R. 855, 859 (Bankr. E.D.Va. 2009) (describing “educational benefit overpayment” as “an overpayment from a program like the GI Bill, where students receive payments even though they are not attending school”).}
\footnotetext{34}{See, e.g., \textit{In re Corbin}, 506 B.R. 287, 296 (Bankr. W.D. Wash. 2014) (observing that “a majority of courts have held that a loan qualifies as an ‘educational benefit’ if the stated purpose for the loan is to fund educational expenses.” (citing \textit{In re Maas}, 497 B.R. 863, 869–870 (Bankr. W.D. Mich. 2013).)
\footnotetext{35}{See, e.g., \textit{In re Rumer}, 469 B.R. 553, 561 (Bankr. M.D.Pa. 2012) (writing that “loans received as an educational benefit, scholarship, or stipend” are excepted from discharge); \textit{In re Beesley}, 2013 WL 5134404, at *4 (Bankr.W.D.Pa. 2013) (noting that “courts . . . have interpreted ‘funds received as an educational benefit’ to include loans”).
\footnotetext{37}{See id. at *2
\footnotetext{38}{\textit{Id}.}
could not be discharged absent a showing of undue hardship. Liberty Bay’s primary argument was that Patricia’s handwritten note requesting the personal loan increase to pay for her children’s tuition and books proved that the loan’s purpose was to confer an “educational benefit.”

Liberty Bay’s position is odd for a number of reasons. First, and most notably, Patricia received no educational benefit from the loan. To the extent any educational benefit was conferred, it was solely upon her children. Second, despite having an educational loan program, the credit union opted to advance the funds under Patricia’s existing unsecured personal line of credit. Third, Liberty Bay evinced a conspicuous lack of oversight with regard to the loan. The company made no inquiries into where Patricia’s children were enrolled, much less whether such schools were accredited.

Given the credit union’s lack of interest in collecting this information before approving the loan, it is hard to believe that the company only lent the money to Patricia because it thought the loan was a nondischargeable educational debt. The only way to maintain this position was for the credit union to argue that the statute exempts from discharge any loan that a debtor professes to use for any educational purpose whatsoever. Unsurprisingly, engaging in a bit of post hoc legal maneuvering, the credit union set forth that exact argument. What is surprising, however, is that the court granted summary judgment in favor of the credit union.

Finding the outcome so obvious as to be unworthy of a full trial, the judge held that the debtor’s handwritten note stating that the funds would be used for “tuition [and] books” was sufficient to transform this loan into “an obligation to repay funds received as an educational benefit.” The court did not go so far as to explicitly hold that any loan that a debtor professes to use for “educational purposes”—no matter how indirect or unlikely the educational benefit—qualifies as a nondischargeable student loan, but that is the clear implication of the opinion.

Although this outcome is striking, the Belforte court is far from alone in adopting such an expansive reading of the statute. As one bankruptcy judge observed, “The Code does not define the term ‘educational benefit,’ but a majority of courts have held that a loan qualifies as an ‘educational benefit’ if the stated purpose for the loan is to fund educational expenses.” Relying on this broad understanding of the

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39 Id. at *3–4.
40 Id. at *3.
41 Id. at *3 (“Liberty Bay asserts that the funds were received as an educational benefit because the Debtor asked for money for her children’s education, and that the actual use of the funds does not affect the analysis.”).
42 See id. at *9.
43 Id. at *8.
44 Id. at *6 (holding that “§523(a)(8)(A)(i) must be read as encompassing a broad range of educational benefit obligations, such as those in the instant case”).
statute, courts have held that funds borrowed to pay for everything from tutoring services\textsuperscript{46} to bar review courses\textsuperscript{47} to vocational schools that committed fraud\textsuperscript{48} count as an “educational benefit” and are, therefore, nondischargeable. These decisions are not only problematic at the policy level, they are wrong as a matter of law. In Part II, I develop a critique of the prevailing bankruptcy court decisions on the subject. For now, though, I turn to the Bankruptcy Code’s third and final student loan discharge exception.

C. § 523(a)(8)(B)

This final provision exempts “any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.”\textsuperscript{49} As one might suspect, fully understanding the scope of this exception requires going on a definitional scavenger hunt. Indeed, the Tax Code’s definition of “qualified education loan”\textsuperscript{50} relies upon another defined term (“qualified higher education expenses”\textsuperscript{51}), the definition of which, in turn, references two other

\begin{itemize}
  \item \textsuperscript{46} See In re Roy, 2010 WL 1523996 *1 (Bankr. D.N.J.) (hold that loans for tutoring services for a debtor’s child conferred an “educational benefit” and were, therefore, nondischargeable absent a showing of undue hardship).
  \item \textsuperscript{47} See In re Vuini, 2012 WL 5554406 (Bankr. M.D.Fla.) (holding that the more than fourteen thousand dollars the debtor borrowed to pay for a bar exam review course is a nondischargeable student loan); In re Skipworth, 2010 WL 1417964 *2 (Bankr. N.D.Ala.) (finding that the “debtor’s obligation to Citibank is clearly ‘an obligation to repay funds received as an educational benefit’ for purposes of § 523(a)(8)(A)(ii) in that Citibank loaned funds to the debtor to assist the debtor with his educational expenses i.e. the debtor’s bar review course”).
  \item \textsuperscript{48} See In re Kidd, 458 B.R. 612, 620–21 (Bankr. N.D.Ga. 2011) (finding the loan nondischargeable even though the school closed before the debtor received her education).
  \item \textsuperscript{50} See 26 U.S.C. § 221(d)(1) (defining “qualified education loan” as follows: any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses—
    \begin{itemize}
      \item (A) which are incurred on behalf of the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,
      \item (B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and
      \item (C) which are attributable to education furnished during a period during which the recipient was an eligible student."
    \end{itemize}
  \item \textsuperscript{51} See 26 U.S.C. § 221(d)(2) (defining “qualified higher education expenses” as follows: the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) at an eligible educational institution, reduced by the sum of—
    \begin{itemize}
      \item (A) the amount excluded from gross income under section 127, 135, 529, or 530 by reason of such expenses, and
defined terms ("cost of attendance"52 and "eligible educational institution"53) which, yet again, reference other defined terms.

To further complicate matters, the definitions for many of these terms are rather lengthy. Therefore, to avoid reproducing entire pages of the Tax Code and, in light of my more modest goal of providing a broad outline of this exception, I focus only on the general scope of the provision. Condensed down to its most basic form, §523(a)(8)(B) exempts from discharge any loans that are provided for the purpose of paying approved costs of attending an accredited educational institution.

There are four key points to keep in mind with this definition. First, because government-backed loans and non-profit-backed loans are already exempt from discharge under §523(a)(8)(A)(i), this section of the statute only alters the treatment of private student loans. Whereas private educational loans had previously been dischargeable, this provision—added in 2005—exempts those that meet certain criteria from discharge. Second, there must be a lender/borrower relationship. If there is not a contract in which one party advances funds to another in exchange for a promise of future repayment, then the debt does not qualify.54

Third, the loans only become nondischargeable if the debtor borrows them to attend an educational institution that is accredited under Title IV of the Higher Education Act of 1965.55 Although...
accreditation is by no means a high hurdle, this requirement does ensure that students can discharge their educational debts from some of the worst-performing for-profit institutions. Finally, private loans are only exempt from discharge up to the cost of attendance. This criterion means that, if a school calculates its cost of attendance to be fifty thousand dollars, then any borrowing in excess of that amount is dischargeable absent a showing of undue hardship. A creditor who lends sixty thousand dollars to the student, for example, will only be able to maintain that the first fifty thousand dollars is nondischargeable. Although parsing the Tax Code to uncover which debts are qualified education loans can be time consuming, the actual determinations are not particularly contentious.

II. The Meaning of Educational Benefit

It is a truism to state that there are as many methods of statutory interpretation as there are judges and legal scholars.56 Despite the vast number of approaches, there are, nonetheless, underlying similarities. In particular, when seeking to discern the meaning of a statute, all judges evaluate the text, the legislative history, and the policy implications. Without further qualification, this would be a controversial claim. Therefore, let me add a qualification by emphasizing that I do not mean that judges weigh these factors equally or even that they acknowledge these factors in most cases. Instead, I am making two far more modest claims: First, that these three factors guide statutory interpretation and second, that—at least in extreme circumstances—every judge is willing to consider each of these factors.57 It is, for example, apparent that even the most ardent textualist will look to the legislative history if that is necessary to avoid an absurd result. Likewise, even the most dedicated intentionalist or

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56 See, e.g., Muriel Morisey Spence, The Sleeping Giant: Textualism as Power Struggle, 67 S. CAL. L. REV. 585, 586 (1994) (“There are many approaches to statutory interpretation precisely because judges so often must decide how to apply ambiguous statutory provisions to specific cases.”).

57 See, e.g., HENRY J. FRIENDLY, BENCHMARKS 200 (1967) (“Indeed the same judges—even very great ones—give different emphasis at different times to the two souls that dwell within their breasts. Thus Holmes, whom Frankfurter quoted as saying of legislators, ‘I don’t care what their intention was. I only want to know what the words mean,’ wrote also that ‘the general purpose is a more important aid to the meaning than any rule which grammar or formal logic may lay down,’ and even that ‘the meaning of a sentence is to be felt rather than to be proved.’”). Whether all judges will admit to considering each of these factors is a different matter. See TOBIAS A. DORSEY, LEGISLATIVE DRAFTER’S DESKBOOK: A PRACTICAL GUIDE 75–76 (2006) (“Courts consider everything they can, including policy,” but “[w]hether they admit in writing to doing so is another matter.”).
purposivist will give weight to the textual language if the meaning is clear and permits only one interpretation.

Accordingly, the dispute among the different interpretive camps is not over which factors merit examination but rather over the relative weight that the various factors should have in the final determination. For textualists, the statutory text is primary. For intentionalists, legislative intent is worthy of greater deference, and for pragmatists, policy considerations are most important. It is when these factors—text, legislative intent, and policy effects—point towards different legal meanings that conflicts arise.

Fortunately, the present case is not one of these situations. All three factors mandate the same conclusion—namely, a narrow reading of the term “educational benefit.” The broad reading of the term that dominates judicial discourse today was borne not out of a differing interpretive methodology but rather out of a fundamental misreading of the text, legislative history, and policy consequences of the statute. In the remainder of this Article, I show where the courts have gone wrong and why a narrow reading of the statute is required regardless of one’s preferred interpretive framework.

A. Text

58 For a defense of textualism, see generally ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 3–48 (1997); see also ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS (Textualists “look for meaning in the governing text, ascribe to that text the meaning that it has borne from its inception, and reject judicial speculation about both the drafters’ extratextually derived purposes and the desirability of the fair reading’s anticipated consequences.”).

59 For a defense of intentionalism, see generally KEITH E. WHITTINGTON, CONSTITUTIONAL INTERPRETATION 1–16 (1999). Purposivism is a related—though distinct—theory that places great weight on the purpose of the statute. For a defense of this theory and a discussion of its use in statutory interpretation, see generally STEPHEN BREYER, ACTIVE LIBERTY: INTERPRETING OUR DEMOCRATIC CONSTITUTION 85–101 (2005).

60 For a defense of pragmatism, see generally RICHARD A. POSNER, HOW JUDGES THINK 93–124 (2010). For another theory that falls under the same umbrella, see generally WILLIAM ESKRIDGE, DYNAMIC STATUTORY INTERPRETATION 9–106 (1994) (defending an account he refers to as “critical pragmatism”).

61 See William N. Eskridge, Jr., Dynamic Statutory Interpretation, 135 U. PA. L. REV. 1479, 1483 (1987) (“[S]tatutory interpretation involves the present-day interpreter's understanding and reconciliation of three different perspectives, no one of which will always control. These three perspectives relate to (1) the statutory text, which is the formal focus of interpretation and a constraint on the range of interpretive options available (textual perspective); (2) the original legislative expectations surrounding the statute's creation, including compromises reached (historical perspective); and (3) the subsequent evolution of the statute and its present context, especially the ways in which the societal and legal environment of the statute has materially changed over time (evolutive perspective).”).
For any issue of statutory interpretation, the starting point is the text of the statute itself. If the language is clear and unambiguous, the inquiry ends there. This approach—known as the “plain meaning rule”—is a hallmark of judicial interpretation and is a fundamental principle for resolving cases in which the meaning of a text is in dispute. With that in mind, I begin my analysis with the statutory text.

This choice, of course, requires defining the scope of the inquiry. Should the investigation be limited to the dictionary definition of the particular terms in dispute? Or is how Congress uses the same language in other sections of the statute relevant? Or perhaps understanding the text requires determining the overall purpose of the statute? In grappling with these questions, the Supreme Court has emphasized that “[s]tatutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear, or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.”

Before looking at the entire statute, however, it makes sense to first review the provision in dispute. Only then is it possible to expand outward to evaluate how the possible interpretations fit into the broader statute. The relevant provision reads as follows: “A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . (8) unless excepting such debt from

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62 See Ross v. Blake, 136 S.Ct. 1850, 1856 (2016) (“Statutory interpretation, as we always say, begins with the text.”) (citing Hardt v. Reliance Standard Life Ins. Co., 560 U.S. 242, 251 (2010)). As Justice Frankfurter’s “threefold imperative to law students” goes, “(1) Read the statute; (2) read the statute; (3) read the statute!” HENRY J. FRIENDLY, BENCHMARKS 202 (1967) (quoting Justice Frankfurter).

63 See King v. Burwell, 135 S Ct 2480, 2489 (2015) (noting that “[i]f the statutory language is plain, we must enforce it according to its terms.”); Connecticut Nat. Bank v. Germain, 503 U.S. 249, 253–54 (1992) (“[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: ‘judicial inquiry is complete.’”). In recent years, the Supreme Court has relied in even greater part on the statutory text. See John F. Manning, The New Purposivism, 2011 SUP. CT. REV. 113, 124–27 (arguing that “except in cases of absurdity, the Court no longer claims the authority to deviate from the clear import of the text”).

64 The plain meaning rule applies in any area of law where the meaning of a text is in dispute. See, e.g., N.L.R.B. v. Enterprise Leasing Co. Southeast, LLC, 722 F.3d 609, 664 (Duncan, J., concurring) (“The first rule of constitutional interpretation is, of course, to apply the plain meaning of the text.”) (citing McPherson v. Blacker, 146 U.S. 1, 13 S.Ct. 3, 36 L.Ed. 869 (1892)); Evans v. Stephens, 387 F.3d 1220, 1229 (11th Cir. 2004) (“The first rule of constitutional interpretation is to look to the plain meaning of the Constitution’s text.”) (citing Solorio v. United States, 483 U.S. 435, 447, 107 S.Ct. 2924, 97 L.Ed.2d 364 (1987)); 5 Margaret N. Kniffin, Corbin on Contracts § 24.7, at 33 (Joseph M. Perillo ed. 1998) (“[I]f a ‘clear, unambiguous’ meaning is discernible in the language of the contract, no extrinsic evidence of surrounding circumstances may be admitted to challenge this interpretation.”).

discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for . . . (ii) an obligation to repay funds received as an educational benefit . . . .” 66

The language up until the second ellipsis is straightforward. It states that, absent undue hardship, a bankruptcy discharge does not eliminate the debtor’s need to repay certain debts. Courts have read the statutory language in this way, and it seems undeniable that this interpretation is correct. Following that point, however, the standard interpretation falters.

The statute sets forth a number of nondischargeable educational debts and lists among them “an obligation to repay funds received as an educational benefit . . . .” 67 Notably, “educational benefit” is not defined anywhere in the Bankruptcy Code, so determining its meaning requires other interpretive tools. 68 One common tool is to look at the ordinary, everyday meaning of the term. Upon first pass, most people would likely understand the statutory language to include any debt that an individual incurs for the intended purpose of advancing her education. In this reading, “benefit” is taken to be equivalent to “an advantage or profit gained from something.” 69 The majority of courts have adopted this interpretation, and I henceforth refer to it as the Broad Reading.

There is something to be said for the Broad Reading. Not only is it consistent with one common usage of the words, but also it reflects the primary dictionary definition of the term “benefit.” 70 As The American Heritage Dictionary states, the principle meaning of benefit is “[s]omething that promotes or enhances well-being; an advantage.” 71 Likewise, the Merriam-Webster Dictionary lists the primary definition as “something that produces good or helpful results or effects or that promotes well-being.” 72

Although the dictionary definitions are in line with the Broad Reading, that alone is not sufficient to reveal the plain meaning and conclude the inquiry. As any speaker of English knows, words have multiple meanings and, oftentimes, the most sensible reading of a word in a particular context is not its most common reading.

With that in mind, I turn to the secondary meaning of “benefit.” According to the dictionary, “benefit” can also mean “a payment or gift made by an employer, the state, or an insurance company.” 73 This phrasing may sound a bit unusual, but it captures a common way in which “benefit”

68 See In re Vasa, 2014 WL 6607512 *3 (Bankr. S.D. 2014) (“The term ‘educational benefit’ is not defined in § 523(a)(8)(A)(ii) or in any other provision of the bankruptcy code.”).
70 See id.
is used. Consider, for instance, the terms “unemployment benefits,” “insurance benefits,” “social security benefits,” “retirement benefits,” and “welfare benefits.” The core feature behind these types of benefits is not that they promote an individual’s well-being (although they do) but rather that they provide monetary assistance that the beneficiary is entitled to receive. The payment may come from the state, an employer, or an insurance company, but in each instance, the payer is distributing guaranteed benefits.

Although most Americans are more familiar with the aforementioned types of benefits, such distributions also occur in the educational context and are, in those circumstances, referred to as “educational benefits.” To be more precise, this term denotes conditional educational grants—i.e., educational funds that a student receives in exchange for agreeing to perform services in the future.

A salient example of this type of educational benefit is the Reserve Officer Training Corps program. This program covers the cost of college for students who meet certain qualifications and agree to serve in the military for a given number of years (generally four to ten) following graduation. Another example is the federally funded National Health Service Corps scholarship, a program which pays the tuition for medical school students who agree to spend a fixed period of time working in underserved areas after graduation. Notably, these programs are not loaning money but rather offering conditional educational grants. They are, in other words, providing educational benefits under the second definition of the term. I refer to this interpretation of the provision as the Narrow Reading.

Thus far, it seems that the dictionary analysis yields two plausible readings of the term “educational benefit.” The Broad Reading encompasses any funds that are used to provide an educational advantage, while the Narrow Reading is limited to conditional educational grants. Given the existence of competing interpretations, some method for selecting between these possibilities is necessary. Fortunately, textualists have a strategy for resolving statutory ambiguities such as this. They pull back the lens to see whether the surrounding clauses or the broader statute provide any clues as to the appropriate meaning.

The initial step in this analysis is to look at the words that surround

74 See OXFORD ENGLISH DICTIONARY, supra note 69 (“A payment made by the state or an insurance scheme to someone entitled to receive it.”).

75 See MERRIAM-WEBSTER DICTIONARY, supra note 72 offering one definition of “benefit” as “financial help in time of sickness, old age, or unemployment . . . a payment or service provided for under an annuity, pension plan, or insurance policy . . . a service (such as health insurance) or right (as to take vacation time) provided by an employer in addition to wages or salary”).


“educational benefit.” Specifically, the statute excepts from discharge “an obligation to repay funds received as an educational benefit, scholarship, or stipend.” The phrase “obligation to repay funds received” stands out as notable. This word choice, in particular, is extremely unusual—a characteristic that suggests the phrase has a specialized or nuanced meaning.

Despite this indication, a majority of courts have declined to comment on the odd nature of the phrase. Instead, they have opted to read “obligation to repay funds received” out of the statute and to insert the word “loan” in its place.\(^7\) In doing so, these courts endorsed the Broad Reading of “educational benefit” and thereby shifted the inquiry away from the question of whether a debt was an educational benefit and to the question of whether a debt was a loan that conferred an educational benefit. Although similar sounding, there is a stark difference in these two categories, as the definitional examination above highlighted.

Strikingly, many courts that have taken this approach have failed to acknowledge their substitution,\(^7\) instead simply assuming the change to be so unobjectionable as to be unworthy of mention.\(^8\) As one Pennsylvania bankruptcy court declared without explanation, “Section 523(a)(8) protects . . . loans received as an educational benefit, scholarship, or stipend.”\(^9\)

A substitution of this sort conflicts with a basic principle of statutory interpretation: where Congress has shown that it knows how to use a term, the absence of that term in the same or a related section of a statute should be taken as meaningful and deliberate.\(^10\) As the Supreme Court has held in numerous cases, “where Congress includes particular language in one section of a statute but omits it in another . . ., it is generally presumed that Congress acts intentionally and purposely in the

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\(^7\) See, e.g., In re Beesley, 2013 WL 5134404, *4 (Bankr. W.D.Pa. 2013) (holding that loans could be “funds received as an educational benefit”); In re Belforte, 68 Collier Bankr.Cas. 2d 829 *8 (Bankr. D. Mass. 2012) (holding that “under the plain language of 11 U.S.C. § 523(a)(8)(ii), the August 2007 Agreement is a loan for an educational benefit”); see also In re Rust, 510 B.R. 562, 567 (Bankr. E.D.Ky. 2014) (noting that “a majority of courts determine whether a loan qualifies as an ‘educational benefit’ by focusing on the stated purpose for the loan when it was obtained”).

\(^8\) See In re Christoff, 527 B.R. 624, 635 (9th Cir. BAP 2015) (observing that “those bankruptcy cases [in the majority], perhaps inadvertently, imprecisely quote the provisions of the discharge exception statute as applying to ‘loans received,’ as opposed to the ‘obligation to repay funds received’”).

\(^9\) See e.g., In re Campbell, 547 B.R. 49, 54 (Bankr. E.D.N.Y. 2016) (noting that “[s]ome courts have decided without explanation, or assumed, that ‘educational benefit,’ as used in § 523(a)(8)(A)(ii), encompasses any loan which relates in some way to education”).


\(^11\) See, e.g., Duncan v. Walker, 533 U.S. 167, 173 (2001) (observing that “[w]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion’) (internal quotations omitted); Keene Corp. v. United States, 508 U.S. 200, 208 (1993).
disparate inclusion or exclusion.” Accordingly, when a term is ambiguous, courts should disfavor a reading that is clearly and directly captured by a different term that Congress has already proven it knows how to use.

The key question, then, is as follows: if Congress meant “loan,” why did it not simply say “loan” rather than enact the clunky circumlocution “obligation to repay funds received.” After all, Congress used the word “loan” three times in section 523(a), so this is not an instance of ignorance. To the contrary, the evidence suggests that Congress’ choice to forego the term “loan” in this portion of the statute represented a considered decision. Therefore, if we are to take the Supreme Court’s interpretative principle seriously, there is no option but to conclude that “obligation to repay funds received” refers to something other than a loan. Recently, a small number of courts have endorsed precisely this argument.

The case of In re Christoff is the most prominent. Focusing on Congress’ word choice, the Ninth Circuit Bankruptcy Appellate Panel emphasized that §523(a)(8)(A)(ii) “excepts from discharge only those debts that arise from ‘an obligation to repay funds received as an educational benefit,’ and must therefore be read as a separate exception to discharge as compared to that provided in § 523(a)(8)(A)(i) for a debt for an ‘educational overpayment or loan’ made by a governmental unit or nonprofit institution or, in § 523(a)(8)(B), for a ‘qualified education loan.’” The court went on to explain that

[The appellant’s] arguments conflating “loan” as used in § 523(a)(8)(A)(i) and (a)(8)(B) . . . with “an obligation to repay funds received” as provided in § 523(a)(8)(A)(ii) are unconvincing. According to [the appellant], “[t]here is no reason why the word ‘funds’ should not be interpreted in the same light that ‘loans’ has been interpreted in prior cases in the Ninth Circuit . . . .” In effect, [the appellant] argues that we should read § 523(a)(8)(A)(ii) to say “loans received” as opposed to “funds received.” But this we must not do . . . . Instead, we must presume that, in organizing the provisions of § 523(a)(8) as it did in BAPCPA, Congress intended

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83 Keene Corp. v. United States, 508 U.S. 200, 208 (1993) (quoting Rusello v. United States, 464 U.S. 16, 23 (1983)). See Bailey v. United States, 516 U.S. 137, 146 (1995) (concluding that the term “used” does not encompass intended uses of a firearm because Congress had used the phrase “intended to be used” in a parallel provision of the statute and, therefore, the absence of the words “intended to be” should be understood as meaningful and intentional).

84 See Keene Corp., 508 U.S. at 208 (contrasting Congress’ use of “jurisdiction to render judgment” with “jurisdiction” and emphasizing the Court’s “duty to refrain from reading a phrase into the statute when Congress has left it out”).

85 See, e.g., In re Essangui, 573 B.R. 614, 625 (Bankr. D. Md. 2017) (“the Court is not persuaded by the Defendant’s argument that an ‘obligation to repay funds’ is equivalent to a loan”).

86 See In re Christoff, 527 B.R. 624 (9th Cir. B.A.P. 2015).

87 Id. at 634.
each subsection to have a distinct function and to target different kinds of debts.88

Based on this analysis, the Bankruptcy Appellate Panel rejected the argument that “educational benefit” refers to all debts incurred to advance one’s education.89 Adopting the Narrow Reading, the court concluded that the phrase only excepts from discharge conditional educational grants.90

Although significant, Congress’ use of the phrase “obligation to repay funds received” is not the only textualist consideration that favors the Narrow Reading of “educational benefit.” Recall that “educational benefit” is only one of three categories of obligations that Congress excepted from discharge in this subsection—scholarships and stipends being the other two. By including these two additional terms, Congress provided an important clue regarding the meaning of “educational benefit.” Specifically, the fact these three terms are grouped together suggests that they have similar features and should be interpreted in relation to each other. As the Supreme Court has written, “a word is known by the company it keeps.”91

This interpretative principle derives from noscitur a sociis, a fundamental rule of statutory construction holding “that the meaning of an unclear word or phrase, esp. one in a list, should be determined by the words immediately surrounding it.”92 In practice, the Supreme Court invokes this canon “where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress.”93

The case of Gustafson v. Alloyd Co. provides an excellent illustration

88 Id.
89 See id.; see also In re Kashikar, 567 B.R. 160, 167 (9th Cir. B.A.P. 2017) (holding that “a loan” is not an ‘educational benefit’ within § 523(a)(8)(A)(ii)).
90 In re Christoff, 527 B.R. at 634 n.9 (“§ 523(a)(8)(A)(ii) is not a ‘catch-all’ provision designed to include every type of credit transaction that bestows an educational benefit on a debtor. Instead, this subsection includes a condition, distinct from those in the other subsections of § 523(a)(8), that must be fulfilled . . . [T]his unique requirement, that ‘funds [be] received’ by the debtor, mandates that cash be advanced to or on behalf of the debtor. In light of the many programs available to students which provide cash benefits to students, like veteran’s educational benefits, stipends for teaching assignments, and cash scholarships, it is not absurd to assume that Congress intended the scope of § 523(a)(8)(A)(ii) to target obligations other than those arising from traditional student loans.”); see also In re Decena, 549 B.R. 11, 19 (Bankr. E.D.N.Y. 2016) (“Because loans are specifically mentioned in subsection 523(a)(8)(A)(i) and are not mentioned in subsection 523(a)(8)(A)(ii), and because ‘educational benefit’ refers to funds not required to be repaid, the Court finds that Congress intended subsection 523(a)(8)(A)(ii) to refer to educational debts other than loans.”).
92 BLACK’S LAW DICTIONARY (10th ed. 2014) (translating the Latin as “it is known by its associates”); see Maracich v. Spears, 133 S.Ct. 2191, 2201 (2013) (noting that “the canon of noscitur a sociis ‘counsels that a word is given more precise content by the neighboring words with which it is associated’”) (quoting United States v. Williams, 553 U.S. 285, 294 (2008)).
93 McDonnell, 136 S.Ct. at 2368 (internal quotations omitted).
of how the Court applies the doctrine of *noscitur a sociis.*94 Central to this case was the meaning of the word “communication.”95 Rejecting the appellee’s argument that “communication” should be read to refer to any written transmission of information, the Court emphasized that “communication” appears in a list of words and must, therefore, be read in conjunction with those surrounding words.96 Observing that the accompanying terms of “prospectus, notice, circular, advertisement, [and] letter” refer to “documents of wide dissemination,” the Court held that “communication” must, likewise, refer only to public transmissions of information and cannot be read to include private writings between two—or a small number of—parties.97 In support of its decision, the Court wrote, “we rely upon [the canon of *noscitur a sociis*] to avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words.”98

The parallels between the statute in *Gustafson* and the student loan statute are too strong to ignore. There is a disputed term that is capable of two meanings.99 One of these meanings is extremely broad; the other is narrow. And there are two accompanying terms in the list that suggest a narrow reading of the disputed term.100 These factors suggest that the student loan provision is an ideal candidate for the canon of *noscitur a sociis.*

As one bankruptcy court that relied on this principle wrote, what “educational benefits,” “scholarships,” and “stipends” have in common is that “[u]nlike loans, [they] are conditional educational grants, which are not generally required to be repaid.”101 Viewed from this perspective, Congress’
decision to group these terms together and preface them with the phrase “obligation to repay funds received” makes complete sense. The subsection was designed to except from discharge grants of money that are tied to service obligations—a category wholly distinct from loans.\textsuperscript{102} In other words, the canon of \textit{noscitur a sociis} provides further support for the Narrow Reading.\textsuperscript{103}

Another core interpretive principle that bears on this case is the canon against surplusage .\textsuperscript{104} As its name suggests, this canon holds that courts must “give effect, if possible, to every clause and word of a statute.”\textsuperscript{105} This mandate creates a strong presumption against reading statutory terms or phrases in a manner that duplicates other terms or renders entire clauses superfluous.\textsuperscript{106} To do otherwise, the canon holds, would cast Congress as an inarticulate drafter who deploys redundant language. Emphasizing the canon’s importance, the Supreme Court has—on numerous occasions—described it as a “cardinal principle of statutory construction.”\textsuperscript{107}

both refer to funds which are not generally required to be repaid by the recipient. Therefore, in the absence of plain meaning to the contrary, or compelling legislative history, educational benefit must be understood to refer to something other than a loan, especially given that Congress uses the word loan elsewhere in § 523(a)(8). The concept which unites the three separate terms in the list in § 523(a)(8)(A)(ii) is that they all refer to types of conditional grants.”).

\textsuperscript{102} See id. (concluding that, based on this analysis, “[i]t follows that ‘educational benefit’ does not encompass loans”).

\textsuperscript{103} See Austin Smith, Where a Student Loan is Not Really a Student Loan, GET OUT OF DEBT Guy, Dec. 29, 2016, https://getoutofdebt.org/100708/private-student-loan-may-be-eliminated-bankruptcy (applying the canon of \textit{noscitur a sociis} to § 523(a)(8)(A)(ii) and arguing that it supports a narrow reading of “educational benefit”).

\textsuperscript{104} This canon is frequently discussed in conjunction with \textit{noscitur a sociis} and, like that canon, supports the Narrow Reading of “educational benefit.” See, e.g., McDonnell v. U.S., 136 S.Ct. 2355, 2369 (2016) (observing that the “more limited reading [required by the canon of \textit{noscitur a sociis}] also comports with the presumption ‘that statutory language is not superfluous’”) (quoting Arlington Central School Dist. Bd. of Ed. v. Murphy, 548 U.S. 291, 299, n.1 (2006); Bullock v. BankChampaign, N.A., 569 U.S. 267, 274 (2013) (discussing the canon of \textit{noscitur a sociis} and the canon of surplusage and finding that they both favor the same reading of the disputed term).

\textsuperscript{105} N.L.R.B. v. SW General, Inc., 137 S.Ct. 929, 941 (2017) (internal quotation marks omitted); see TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001) (noting that “a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant”) (internal quotation marks omitted); Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825, 836 (1988) (“As our cases have noted in the past, we are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law.”).

\textsuperscript{106} See Corley v. United States, 556 U.S. 303, 314 (2009) (explaining that “one of the most basic interpretative canons” is that “ ‘[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant’ ”) (quoting Hibbs v. Winn, 542 U.S. 88, 101 (2004)). Matthew R. Christianson & William N. Eskridge, Jr., Congressional Overrides of Supreme Court Statutory Interpretation Decisions, 92 TEX. L. REV. 1317, 1447 (2014) (noting that the “presumption against surplusage . . . presumes each term or phrase in a statute adds something and does not duplicate another term or phrase”)

\textsuperscript{107} See, e.g., N.L.R.B., 137 S.Ct. at 941; Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S.
On this dimension, the Broad Reading again fares poorly. To begin, it renders all the accompanying terms within § 523(a)(8)(A)(ii) irrelevant. Because scholarships and stipends both provide educational benefits, Congress would have had no reason to include them in the statute if the Broad Reading were correct. Although this is a point in favor of the Narrow Reading, there is a more compelling one.

To fully appreciate the extent to which the Broad Reading violates the canon against surplusage, it is necessary to step back even further and look at all of § 523(a)(8). Recall that this section of the statute contains three clauses, each of which excepts distinct educational debts from discharge. In addition to the provision excepting scholarships and stipends, there is a clause that excepts any “educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution”108 and a third clause that excludes “any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.”109

Under the Broad Reading, these additional clauses are superfluous.110 Debt obligations backed by the federal government or nonprofit institutions and qualified educational loans both fall under the broad interpretation of educational benefit. These exceptions are undeniably funds that recipients use to advance their educations. Therefore, when courts adopt the Broad Reading, they render irrelevant every other exception that Congress set forth in these three clauses. This is a clear violation of the canon against surplusage,111 particularly given the existence of an alternative reading that preserves meaning for all three sections of the statute.112 As the Supreme Court has held in similar contexts, it is

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109 Id. at § 523(a)(8)(B).

110 See In re Scott, 287 B.R. 470, 474 (Bankr. E.D. Mo. 2002) (“If the third provision of section 523(a)(8) were interpreted to mean that all educational loans were excepted from discharge then the first two categories . . . would certainly be rendered meaningless and superfluous . . . . The third category would subsume the first two provisions and make them completely unnecessary. Such an interpretation is contrary to statutory interpretation and to common sense.”).

111 See Chevron Mining Inc. v. United States, 863 F.3d 1261, 1283 n.15 (10th Cir. 2017) (citing Marx v. Gen. Revenue Corp., 568 U.S. 371, 133 S.Ct. 1166, 1178, 185 L.Ed.2d 242 (2013)) (“The canon against surplusage indicates that we generally must give effect to all statutory provisions, so that no part will be inoperative or superfluous—each phrase must have distinct meaning.”).

imperative to “resist a reading of [a term] that would render superfluous an entire provision passed in proximity as part of the same Act.”

Although the vast majority of courts have continued to adhere to the Broad Reading, in the past couple of years, a small number of bankruptcy judges have embraced the Narrow Reading on the basis of this argument. As one such court wrote, the Broad Interpretation “would render § 523(a)(8)(B) . . . superfluous and makes no sense. After all, if any educational loans of any kind are excepted from discharge by § 523(a)(8)(A)(ii), what addition does excepting qualified educational loans under the Internal Revenue Code make to the discharge exception? [Those loans] would be no more than a subset of such loans already excepted from discharge under § 523(a)(8)(A)(ii)”.

Similarly, another court observed that the Broad Reading “effectively find[s] that subsection 523(a)(8)(A)(i) is subsumed by subsection 523(a)(8)(A)(ii). Such an interpretation also results in subsection 523(a)(8)(B) being subsumed by subsection 523(a)(8)(A)(ii), and renders subsection 523(a)(8)(B) superfluous. It defies logic to suggest that Congress added subsection 523(a)(8)(B) in 2005 to encompass a subset of loans already covered under subsection 523(a)(8)(A)(ii).”

Ultimately, this court endorsed the Narrow Reading, finding “that section 523(a)(8)(A)(ii) is not a ‘catch-all’ provision designed to encompass any educational claim arising out of any transaction that bestows an educational benefit on a debtor.”

Before this section concludes, it is necessary to discuss one final textualist principle—the whole act canon. This rule of statutory construction instructs that provisions of a statute must be read in the context of the entire statute. One of the key corollaries of this canon is

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113 Yates v. U.S., 135 S.Ct. 1074, 1085 (2015); see also (“As our cases have noted in the past, we are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law”) U S. v. Jicarilla Apache Nation, 564 U.S. 162, 185 (2011) (quoting Mackey v. Lanier Collection Agency & Service, Inc., 486 U.S. 825, 837, 108 S.Ct. 2182, 100 L.Ed.2d 836 (1988))

114 See, e.g., In re Christoff, 527 B.R. 634 (9th Cir. B.A.P. 2015) (“[W]e must presume that, in organizing the provisions of § 523(a)(8) as it did in BAPCPA, Congress intended each subsection to have a distinct function and to target different kinds of debts.”).

115 In re Nunez, 527 B.R. 410, 415 (Bankr. D. Ore. 2015); see In re Schultz, 2016 WL 8808073 *3 (Bankr. D.Minn.) (reaching the same conclusion).


117 Id. See also In re Scott, 287 B.R. 470, 474 (Bankr. E.D. Mo. 2002) (Educational benefit “clearly has a plain meaning. It does not need to be construed broadly to except all loans for educational benefits from discharge . . . An example of such an obligation would be for funds provided as grants that must be repaid only under certain conditions (like the failure of a medical student grant recipient to practice in a physician shortage area after graduation).”).

118 See U.S. v. Cooper, 396 F.3d 308, 313 (3rd Cir. 2005) (writing that the “Whole Act Rule instructs that subsections of a statute must be interpreted in the context of the whole enactment”); WILLIAM N. ESKRIDGE, JR. & PHILLIP P. FRICKLEY, LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY 646 (“The key to the whole act approach is, therefore, that all provisions and other features of the enactment must be given force, and provisions must be interpreted so as not to derogate from the force of other provisions and features of the whole statute.”).
that “identical words used in different parts of the same statute carry the same meaning.”119 Therefore, to understand the meaning of “educational benefit” in this context, it is worth looking at how the term is used elsewhere in the statute.120

As you may recall, the phrase “educational benefit” does appear in an earlier provision—namely, § 523(a)(8)(A)(i).121 In that instance, it takes the following form: “an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution.”122 Notably, the phrase has not been a subject of controversy in this context. Even more interestingly, though, in interpreting this provision, courts have consistently adopted a meaning that tracks the Narrow Reading. They have, in other words, concluded that “educational benefit overpayments” are excess payments made as part of conditional educational grants. An opinion by a New Mexico district court provides a clear, representative explanation: “Educational benefit overpayment occurs in programs like the GI Bill, where students receive periodic payments upon their certification that they are attending school. When a student receives funds but is not in school, this is a [sic] educational benefit overpayment.”123

To use “educational benefit” in completely different ways in related sections of the same statute would be to disregard the whole act canon. The whole act canon provides an imperative to choose a consistent interpretation, and the other textualist considerations show that the Narrow Reading in the only plausible option. Quite simply, on the textualist front, the evidence is overwhelming. From the canon against surplusage to the canon of noscitur a sociis to the whole act canon, the principle tools in the textualist toolkit all favor the Narrow Reading.

B. Legislative Intent

Although certain strains of textualism maintain that the text is the only relevant consideration,124 most judges are open to the possibility that

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120 See U.S. v. Ticklenberg, 563 U.S. 647, 666 (2011) (noting that “[i]dentical words used in different parts of a statute are presumed to have the same meaning absent indication to the contrary”).
121 See supra Part I.A.
123 In re Coole, 202 B.R. 518, 519 (Bankr. D. N.M. 1996); see also In re Alibatya, 178 B.R. 335, 338 (Bankr. E.D. N.Y. 1995) (“Clearly, Plaintiff's failure to pay his student housing obligations cannot be deemed debt for ‘an educational benefit overpayment.’ Defendant paid nothing to Plaintiff. NYU merely allowed Plaintiff to live at school facilities in consideration for certain charges which were not paid. No linguistic gyration can twist a no payment or underpayment by Plaintiff to an overpayment by Defendant.”).
124 See, e.g., Harbison v. Bell, 556 U.S. 180, 198 (2009) (“Congress' intent is found in the words it has chosen to use.”) (Thomas, J., concurring); Felix Frankfurter, Some
legislative history can illuminate the meaning of a statute. Even among those who fall into this latter camp, however, there is disagreement over the appropriate use of legislative history. Some judges maintain that it is only relevant when the statutory language is ambiguous, but others are willing to look to legislative history even in circumstances where the plain meaning is apparent from the text alone. Fortunately, regardless of how much weight one places on legislative history, the best reading of the student loan discharge statute remains unchanged. The legislative history—just like the statutory text—demands the Narrow Reading of “educational benefit.”

To understand legislative intent in this context, one must understand the evolution of § 523(a)(8). Accordingly, I start the discussion in 1976. Prior to that year, educational debt held no special status in the Bankruptcy Code. It could be discharged via the normal bankruptcy process in the same manner as other unsecured claims. With the passage of the Higher Education Amendments of 1976, however, the situation changed. That legislation excepted federally guaranteed student loans from discharge for a period of five years after first becoming due.

Reflections on the Reading of Statutes, 47 COLUM. L. REV. 527, 538 (1947) (quoting Oliver Wendell Holmes) (“I don’t care what [Congress'] intention was. I only want to know what the words mean.”). See also ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 3–48 (1997).

125 See, e.g., Milner v. Dep’t of Navy, 562 U.S. 562, 572 (2011) (“Those of us who make use of legislative history believe that clear evidence of congressional intent may illuminate ambiguous text.”); Bruesewitz v. Wyeth LLC, 562 U.S. 223, 242 (2011) (“[L]egislative history is persuasive to some because it is thought to shed light on what legislators understood an ambiguous statutory text to mean when they voted to enact it into law.”); Stephen Breyer, On the Uses of Legislative History in Interpreting Statutes, 65 S. CAL. L. REV. 845, 848 (1992) (“Using legislative history to help interpret unclear statutory language seems natural. Legislative history helps a court understand the context and purpose of a statute.”);

126 See United States v. Woods, 134 S Ct 557, 567 n.5 (2013) (“Whether or not legislative history is ever relevant, it need not be consulted when, as here, the statutory text is unambiguous.”).

127 See Darby v. Cisneros, 509 U.S. 137, 147 (1993) (observing that “[c]ourse to the legislative history . . . is unnecessary in light of the plain meaning of the statutory text,” but nonetheless choosing to review the legislative history and finding that it is consistent with the Court’s interpretation of the statute).


130 The restriction was inserted in the Bankruptcy Code at 11 U.S.C. § 523(a)(8) (1978) (“A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—

(a) to a governmental unit, or a nonprofit institution of higher education, for an educational loan, unless—

(A) such loan first became due before five years before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue

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discharge student loan debt during the five-year period, a debtor would have to prove undue hardship.

Congress mandated this waiting period to prevent abuse and protect the integrity of the federal student loan system. The alleged fear was that recent graduates were exploiting the system by taking on publicly guaranteed debts and then discharging them through bankruptcy once they received their university degrees. Because recent graduates generally have little in the way of assets, such a strategy would permit unscrupulous debtors to foist the entire cost of their education upon taxpayers.

Over the years, Congress has carved out additional exceptions under the guise of protecting the student loan market from such unscrupulous debtors. For instance, in 1979, Congress amended the Bankruptcy Code so that the five-year waiting period would toll during loan deferment and forbearance periods. And in 1984, they expanded the set of nondischargeable student loans to include those that are funded by any nonprofit institutions.

Even greater changes came in 1990. That year, Congress extended the waiting period from five years to seven years and—more importantly for our purposes—added to the list of nondischargeable debts any “obligation to repay funds received as an educational benefit, scholarship or stipend.” During the congressional hearings there was only one exchange that mentioned this addition to the statute. It transpired when

131. See, e.g., Roundtree–Crawley v. Educ. Credit Mgmt. Corp., (In re Crawley), 460 B.R. 421, 432 (Bankr. E.D.Pa. 2011) (citing In re Pelkowski, 990 F.2d 737, 743 (3rd Cir. 1993)). (“Section 523(a)(8) is intended to prevent abuse of the bankruptcy process as well as to preserve the integrity of the student loan program by protecting it from fiscal doom.”). In re Segal, 57 F.3d 342, 348 (3rd Cir.1995) (citing 124 Cong.Rec. 1791–98 (1978)) (“Although limited, the legislative history of section 523(a)(8) teaches that the exclusion of educational loans from the discharge provisions was designed to remedy abuses of the educational loan system by restricting the ability of a student to discharge an educational loan by filing for bankruptcy shortly after graduation, and to safeguard the financial integrity of educational loan programs.”).

132. See, e.g., Corso v. Walker, 449 B.R. 838, 846 (W.D. Pa. 2011) (quoting Pelkowski, 990 F.2d at 744) (“Congress sought to help ‘preserve the integrity of the student loan program’ and, thus, protect creditors from the ‘legal loophole’ which permitted the practice of students receiving the benefit of higher education and then discharging their student loans before they became ‘wage-earning members of the community.’”).

133. See, e.g., “In re Renshaw, 222 F.3d 82, 86–87 (2d Cir. 2000) (observing that “because student loans are generally unsecured and recent graduates often have few or no assets, these debtors have an incentive to try to discharge their educational loans in bankruptcy. If successful, they can then enjoy the higher earning power the loans have made possible without the financial burden that repayment entails.”); H.R. Rep. No. 95-595, 536 (1977) (statement of Rep. Ertel) (arguing that dischargeable student loans “encourage fraud”).

134. See Pub. L. No. 96-56, 93 Stat. 387, 387 (1979) (modifying the waiting period so that it is “exclusive of any applicable suspension of the repayment period”).


the chairman of the Subcommittee on Economic and Commercial Law asked the U.S. attorney for the Eastern District of Texas to explain “[t]he specific problem [the provision] is designed to address.”

The response to the question was as follows:

This section adds to the list of non-dischargeable debts, obligations to repay educational funds received in the form of benefits (such as VA benefits), scholarships (such as medical service corps scholarships) and stipends. These obligations are often very sizeable and should receive the same treatment as a “student loan” with regard to restrictions on dischargeability in bankruptcy.

This answer precisely aligns with the Narrow Reading. It states that educational benefits are not loans but rather “educational funds received in the form of benefits.” They are, in other words, conditional educational grants. In addition to giving VA benefits as an example, the U.S. attorney provided further evidence of the meaning of educational benefit by citing the Eighth Circuit case of U.S. Department of Health and Human Services v. Smith.

Smith was a 1986 case that centered on a medical student who had been awarded approximately fourteen thousand dollars in tuition assistance from the Physician Shortage Area Scholarship Program—a federal program designed to encourage physicians to work in underserved areas. As a condition of receiving the award, Smith agreed to practice medicine in an area with a physician shortage for three years following the completion of his medical training. After graduation, however, Smith declined to work in an area that satisfied the terms of the agreement. In response to Smith’s breach, the U.S. Department of Health and Human Services sought to collect from him approximately twenty-eight thousand dollars—an amount that included the principal of the original award plus interest. Shortly thereafter, Smith filed for bankruptcy.

The question before the court was whether the tuition assistance qualified as a nondischargeable loan. At the time, §523(a)(8) only excepted from discharge debts “‘for an educational loan made . . . by a governmental unit, or made under any program funded . . . by a governmental unit.’” Both the bankruptcy court and district court found

138 Id. at 74–75.
139 Id. at 74.
140 Id. at 75.
141 U.S. Dep’t of Health & Human Servs. v. Smith, 807 F.2d 122, 123 (8th Cir.1986).
142 Id.
143 Id.
144 Id.
145 Id.
146 Id. at 124 (quoting 11 U.S.C. § 523(a)(8)).
that Smith’s debt was not a “loan” and was, therefore, dischargeable.

On appeal, however, the eighth circuit reversed, holding that “loan” could be read to include contingent “obligation[s] to repay.” The Court based its decision, not on the language of the statute, but rather on the congressional purpose underlying the provision—namely, to prevent debtors from abusing the student loan system. As the Court observed, “[a]lthough we recognize that the language of PSASP . . . arguably may give rise to certain ambiguities . . . the circumstances which led to the enactment . . . compels the conclusion that Congress intended § 523(a)(8) of the Bankruptcy Code to except from dischargeability debts incurred under scholarship programs such as PSASP.” When Congress added the “educational benefit” language to § 523(a)(8) in 1990, it did so to codify the ruling in Smith and thereby eliminate the aforementioned ambiguity.

In addition to Congress’ awareness of Smith, another factor indicating that Congress intended the Narrow Reading is the absence of any discussion or debate over the provision. As mentioned, the sole reference to the meaning of “educational benefit” was the U.S. attorney’s response to the congressman’s question. If Congress had intended the clause to except from discharge all debts that advanced a debtor’s education, surely it would have engendered substantial debate and public opposition from at least some legislators. The fact that none of them discussed the provision, much less objected to its inclusion, strongly suggests that Congress intended the Narrow Reading. This is particularly true given that the congressional debate over the original 1978 student loan discharge exception was both extensive and contentious.

Despite this strong evidence, in the nearly thirty years since Congress added the “educational benefit” language to § 523(a)(8), only a handful of courts have looked to the legislative history of the provision. To their credit, though, those courts have concluded that the Narrow Reading provides the correct interpretation of educational benefit. As one bankruptcy court held, the “legislative history unambiguously indicates that Congress added the phrase ‘educational benefit’ to section 523(a)(8) in order to” exempt from discharge conditional educational grants.

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147 Id. at 125–27.
148 Id. at 126–27.
151 In re Decena, 549 B.R. 11, 20 (Bankr. E.D.N.Y. 2016). The court observed that “Congress intended section 523(a)(8)(A)(ii) to encompass alternatives to the typical
Likewise, in finding that a bar exam loan from a for-profit lender was not an “educational benefit,” another court determined that the Narrow Reading “is consistent with legislative history.”\textsuperscript{152} Like the textual analysis, the legislative history is clear. Congress intended that the phrase “obligation[s] to repay funds received as an educational benefit” refer only to a very small category of educational debt—namely, conditional educational grants.

\section*{C. Social Impact}

The third major consideration—in addition to the text and legislative history—that many judges weigh when engaging in statutory interpretation is the social impact. William Eskridge, one of the foremost proponents of this policy-based approach to statutory interpretation, maintains that judges should ask “not only what the statute means abstractly, or even on the basis of legislative history, but also what it ought to mean in terms of the needs and goals of our present day society.”\textsuperscript{155} This analysis incorporates a normative dimension into statutory interpretation. Whereas the other methods ask what, this method asks what ought to be.

In defense of this interpretative framework, Eskridge argues that, when ambiguities arise in a statute, “it seems sensible that ‘the quest is not properly for the sense originally intended by the statute, [or] for the sense sought originally to be put into it, but rather for the sense which can be quarried out of it in the light of the new situation.’”\textsuperscript{154} He goes on to write that “[i]nterpretation is not static, but dynamic. Interpretation is not an archeological discovery, but a dialectical creation. Interpretation is not mere exegesis to pinpoint historical meaning, but hermeneutics to apply that meaning to current problems and circumstances.”\textsuperscript{155} Judges must, in other words, be mindful of the real-world effects of their decisions.\textsuperscript{156} In the present case, this normative analysis requires understanding the broader effect of the Bankruptcy Code and appreciating how the student loan exception fits into that framework.

The former inquiry is straightforward. For more than a century, the debtor–creditor relationship in the education context. These alternatives encompass cash benefit programs, such as veteran educational benefits, stipends for teaching assignments, conditional grants, cash scholarships and other obligations that are distinct from traditional student loans.” Id.

\textsuperscript{152} In re Campbell, 547 B.R. 49, 55–60 (Bankr. E.D.N.Y. 2016).

\textsuperscript{153} WILLIAM N. ESKRIDGE, JR., DYNAMIC STATUTORY INTERPRETATION 50 (1994) (quoting Arthur Phelps, Factors Influencing Judges in Interpreting Statutes, 3 VAND. L. REV. 456, 469 (1950)).


\textsuperscript{155} Id. at 1482.

\textsuperscript{156} Ronald Dworkin envisions a similar, though somewhat more ambitious, framework in which statutory meaning changes as “law’s integrity” develops. See RONALD DWORFIN, LAW’S EMPIRE 313–54 (1986).
Supreme Court has held that consumer bankruptcy laws exist to give individuals a “new opportunity in life,” free and clear from crippling debts.\footnote{See Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (stating the fresh start policy is a “public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt” (emphasis omitted)); Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554–55 (1915) (“It is the purpose of the bankrupt act to convert the assets of the bankrupt into cash for distribution among creditors, and then to relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.”).} This bestowal of a second chance is referred to as bankruptcy’s “fresh start” policy\footnote{For a discussion of the fresh-start policy, see generally Thomas H. Jackson, The Fresh-Start Policy in Bankruptcy Law, 98 Harv. L. Rev. 1393 (1985).} and is what the Supreme Court has described as the “principal purpose of the Bankruptcy Code.”\footnote{Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 365 (2007). Notably, bankruptcy has not always been tied to the idea of a fresh start, nor has discharge always been an option for American debtors. See U.S. v. Kras, 409 U.S. 434, 447 (1973) (noting that discharge is “a legislatively created benefit, not a constitutional one, and…[was] withheld, save for three short periods, during the first 110 years of the Nation’s life”).} Over the decades, courts,\footnote{See, e.g., Segal v. Rochelle, 382 U.S. 375, 380 (1966) (saying bankruptcy individuals have a right to “start[] out on a clean slate”); In re Hudgens, 149 Fed.Appx. 480, 483 (7th Cir. 2005) (quoting In re Chambers, 348 F.3d 650, 653 (7th Cir. 2003)) (“The primary purpose of the bankruptcy discharge is to give the debtor a ‘fresh start.’”); In re Seminole Oil & Gas Corp. 963 F.2d 368 (4th Cir. 1992) (“The fundamental goal of bankruptcy is to provide the debtor a ‘fresh start’ free from… the dismembering hands of creditors.”)} and scholars\footnote{See, e.g., Rafael Efrat, The Fresh-Start Policy in Bankruptcy in Modern Day Israel, 7 Am. Bankr. Institute L. Rev. 555, 555 (1999) (“The notion that such individuals should be able to promptly and effectively re-join economic life through an unduly punitive and certain bankruptcy system is an essential component of any progressive and industrialized society.”); Karen Gross, Preserving a Fresh-Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments, 135 U. Pa. L. Rev. 59, 60 (1986) (“The opportunity for an individual debtor to obtain relief from indebtedness and begin anew as a productive member of society—commonly termed the “fresh start policy”—has been an essential principle of our bankruptcy laws for more than seventy-five years.”).} have repeatedly affirmed the importance of providing debtors with an opportunity to obtain a fresh start.

Notably, the mere fact that such individuals view the fresh start as a laudable policy goal does not mean that it is. Unlike with regard to analyses of legislative history, declarations by government officials are not conclusive determinants of the objective desirability of a given statutory reading. Instead, they merely serve as indirect evidence that can guide a
judge in identifying the social impact of various possible interpretations. For this reason, it is worth looking at the reasons why judges, politicians, and academics have all endorsed the fresh-start policy.

There are two primary justifications: protecting the individual and protecting society. With regard to the former, there exists substantial research showing that people are subject to a number of cognitive biases that cause them to underestimate risks. These deficiencies lead people to overestimate their likelihood of success and consequently miscalculate their likelihood of financial ruin. Bankruptcy offers people a way to recover when such unanticipated financial risks come to pass. In doing so, the fresh-start policy seeks to correct for problems that arise not out of immoral action but rather out of cognitive biases that misguided people who believed they were making sound decisions.

At a society-wide level, the fresh-start policy has a number of other benefits. First, an individual who is unable to get out from under her debts will likely turn to social welfare programs for assistance. This course of action places taxpayers on the hook for debtors’ poor financial decisions. Because society was not a party to the original contract, it seems unreasonable to expect taxpayers to shoulder the costs if there are other parties better able to monitor risk. In this situation, the creditor is such a party. A system that permits bankruptcy discharges is one that encourages creditors to be judicious when extending lines of credit. After all, if creditors lend to individuals who are unable to repay the loan, they will bear the loss when a borrower discharges the debt.

A second way in which the fresh-start policy benefits society is by encouraging individuals to be productive. As John Weistart has written, “excessive debt, with its attendant pressure on family and emotional stability and job security [might] so inhibit productivity that there would be a net social gain from terminating costly collection actions, excusing the debts, and giving the poorer-but-wiser debtor a second chance.” The argument goes that an individual who is overburdened by his debts will be far less productive than one who receives the benefits of his efforts. After all, as creditors garnish a higher and higher portion of a debtor’s wages, the debtor’s incentive to work gets weaker and weaker. By substituting leisure for work, the debtor comes out ahead, but everyone else is left worse off. The fresh-start policy mitigates this problem by enabling debtors to reach a position where they are once again incentivized to work and make productive contributions that benefit society.

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163 For a thorough discussion of the normative justifications for the fresh-start policy, see Jackson, supra note 158, at 1405–24.
164 For a discussion of the seminal research illustrating these cognitive biases, see Richard E. Nisbett & Lee Ross, Human Inference 17–192 (1980).
166 This is not to say that the procedures underlying the fresh-start policy cannot be improved upon. See Katherine Porter & Dr. Deborah Thorne, The Failure of Bankruptcy’s Fresh Start, 92 Cornell L. Rev. 67, 70 (2006) (finding that “many former debtors continue to experience financial hardship that is as bad as or worse than the distress that initially triggered their bankruptcy filings”).
To further this goal, the Bankruptcy Code provides debtors with a process to eliminate the burden of their debt obligations. In exchange for surrendering their nonexempt assets or part of their future income, debtors are able to discharge most of their existing debts.\(^{167}\)

Although the fresh-start policy confers many benefits on society, it is clear that a blanket rule allowing the discharge of any debts would be problematic. There are some actions that are so morally objectionable or that would so severely undermine the functioning of the bankruptcy system that it is reasonable to exclude the associated debts from discharge. The purpose of the Bankruptcy Code is, after all, to give honest debtors a new lease on life so they can become productive members of society once again; the purpose is decidedly not to give unscrupulous debtors a method to cheat the system and force society to carry the cost of their immoral decisions.

On this basis, Congress has enacted two kinds of exceptions to the fresh-start policy. The Bankruptcy Code identifies a number of general activities that, if undertaken by the debtor, preclude a discharge. For instance, debtors are not entitled to a discharge if they transferred or destroyed property with the intent to defraud a creditor,\(^{168}\) knowingly and fraudulently presented false evidence in connection with the bankruptcy proceeding,\(^{169}\) unlawfully refused to obey a court order,\(^{170}\) or filed for bankruptcy fewer than eight years prior.\(^{171}\)

In addition to these general exceptions that focus on a debtor’s conduct, there is a separate section of the Bankruptcy Code that exempts specific debts from discharge.\(^{172}\) This list of nondischargeable debts includes debts for tax evasion,\(^{173}\) debts incurred via fraud, false pretenses,\(^{174}\) embezzlement, or larceny,\(^{175}\) debts for child support or alimony,\(^{176}\) debts for willful or malicious injury,\(^{177}\) debts arising due to injuries or deaths caused while the debtor was driving under the influence of drugs or alcohol,\(^{178}\) debts for criminal restitution,\(^{179}\) and finally, student loan debts.\(^{180}\)

As the listing suggests, both the general and specific carveouts have a common justification.\(^{181}\) They seek to discourage fraud and abuse of the

\(^{167}\) The precise contours of the debtors’ obligations depend upon whether they file under Chapter 7 or Chapter 13 of the Bankruptcy Code. See 11 U.S.C. §§ 701–84; id. at §§ 1301–30.

\(^{168}\) Id. at § 727(a)(2).

\(^{169}\) See id. at § 727(a)(4).

\(^{170}\) See id. at § 727(a)(6).

\(^{171}\) See id. at § 727(a)(8).

\(^{172}\) See id. at § 523(a).

\(^{173}\) See id. at § 523(a)(1)(c).

\(^{174}\) See id. at § 523(a)(2).

\(^{175}\) See id. at § 523(a)(4).

\(^{176}\) See id. at § 523(a)(5).

\(^{177}\) See id. at § 523(a)(6).

\(^{178}\) See id. at § 523(a)(9).

\(^{179}\) See id. at § 523(a)(13).

\(^{180}\) See id. at § 523(a)(8).

\(^{181}\) There are a number of other provisions in this portion of the Bankruptcy Code.
bankruptcy system. If debtors were free to transfer away their property prior to filing or to fabricate financial records, the bankruptcy system would be unable to function. In addition to promoting efficiency, these exceptions are also designed to penalize debtors for engaging in morally objectionable conduct. From tax evasion to drunk driving to intentionally harming others, each exception is designed to ensure that debtors are held accountable for their unethical actions. Each of these exceptions, that is, save one: the student loan exemption.

Borrowing student loans does not earn one moral condemnation. To the contrary, most people consider it a prudent decision, and the system is even structured to encourage students to borrow money to fund their educations. For this reason, it is surprising that student loan obligations are treated the same as embezzlement and tax evasion. Emphasizing this exact point, one congressman stated that the bankruptcy provision . . . visits a special discrimination upon [student loan debtors] . . . it treats educational loans precisely as the law now treats loans incurred by fraud, felony, and alimony-dodging. No other legitimately contracted consumer loan, applied to a legitimate undertaken [sic], is subjected to the assumption of criminality which this provision applies to every educational loan. This [provision], whatever else it may be called, hardly deserves the name of “student assistance.” On the contrary, it is a direct, unmitigated, slap in the face of every single student borrower in the nation. It assumes that borrower’s bad intentions, and deprives him of a right which every other citizen has available to him if he needs it.

Not all members of Congress, however, agreed with this portrait of well-intentioned student loan debtors. A number argued that student loan debtors who sought discharges were abusing the system, not unlike those individuals who had evaded taxes or committed fraud. Representative

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182 See, e.g., In re Cox, 41 F.3d 1294, 1296 (9th Cir. 1994) (“The purpose of [section 727] is to make the privilege of discharge dependent on a true presentation of the debtor’s financial affairs.”) (internal quotations omitted); In re Zhang, 463 B.R. 66, 86 (Bankr. S.D. Ohio 2012) (“The fundamental purpose of § 727(a)(4)(A) is to insure that the trustee and creditors have accurate information without having to do costly investigations.” (internal quotations omitted)); In re Jones, 327 B.R. 297, 303 (Bankr. S.D. Tex. 2005) (citing Meridian Bank v. Alten, 958 F.2d 1226, 1230 (3rd Cir. 1992) (“The purpose of 727(a)(3) is to force the Debtor to produce dependable records such that the Chapter 7 Trustee, the creditors, and the Court may rely on these records in tracing the Debtor’s financial history and condition.”)).


Allan Ertel’s statement is perhaps the most direct in its support for this position:

[Student loan discharges] encourage fraud . . . [A]s a student leaves college to find a job, that student would have two options: (1) repay a substantial loan at a time when that student’s financial situation is probably at its lowest, or (2) discharge the debt in bankruptcy, having received the benefit of a free education. If Student A elects to repay the loan, honoring the legal and moral obligation that was incurred, he begins his career with a substantial debt and the accompanying financial pressure. Meanwhile, Student B (who chooses to declare bankruptcy) can begin with a clean slate and is free to spend his initial earnings on other items . . . . Student B is rewarded for refusing to honor a legal obligation. The lesson that Students A and B have learned is that it ‘does not pay’ to honor one’s debts or other legal obligations. A valuable educational program should not be destroyed because of a loophole that Congress can easily correct.185

If the congressman’s fears were warranted, then an expansive discharge exception might be defensible on policy grounds. There is, however, no evidence that any appreciable number of borrowers sought to exploit the system, much less that the federal student loan program was on the verge of being “destroyed” by debtor abuses.186 Quite the opposite, in fact. The empirical data show that student loan debtors are not cold, calculating decision makers, racing to exploit every legal loophole to gain an advantage.187 Instead, as a group, they work hard to repay their loan


186 See Jean Braucher, Mortgaging Human Capital: Federally Funded Subprime Higher Education, 69 WASH. & LEE L. REV. 439, 473 (2012) (noting that “[t]he nondischargeability of student loans . . . depended on a theoretical argument that former students might abuse the discharge by going to school and then filing in bankruptcy before getting a lucrative job, despite lack of evidence that this was actually happening”).

187 See Oliver B. Pollack & David G. Hicks, Student Loans, Chapter 13, Classification of Debt, Unfair Discrimination and the Fresh Start after the Student Loan Default Prevention Initiative Act of 1990, 1993 DET. C.L. REV. 1617, 1621 (arguing that the “concern . . . was more perceived than real”); Kurt Weise, Discharging Student Loans in Bankruptcy: The Bankruptcy Court Test of “Undue Hardship,” 26 ARIZ. L. REV. 445, 446 (1984) (citing H.R. Rep. No. 95-595 at 133 (1977)) (noting that “less than one percent of all matured educational loans had been discharged in bankruptcy”); Rafael I. Pardo & Michelle R. Lacey, The Real Student-Loan Scandal: Undue Hardship Discharge Litigation, 83 AM. BANKR. L.J. 179, 181 (2009) (“Tragically, Congress disregarded empirical evidence from a General Accounting Office study which found that less than one percent of all federally insured and guaranteed student loans were discharged in bankruptcy.”). Upon analyzing student loan bankruptcy
obligations and only turn to bankruptcy after exhausting other options.\footnote{One attorney who handles student loan undue hardship cases described the situation as follows: “There is a story about doctors crossing the stage as they graduate medical school with a diploma in one hand and a bankruptcy filing in the other . . . [But] there is no data to support this. The average consumer does not want to file bankruptcy.” 

Notably, Congress was aware of this fact prior to the floor debate surrounding the original 1978 student loan discharge exception. Earlier that year, the General Accounting Office had released a study finding that only three-tenths of one percent of the amount of federally insured student loans were discharged through bankruptcy.\footnote{See H.R. Rep. No. 95-595, at 148 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6108 (statement of Rep. James O’Hara) (highlighting that only “two-tenths of one percent of the loans made have been discharged in bankruptcy, involving less than three-tenths of one percent of the dollars”); John A.E. Pottow, \textit{The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory}, 44 CAN. BUS. L.J. 245, 249 (2006) (lamenting that the “empirical data, like many empirical data gathered in Washington, fell on deaf ears”). This lack of evidence has, unfortunately, not stopped courts from asserting that a problem existed. \textit{See, e.g.}, In re Renshaw, 222 F.3d 82, 87 (2d Cir. 2000) (asserting that “Congress enacted § 523(a)(8) because there was evidence of an increasing abuse of the bankruptcy process that threatened the viability of educational loan programs and harm to future students as well as taxpayers”).} In other words, for every one hundred dollars in student loan debt, only three cents were discharged. Keep in mind that this strikingly low percentage was at a time when there were no barriers to eliminating student loan debt through bankruptcy. As the General Accounting Office’s study showed, there was no need to except educational debts from discharge. Contrary to the fear of widespread abuse, few student loan debtors were filing for bankruptcy and even fewer were seeking to game the system. As one congressman observed, the student loan discharge exception is nothing more than “a discriminatory remedy for a ‘scandal’ which exists primarily in the imagination.”\footnote{See H.R. Rep. No. 94-1232 (1976).}

In light of the lack of evidence of abuse, it makes no sense to adopt the Broad Reading of educational benefit. Doing so penalizes all of the debtors who are acting in good faith in order to prevent a nonexistent kind of fraud. Unlike the Broad Reading, the Narrow Reading comports much better with the sound policy goals of the Bankruptcy Code. Specifically, this reading precludes a type of discharge that only arises in situations worthy of moral opprobrium. It effects only those cases where the borrower, due to his own changed preferences, refuses to honor the terms filings surrounding the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, scholars found no evidence “that would indicate widespread opportunistic behavior by private student loan borrowers before the policy change.” Rajeev Darolia, \textit{Should Student Loans be Dischargeable in Bankruptcy?}, BROOKINGS, Sep. 29, 2015, https://www.brookings.edu/blog/brown-center-chalkboard/2015/09/29/should-student-loans-be-dischargeable-in-bankruptcy.}
of the agreement.\textsuperscript{191} By adopting the Narrow Reading, courts can eliminate a potential loophole without harming upstanding debtors. Whereas the Broad Reading clearly contravenes the Bankruptcy Code’s underlying goal of offering debtors a fresh start in the absence of fraud, the Narrow Reading is consistent with this policy.\textsuperscript{192}

\section*{Conclusion}

In the two decades since Congress excepted from discharge “funds received as an educational benefit,” courts have interpreted the phrase in a more and more expansive manner. Today, “educational benefit” has come to mean any loan that an individual uses—or professes to use—to advance her education. This interpretation, which I have referred to as the Broad Reading, has led billions of dollars in student loans to be miscategorized as nondischargeable. Such a mistake has, expectedly, been detrimental to a large number of student loan debtors, depriving many individuals of the protections of bankruptcy and forcing them to shoulder burdensome debts they have little hope of repaying.\textsuperscript{193}

Fortunately, there is a way to prevent these harms from befalling any other debtors. All courts must do is interpret the student loan exceptions in line with the Narrow Reading. By doing so, not only would courts be furthering a good social policy but also adopting a reading that is required by both the statutory text and the legislative history.

In this Article, I have argued that the Narrow Reading follows from all of the prevailing interpretive methodologies. In light of this assuredness, one may wonder why the Broad Reading has prevailed in the majority of cases. The answer is simple. Debtors have not

\footnotesize{\textsuperscript{191} If the borrower is unable to honor the terms of the agreement due to incapacity or other severe hardship, the undue hardship exception would provide an escape valve.}

\footnotesize{\textsuperscript{192} In discussing the scope of the student loan exception, politicians have noted its incompatibility with the Bankruptcy Code’s fresh start policy. \textit{See} Press Release, Dick Durbin United States Senator Illinois, As Student Loan Debt Surpasses $1 Trillion, Senators Introduce Legislation To Address Crisis (Jan. 23, 2013), available at https://www.durbin.senate.gov/newsroom/press-releases/as-student-loan-debt-surpasses-1-trillion-senators-introduce-legislation-to-address-crisis (“A basic principle of our country is a fresh start for those who get in over their heads with debt, if they’re willing to face the rigors of bankruptcy.”) (quoting Senator Sheldon Whitehouse).}

\footnotesize{\textsuperscript{193} \textit{See} Austin C. Smith, The Misinterpretation of 11 U.S.C. § 523(a)(8) \textit{AM. BANKR. INST.}, Dec. 28, 2016, https://www.abi.org/committee-post/the-misinterpretation-of-11-usc-%2C2%a7-523a8 (noting that the bankruptcy courts’ “overbroad interpretations have abrogated the fresh start for thousands of debtors and provided commercial lenders with protections from discharge in circumstances that were never intended by the Bankruptcy Code”).}
contested that interpretation. Instead, they have allowed creditors’ arguments to go unchallenged and given courts no reason to consider—much less adopt—the Narrow Reading. In writing this piece, I hope to provide student loan debtors and their attorneys with a roadmap to push back against the Broad Reading. Courts are willing to endorse the Narrow Reading194; they just need borrowers to present the merits of the argument.195

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194 See infra notes 114–117 and accompanying text.
195 Although the majority of courts to consider the Narrow Reading embraced it, those few which rejected it did so purely out of respect for precedent. See In re Corbin, 506 B.R. 287, 296 (Bankr. W.D.Wash. 2014) (citing In re Maas, 497 B.R. 863, 869–870 (Bankr. W.D.Mich. 2013) (finding that precedent requires the court to adopt the Broad Reading despite the fact that “courts have interpreted the phrase ‘obligation to repay funds received as an educational benefit’ so broadly that it seems to this Court that Section 523(a)(8)(A)(i) is almost subsumed by subsection (ii)”)).
In re LaDeidra Antoinette Berry Pennsylvania Higher Education Assistance Agency, Appellant, v.

LaDeidra Antoinette Berry, Appellee.

C/A No. 2:18-444-MBS

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF SOUTH CAROLINA

March 4, 2019

Appeal from the United States Bankruptcy Court For the District of South Carolina

(Hon. John E. Waites)

ORDER AND OPINION

This is an appeal of an order awarding attorney's fees with respect to a motion to enforce a bankruptcy plan. A bankruptcy court has the power to hold a litigant in contempt and sanction it for violating the court's orders pursuant to 11 U.S.C. § 105(a), which provides:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

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I. FACTS

Appellee LaDeidra Antoinette Berry ("Debtor") is obligated on student loans held by the United States Department of Education ("DOE") and served by Appellant Pennsylvania Higher Education Assistance Agency ("PHEAA"), d/b/a FedLoan Servicing. Debtor was enrolled in an income-driven repayment ("IDR") plan, which allows a borrow to make payments based on income; and the Public Service Loan Forgiveness ("PSLF") program, which provides for forgiveness of student loan debt for borrowers employed full time in public service positions.

On March 25, 2016, Debtor filed for relief under Chapter 13 of the Bankruptcy Code. Debtor's proposed Chapter 13 plan provided for Debtor to pay PHEAA directly, rather than through the bankruptcy trustee. Debtor had made 43 qualifying pre-petition payments toward the 120 qualifying payments required under the PSLF. Debtor's intent was to maintain her student loan payments under the IDR plan and PSLF program in order to continue to accrue the benefits of that arrangement. The Honorable John E. Waites entered an order confirming the plan on May 9, 2016.

PHEAA placed Debtor's loan in administrative forbearance, as required by applicable law. On June 14, 2016, PHEAA filed a proof of claim on behalf of DOE in the amount of $97,009.87. However,
PHEAA discontinued applying Debtor's payments in accordance with the IDR plan and PSLF program. Counsel for Debtor contacted PHEAA, and was informed that Debtor was not eligible for the PSLF program until the bankruptcy was concluded. PHEAA further informed counsel that, because the loan was in administrative forbearance, any payments made were voluntary and not considered to be qualifying payments under the PSLF.

On October 3, 2016, Debtor filed an amended Chapter 13 plan that provided, in relevant part:

F. Student Loan Claims: As indicated on Schedule J, the Debtor will pay this creditor directly; this creditor will not share in the pro rata distribution from the Trustee: FedLoan Servicing [PHEAA]. If this claim is filed by any other entity or account number, Debtor will be responsible to notify the Trustee or Trustee may make disbursements on the claim pursuant to IV.E. above.

Debtor agrees that if she signs a certification of plan completion, she will be certifying that all contractual payments that come due to this creditor have been made through the date of certification.

The debtor is not seeking nor does this Plan provide for any discharge, in whole or in part, of her student loan obligations.

The Debtor shall be allowed to seek enrollment, or to maintain any pre-petition enrollment, in any applicable income-driven repayment ("IDR") plan with the U.S. Department of Education and/or other student loan servicers, guarantors, etc. (collectively referred to hereafter as "Ed"), including but not limited to the Public Service Loan Forgiveness program, without disqualification due to her bankruptcy. Any direct payments made by the Debtor to Ed since the filing of her petition shall be applied to any IDR plan in which the Debtor was enrolled pre-petition, including but not limited to the Public Service Loan Forgiveness program.

Ed shall not be required to allow enrollment in any IDR unless the Debtor otherwise qualifies for such plan.

The Debtor may, if necessary and desired, seek a consolidation of her student loans by separate motion and subject to subsequent court order.

ECF No. 2-6, 5.

The bankruptcy judge entered an order confirming the amended plan on January 20, 2017. On April 27, 2017, Debtor filed a motion to enforce. Debtor asserted that she had continued making payments directly to PHEAA, but that no post-petition payments had been applied to the PSLF program. Debtor argued that PHEAA's forced suspension of her participation in the PSLF program was in violation of the amended plan and constituted discrimination in violation of 11 U.S.C. §
525(c)(1). ECF No. 2-8. The parties resolved the matter, which resolution was memorialized in a consent order filed by the bankruptcy judge on August 29, 2017. The consent order provided that all post-petition student loan payments made by Debtor would be applied to her IDR plan and PSLF program and that her loan balance would be recalculated. The order further provided that Debtor had not waived her right to attorney's fees. The consent order was signed by counsel for Debtor, DOE, and PHEAA. ECF No. 2-15.

On September 28, 2017, Debtor moved for attorney's fees against DOE pursuant to the Equal Access to Justice Act ("EAJA"), 28 U.S.C. § 2412(d); and against PHEAA under 11 U.S.C. § 105. With respect to PHEAA, Debtor asserted that its pre-litigation and post-litigation conduct violated the bankruptcy judge's order confirming the Debtor's Chapter 13 plan. Debtor argued that the bankruptcy judge possessed power under § 105 to sanction where it is necessary to prevent abuse of the judicial system. ECF No. 2-16, 1-4.

The bankruptcy judge held a hearing on October 26, 2017, at which he was informed that Debtor had incurred attorney's fees of approximately $12,574.00, not including fees for time expended on the hearing. Tr. of Hearing, ECF No. 8-3, 6. The bankruptcy judge further was informed that DOE had settled with Debtor for $6,000.00, and that she sought the balance of attorney's fees from PHEAA. Id. at 6-9.

Initially, PHEAA asserted that the confirmed plan was contrary to law, that being the requirement that student loans in bankruptcy must be placed in forbearance. Tr. of Hearing, ECF No. 8-2, 92; see 34 C.F.R § 682.402(f)(2). Relying on United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260 (2010), PHEAA argued that the confirmation order was void, so that PHEAA was not required to conform to the terms of the Chapter 13 plan or confirmation order. Id. PHEAA stated that it had no record of having received the amended plan, and that, in any event, PHEAA had received no guidance from DOE as to applying income-based repayment plan ("IBR") payments to a student loan in forbearance. Id. at 94-95.

At the hearing, PHEAA called Katelynn Marie Bias, manager of the bankruptcy and disability document processing unit at PHEAA, to testify. ECF No. 8-3, 11. Ms. Bias testified that the contract and Common Manual between DOE and PHEAA required PHEAA, as appropriate, to place loans into bankruptcy status, prepare the proof of claim, and assist in defending the loan against a bankruptcy discharge. Id. at 15. Ms. Bias testified that payments received when a loan is in bankruptcy status are applied to interest and principal. Id. at 20. Ms. Bias testified that DOE had given no directive with regard to income-driven repayment, income based repayment, or public service loan forgiveness. Id. at 22. According to Ms. Bias, PHEAA has no authority to appear in court on behalf of DOE, to file an objection to a bankruptcy plan on behalf of DOE, or to retain lawyers and appear in court to make arguments with regard to a bankruptcy plan. Id. at 25. Ms. Bias testified that her office had received the
initial Chapter 13 plan, but had never received the amended plan. Ms. Bias also testified that, had her office received the amended Chapter 13 plan, someone would have reached out to DOE for guidance as to how to handle Debtor's request for the IBR plan and PSLF program. Id. at 32.

Counsel for Debtor argued that Debtor repeatedly had contacted PHEAA in an attempt to have her student loans qualified for the IBR plan and PSLF program, but repeatedly was told by PHEAA via both telephone and correspondence that any payments made could not be applied toward these programs because she was in bankruptcy. Id. at 45. Counsel stated that it had taken a great deal of effort to obtain the August 29, 2017 consent order. Counsel also informed the court that PHEAA had raised for the first time in the hearing that it had never received the amended Chapter 13 plan. Id. at 46.

Counsel for PHEAA asserted that the court should take into consideration the fact that the consent order constituted the first time PHEAA had administered a student loan in administrative forbearance in this manner, and that there were no provisions in the Common Manual to address Debtor's situation. Counsel argued that imposition of attorney's fees under 11 U.S.C. § 105 required a finding of gross negligence, misconduct, or bad faith, and that the facts did not support such a finding. Id. at 50.

The bankruptcy judge issued his order on February 2, 2018. The bankruptcy judge noted that, under 11 U.S.C. § 105(a), the bankruptcy court has authority to award attorney's fees when a party violates the terms of a Chapter 13 plan and the court's confirmation order. Order, ECF No. 2-19, 9. The bankruptcy judge found that the Chapter 13 plan identified FedLoan Servicing (PHEAA) as the creditor on Debtor's student loan. Id. at 11. The bankruptcy judge also found that the Chapter 13 plan provided for Debtor to maintain her enrollment in the IDR plan and PSLF program and also provided clear instruction regarding how her loan payments should be applied. The bankruptcy judge found that the amended plan was properly served on PHEAA and no party objected to confirmation. The bankruptcy judge rejected PHEAA's interpretation of Espinosa, and held that Espinosa stands for the proposition that a plan confirmed after proper notice to the creditor and no objections being filed, remains binding on the parties, even if the plan contains a legal error. Id. at 12, n.18. Thus, the bankruptcy judge determined that PHEAA was bound to the terms of the Chapter 13 plan pursuant to 11 U.S.C. § 1327 and according to the holding in Espinosa. The bankruptcy judge concluded that PHEAA was in violation and contempt of his confirmation order of the amended plan, which required Debtor to file a motion to enforce. According to the bankruptcy judge, the fees and costs associated with the motion to enforce would not have been incurred had PHEAA complied with the amended plan and confirmation order. Id. at 12.

Addressing PHEAA's defenses, the bankruptcy judge first concluded that, contrary to its assertions, PHEAA was not limited to placing the student loan into bankruptcy status by its contract with DOE. The bankruptcy judge determined that PHEAA had sufficient authority to comply with the requirements of the amended plan and confirmation order, or to ensure that DOE provided it with the necessary authority. Id. at 14. The bankruptcy judge further observed that PHEAA could have objected if it felt unable to comply with the Chapter 13 plan, or it could have reported the plan's provisions to DOE
for action. The bankruptcy judge opined that accepting PHEAA's arguments "would allow it and other similarly situated creditors or parties-in-interest to escape the consequences of a duly noticed confirmed plan and § 1327 by simply limiting its or its agents' responsibility. As a matter of statutory construction and public policy, such a defense cannot be accepted." Id. at 15.

Second, the bankruptcy judge determined that bad faith is not a requirement for the court to take action pursuant to § 105(a). Further, the bankruptcy judge found that direct payments made pursuant to a confirmed plan are part of the bankruptcy proceedings, and that federal regulations do not prohibit the acceptance and application of payments pursuant to the specific terms of a confirmed Chapter 13 plan. Id. at 16. Thus, the bankruptcy judge determined that it was necessary and appropriate for him to award Debtor's attorney's fees so as to enforce and implement his orders and prevent an abuse of process. Id. at 17.

The bankruptcy judge recited that Debtor's counsel had submitted time records indicating attorney's fees and costs in the amount of $22,317.30. The bankruptcy judge found the attorney's fee award to be reasonable under the factors set forth in Barber v. Kimbrell's Inc., 577 F.2d 216, 226 n.28 (4th Cir. 1978). The bankruptcy judge reduced the attorney's fee amount by the DOE payment of $6,000.00, and imposed attorney's fees and costs against PHEAA in the amount of $16,317.30. ECF No. 2-19, 18-19.

PHEAA filed a notice of appeal on February 16, 2018. In its brief filed on June 15, 2018, PHEAA identified the following issues on appeal:

1) Whether the Bankruptcy Court's finding that PHEAA had the corporate authority to unilaterally modify the treatment and administration of the Berry Obligations, such that said administration would conform to the Debtor's Second Amended Plan, was clearly erroneous given the record before the Court, including the testimony given at the hearing that the Bankruptcy Court held on October 26, 2017 (the "Hearing") and the other evidence and pleadings in the record (collectively, the "Record")?

2) Whether the Bankruptcy Court's implicit finding that PHEAA's conduct with regard to the Berry Obligations was clearly erroneous given the evidence in the Record?

3) Whether the Bankruptcy Court abused its discretion by imposing sanctions on PHEAA in the Sanctions Order given the evidence in the Record?

4) Whether the Bankruptcy Court abused its discretion by failing to apportion its award of Berry's fees between DOE and PHEAA when Berry incurred the majority of her fees and expenses subsequent to, and as a direct and proximate result of, DOE filing its Objection to Berry's Motion to Enforce?

Brief of Appellant, ECF No. 8, 2.
II. STANDARD OF REVIEW

A district court "sits as an appellate tribunal in bankruptcy." In re Birmingham, 846 F.3d 88, 92 (4th Cir. 2017). Findings of fact by the bankruptcy court in proceedings within its full jurisdiction are reviewable only for clear error and legal questions are subject to de novo review. In re Johnson, 960 F.2d 396, 399 (4th Cir. 1992) (citing Brown v. Pennsylvania State Employees Credit Union, 851 F.2d 81, 84 (3d Cir. 1988); In re Crouthamel Potato Chip Co., 786 F.2d 141, 144 (3d Cir. 1986)).

Decisions committed to the discretion of the bankruptcy court, such as a sanctions order, are reviewed for abuse of discretion. See In re Jemsek Clinic, P.A., 850 F.3d 150, 156 (4th Cir. 2017) (citing McGahren v. First Citizens Bank & Tr. Co., 111 F.3d 1159, 1169 (4th Cir. 1997)). A court abuses its discretion when its conclusion is guided by erroneous legal principles or rests upon a clearly erroneous factual finding. Id. (quoting Westberry v. Gislaved Gummi AB, 178 F.3d 257, 261 (4th Cir. 1999)). Even if the bankruptcy court applies the correct legal principles to adequately supported facts, the discretion of the bankruptcy is not subject to automatic affirmance. See Westberry v. Gislaved Gummi AB, 178 F.3d 257, 261 (4th Cir. 1999) (citing Wilson v. Volkswagen of Am., Inc., 561 F.2d 494, 506 (4th Cir. 1977) (discussing review of district court decisions)). The district court is obligated to review the record and reasons offered by the bankruptcy court and to reverse if the "court has a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." See id. (quoting Wilson, 561 F.2d at 506) (discussing review of district court decisions).

III. DISCUSSION

A. Whether PHEAA Possessed Authority to Implement the Amended Plan

PHEAA asserts that the bankruptcy judge erred in rejecting its limited authority defense. PHEAA argues that it lacked authority under the Common Manual and its contract with DOE to object to the amended Chapter 13 plan or implement its terms. PHEAA contends that PHEAA's only option was to place Debtor's student loans into administrative forbearance, file a proof of claim, and provide additional support to defend against a discharge. ECF No. 8, 19; see ECF No. 2-32, 51-52. PHEAA asserts that it was up to DOE to review Debtor's Chapter 13 plan for issues arising out of the IDR plan and PSLF program and to file any objections. According to PHEAA, nothing in the

Common Manual or contract with DOE provides PHEAA with authority to unilaterally remove Debtor's student loans from administrative forbearance and apply her post-petition payments in accordance with the pre-petition IDR plan and PSLF program.

As recited above, the bankruptcy judge noted that PHEAA was designated and acted as the authorized representative of DOE for purposes of servicing Debtor's student loan, communicating with Debtor, and managing and applying the student loan payments. The bankruptcy judge observed that, even
if PHEAA did not have sufficient authority to comply with the confirmation order, it could have requested guidance from DOE after Debtor and her counsel queried PHEAA about its failure to comply with the confirmation order.

The court cannot say that the bankruptcy judge's determinations that PHEAA possessed authority to apply Debtor's payments to her IDR plan and PSLF program, or to raise the issue to DOE, were guided by erroneous legal principles or rested upon a clearly erroneous factual finding. Certainly PHEAA was aware of its obligations to conform to the requirements of a court order. As Debtor points out, the contract between PHEAA and DOE provides that PHEAA was "responsible for maintaining a full understanding of all federal and state laws and regulations and FSA requirements and ensuring that all aspects of the service continue to remain in compliance as changes occur." ECF No. 2-32, 23. The court notes that PHEAA was obligated to "respond and resolve customer complaints, and create and execute a plan to escalate complaints" to DOE. To the extent it perceived it was limited by its contract and the Common Manual to placing Debtor's student loan in administrative forbearance for the duration of the bankruptcy, in derogation of the confirmation order, PHEAA could have communicated its concerns to DOE. The court is aware of no provision in the contract or Common Manual that prohibits PHEAA from taking any steps beyond placing

loans, "where the borrower has applied for bankruptcy, into a bankruptcy status, prepar[ing] a Proof-of-Claim and provid[ing] any additional support needed to defend the loan against bankruptcy discharge." Id. at 51-52. To the contrary, PHEAA was obligated to have a mechanism in place to elevate complaints to DOE, and could have done so.

B. Whether a 11 U.S.C. § 105 Sanction Requires a Finding of Bad Faith

PHEAA asserts that the bankruptcy judge erred in concluding PHEAA’s conduct was willful so as to support a sanction under § 105. As an initial matter, the bankruptcy judge rejected PHEAA's position that bad faith is a requirement for a bankruptcy judge to take action under § 105. The bankruptcy judge observed that § 105 "provides a sweeping grant of authority to 'issue any order, process or judgment that is necessary or appropriate to carry out the provisions of' the Bankruptcy Code, including ensuring that parties comply with the terms of a confirmed chapter 13 plan under § 1327(a), and is not limited to bad faith conduct." ECF No. 2-19, 16. The Court of Appeals for the Fourth Circuit has held that Congress under § 105(a) granted bankruptcy courts the power to enforce their lawful orders through civil contempt. "Determining if a party has committed civil contempt involves essentially only consideration of whether the party knew about a lawful order and whether he complied with it." In re Walters, 868 F.2d 665, 670 (4th Cir. 1989). Other courts have held the same. See, e.g., In re Eppolito, 583 B.R. 822 (S.D.N.Y. 2018); In re Rhodes, 563 B.R. 380 (M.D. Fla. 2017); In re Sann, Case No. 14-61370-7, 2016 WL 1375022, *3 (D. Montana, April 5, 2016); In re Emergency Room Mobile Servs., L.L.C., 529 B.R. 676 (N.D. Tex. 2015). To establish civil contempt, the following elements must be established by clear and
convincing evidence:

(1) The existence of a valid decree of which the alleged contemnor had actual or constructive knowledge; (2) . . . that the decree was in the movant's "favor"; (3) . . . that the alleged contemnor by its conduct violated the terms of the decree, and had knowledge (at least constructive knowledge) of such violations; and (4) . . . that [the] movant suffered harm as a result.


In this case, the bankruptcy judge issued a confirmation order on the Chapter 13 plan, as amended; PHEAA was aware of the confirmation order; PHEAA failed to abide by the confirmation order, and Debtor was harmed as a result. The question becomes, then, whether PHEAA may defend on the basis of inability to comply with the bankruptcy judge's order. See In re Minh Vu Hoang, Nos. 05-21078-TJC, 05027378-TJC, 2014 WL 1320322 , *4 (D. Md. March 28, 2014) (quoting Elec. Workers Pension Trust Fund v. Gary's Elec. Serv. Co., 340 F.3d 373, 379 (6th Cir. 2003)). PHEAA must show more than "a mere assertion of inability and establish that [it] has made in good faith all reasonable efforts' to comply." Id. (quoting In re Lawrence, 251 B.R. 630, 651 (S.D. Fla. 2000)).

PHEAA reasserts its argument that it did not have authority to unilaterally implement the IDR plan and PSLF program provisions of the Chapter 13 amended plan. Assuming for purposes of appeal that PHEAA is correct, the bankruptcy judge also concluded that PHEAA could have sought guidance from DOE, but failed to do so. The court cannot say the bankruptcy judge's determination was guided by erroneous legal principles or rested upon a clearly erroneous factual finding.

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C. Whether the Imposition of Sanctions Was an Abuse of Discretion

PHEAA contends that the bankruptcy judge abused his discretion in imposing sanctions under 11 U.S.C. § 105, again on its position that civil contempt requires a finding of willfulness. PHEAA contends it did not act willfully because the Common Manual and its contract with DOE delineated its scope of authority, such that it (1) could not unilaterally implement the IDR plan and PSLF program provisions of the amended plan; (2) could not file an objection or otherwise make an appearance in Defendant's bankruptcy case; and (3) had no system in place for monitoring and applying unique provisions of bankruptcy plans. Thus, according to PHEAA, there is no evidence in the record to support a finding that the bankruptcy judge "explicitly or implicitly, [determined] that PHEAA willfully violated the Order confirming the Second Plan." ECF No. 8, 25.

For the reasons set forth hereinafore, the court concludes the imposition of sanctions under § 105 does not mandate a finding of willfulness or bad faith. The court cannot say the bankruptcy judge's determination was guided by erroneous legal principles or rested upon a clearly erroneous factual finding.
D. Whether the Within Action Should be Distinguished from Prior Decisions Sanctioning Creditors

PHEAA contends the bankruptcy judge erred in attempting "to tow [sic] a consistent line on sanctioning creditors that fail to comply with its orders[.]" ECF No. 8, 28. According to PHEAA, the bankruptcy judge's prior decisions involved sanctioning creditors who acted on their own volition, by or through employees who were given authority to take the acts in question. PHEAA suggests that the bankruptcy judge "may [have] improperly weigh[ed] the evidence regarding PHEAA's authority as [he] reached the conclusion that it was appropriate to sanction PHEAA." Id. PHEAA argues that, as a servicer that was strictly following its defined contractual duties, the imposition of sanctions is not appropriate.

In In re Final Analysis, Inc., 389 B.R. 449, 462-63 (Bankr. D. Md. 2008), the bankruptcy court summarized its authority under § 105:

The basic purpose of Section 105(a) is to "enable a court to do whatever is necessary to aid its jurisdiction, i.e., anything arising in or relating to a bankruptcy case." In re DeLorean Motor Co., 991 F.2d 1236, 1242 (6th Cir. 1993) (quoting 2 Collier on Bankruptcy P105.02 at 103-05 (15th ed. 1987)). In Marrama v. Citizens Bank, 549 U.S. 365 [] (2007), the Supreme Court reaffirmed the "broad authority granted to bankruptcy judges to take any action that is necessary or appropriate 'to prevent the abuse of process' described in § 105[]."

Courts have found that equity powers allow them to "sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate." In re Executive Office Centers, Inc., 96 B.R. 642, 650 (Bankr. E.D. La.1988) (quoting Pepper v. Litton, 308 U.S. 295, 307-08 [] (1939)). . . . Section 105(a) grants the Bankruptcy Courts the authority to choose the structure of a remedy. In re Coleman Enterprises, Inc. [266 B.R. 423, 435 (Bankr. D. Minn.2001), held that

[Section] 105(a) puts no facial restriction on the structure of relief that the courts can fashion under it, as long as they are furthering a principle identifiable in the applicable substantive law of bankruptcy. Section 105(a) was enacted to promote such enforcement, through means that are tailored [to] the innumerable scenarios of financial distress in bankruptcy cases.

The bankruptcy judge found the unusual circumstances of this case and the failure of PHEAA to make any attempt to comply with the amended plan warranted sanctions. Although PHEAA may not have affirmatively taken action to harm Debtor, its failure to act caused Debtor to incur costs of litigation, both before and after the consent order was executed. The court cannot say the bankruptcy judge's determination was guided by erroneous legal principles or rested upon a clearly erroneous factual finding.
E. Whether the Sanction Should be Apportioned

Finally, PHEAA contends that the bankruptcy judge erred in failing to apportion damages between it and DOE. According to PHEAA, DOE was the most culpable source of Debtor's difficulties because DOE had not instructed PHEAA to implement the amended plan. PHEAA asserts that a fair adjudication would have allocated no more than $5,368.80 of the fee sanction to PHEAA, which was the amount of attorney's fees incurred by Debtor prior to her filing of the motion to enforce. PHEAA argues that the remaining $13,418.50 should have been allocated to DOE, less the $6,000.00 paid by DOE to Debtor prior to the sanctions hearing.

The bankruptcy judge reviewed Debtor's attorney's time records and observed that the fees included the time counsel spent contacting PHEAA to enforce the plan and confirmation order, through her motion to enforce, negotiations resulting in the consent order, and the hearing on Debtor's motion. The court discerns no reason the time spent by Debtor attempting to convince PHEAA to comply with the amended plan should be excluded from the fee sanction. The court cannot say the bankruptcy judge's determination was guided by erroneous legal principles or rested upon a clearly erroneous factual finding.

IV. CONCLUSION

For the reasons stated, the court concludes that the bankruptcy judge did not abuse his discretion in imposing sanctions on PHEAA in the amount of $16,317.30. The order of the bankruptcy judge issued February 2, 2018, is affirmed.

IT IS SO ORDERED.

/s/ Margaret B. Seymour
Senior United States District Judge

Charleston, South Carolina
March 4, 2019

Footnotes:

\(^1\) Title 11, United States Code, Section 525(c)(1) provides:

\(^1\) (c)(1) A governmental unit that operates a student grant or loan program and a person engaged in a business that includes the making of loans guaranteed or insured under a student loan program may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, or another person with whom the debtor or bankrupt has been associated, because the debtor or bankrupt is or has been a debtor under this title or a bankrupt or debtor...
under the Bankruptcy Act, has been insolvent before the commencement of a case under this title or during the pendency of the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

In Espinosa, a bankruptcy court confirmed a Chapter 13 plan in which the debtor proposed to repay only the principal of his student loan and to discharge accrued interest. Under 11 U.S.C. §§ 523(a)(8) and 1328, a discharge of student loan debt requires a finding that failure to discharge would result in "undue hardship" to the debtor. Bankruptcy procedural rules require the bankruptcy court to hold an adversary proceeding to make an undue hardship determination. Such a hearing was not held, and the creditor moved under Fed. R. Civ. P. 60(b)(4) for the bankruptcy court to rule that is confirmation order was void because the creditor did not receive adequate notice of the debtor's proposed discharge of his student loan interest. On appeal, the Supreme Court determined that Rule 60(b)(4) was not the proper vehicle to challenge the confirmation order because the order was not "premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard." Espinosa, 559 U.S. at 271-72. Significantly, the Court observed that the bankruptcy court's "failure to find undue hardship before confirming Espinosa's plan was legal error. . . . But the order remains enforceable and binding on [the creditor] because [the creditor] had notice of the error and failed to object or timely appeal." Id. at 1380.

The bankruptcy judge observed that the parties used the terms "IBR" and "IDR" interchangeably. According to The bankruptcy judge, an IBR plan is a type of IDR plan. Order, ECF No. 2-19, 2. PHEAA informs the court that Debtor was enrolled in an IDR. Brief of Appellant, ECF No. 8, 12 n.6.

The Common Manual contains complete instructions and guidelines for handling DOE student loans. ECF No. 8-3, 24, 62.

The bankruptcy judge correctly noted that a finding of bad faith is required when a bankruptcy court utilizes its inherent power rather than § 105(a). ECF No. 2-19, 15 n.25.

PHEAA argues in its reply brief that it was unable to elevate the amended plan to DOE because it did not receive a copy. The bankruptcy judge rejected this argument. ECF No. 2-19, 11 n.17. In any event, PHEAA obtained knowledge regarding the amended plan through receipt of the confirmation order. See ECF No. 2-7 (Order Confirming Plan and Resolving Motions and certificate of service filed January 20, 2017). PHEAA also was aware that the bankruptcy judge had confirmed a plan allowing Debtor to make payments directly to PHEAA for her student loans that should be posted according to Debtor's IDR plan and PSLF programs. See, e.g., ECF No. 2-26 (correspondence to PHEAA from Debtor's counsel); ECF No. 2-10, 14-17 (records of conversations between PHEAA and Debtor). Nevertheless, PHEAA did not request guidance from DOE.
Chapter 5—Student Loans and Bankruptcy

32nd Annual Northwest Bankruptcy Institute

5–106
IN RE: KIRK JOHN DUENSING EVE LEONOR DUENSING Debtors.

Case No. 18-10201

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF KANSAS

February 22, 2019

DESIGNATED FOR ONLINE PUBLICATION

Chapter 12

ORDER OVERRULING ECMC'S OBJECTION TO CONFIRMATION AND SUSTAINING CHAPTER 12 TRUSTEE'S OBJECTION TO CONFIRMATION

Two issues remain undecided in the Duensings' chapter 12 case. One is whether the debtors may direct that plan payments on their student loans be applied first to principal. The other is whether they can propose a final distribution of their farming assets to a trust that will pay their unsecured creditors for five years after the plan's completion.

The Student Loans

Student loans are protected from discharge in bankruptcy law unless the debtor can demonstrate that paying would result in undue hardship. The law does not protect them from being modified. In Chapter 12, the terms of any secured or unsecured claim can be modified by the plan. Post-petition interest on student loans may only be paid through the plan if the debtor's disposable income is sufficient after paying the other allowed claims in full. While non-bankruptcy law and federal regulations govern the relationship between student loan lenders, servicers, guarantors, and borrowers, those provisions do not trump the federal Bankruptcy Code's provisions that regulate the relationship between a debtor and the debtor's creditors. If these bodies of law are in conflict, courts must construe them in a way giving both effect.

The Duensings classified student loan claims held by Educational Credit Management Corporation (ECMC) in Class 8 with general unsecured claims. They proposed to pay the student loan claims in full (principal and prepetition interest) without penalties or interest on a pro rata basis, acknowledging that they will remain personally liable for post-petition interest that accrues on their student loan debt during the repayment period and will not be discharged. The Duensings' plan expressly directs that all payments on the student loan claims shall be applied to principal. ECMC objects to this application of payments.
modification of ECMC’s claims is permitted under § 1222(b)(2), as is the debtors' proposal to cure and maintain these claims after the expiration of the five-year plan term. ECMC’s objection is OVERRULED.

The Plan Trust

Nothing in Chapter 12’s provisions keeps debtors from proposing a creditor's trust in their plan if it does not otherwise violate the provisions of title 11 or Chapter 12. Indeed, several provisions give debtors flexibility in disposing of estate assets at confirmation, even in unorthodox ways. The Duensings proposed a plan that provided for five years of payments on secured and unsecured claims through the trustee and another five years of unsecured claim payments after the plan period. At the end of the plan period, the operating farm assets would transfer from the estate to the Duensings as trustees of the Kirk and Eve Duensing Unsecured Creditors Trust (“Plan Trustees” and “Plan Trust” as appropriate), for the benefit of the unsecured creditors. The Plan Trustees would farm by operating the assets and would pay in full the unsecured creditor claims with farm income for another five years, after which, the Plan Trust's assets would revert to the debtors. While no single creditor objected, the Chapter 12 trustee did, arguing that this proposal runs afoul of the five-year plan limitation contained in § 1222(c). Creative as it is, the debtors' plan cannot be confirmed because it does not comply with Chapter 12 and the Chapter 12 Trustee's objection must be SUSTAINED.

I. Chapter 12 Plan Treatment of Student Loans

A. Student Loan Facts

The Duensings classified ECMC's student loan claims with general unsecured claims in Class 8.4 They propose to pay all unsecured claims without penalties or interest on a pro rata basis in quarterly installments of $13,299.46 over the ten-year period described above until paid in full [principal and prepetition interest]. They expressly recognize that this treatment shall "not act as a discharge of student loan obligations as defined in 11 U.S.C. § 523(a)(8)."5 Post-petition interest will accrue on the student loan debt pursuant to the contract terms for that particular debt. With respect to other payment terms for the student loan claims, the Duensings' amended plan provides:

All payments to the student loan claims shall be applied to principal. However, the unpaid interest accumulated during the payment term shall remain due and owing and shall not be discharged.6

ECMC has filed proofs of claims for two PLUS loans (disbursed between Oct 2007-Jan 2008) denominated as a Master Promissory Note to which it succeeded as guarantor of the National Student Loan Program (NSLP) on July 6, 2015.7 It also
holds a Consolidation Loan created in 2007, in which it succeeded College Assist as guarantor on June 25, 2018.\footnote{5} Both loans were made under the Federal Family Educational Loan Program (FFELP) as authorized and governed by the Higher Education Act of 1965 (HEA), as amended, 20 U.S.C. § 1070 et seq. Debtors do not object to these proofs of claim.

Both the Master Promissory Note (the PLUS loans) and the Consolidation Note contain the right to prepay the unpaid balance at any time without penalty. ECMC did not include all the pages and terms and conditions of the applications and notes in its supporting affidavit to its Memorandum.\footnote{6} What is there is very difficult to read. Using the OMB form numbers, the Court located these loan document forms online.\footnote{7} Those forms confirm that there is no bar to prepayment. In addition, at least one of the federal regulations cited by ECMC permits prepayment.\footnote{8} The Note forms provide: "Payments submitted by me [borrower]. . . may be applied first to late charges and collection costs that are due, then to accrued interest that has not been capitalized, and finally to the principal amount."\footnote{9} Nothing in the Notes addresses application of payments if the student loan is in bankruptcy; only that the loans will not be automatically discharged in bankruptcy.\footnote{10}

Among the pages missing from the record are those detailing the repayment terms of these notes. The PLUS note form states that the PLUS loans are payable over a minimum five years beginning 60 days after the last disbursement.\footnote{11} PLUS notes' terms of repayment can extend from five years to 10 or even 25, depending on which repayment plan a borrower chooses.\footnote{12} We can tell that the initial PLUS note was signed in July of 2007 and that the last disbursements were made in January of 2008.\footnote{13} Neither party presented any evidence about which repayment plan Ms. Duensing previously chose. The Consolidation loan (disbursed in 2007), together with the unpaid balance on other student loans, may qualify for a 20-year repayment term.\footnote{14} In any case, more than 10 years have elapsed since the last disbursement. There is nothing in the record about the amount of the payments, whether or when any were made, or when the loan repayment period began or ended. Even so, it appears that ECMC and the debtors share the intention that payments on these claims will continue after the plan's term is completed.

ECMC objects to debtors' directing application of their payments to the claim instead of post-petition interest.\footnote{15} ECMC argues that the HEA and related regulations govern how payments are to be applied and that those rules supersede conflicting plan provisions in the Bankruptcy Code. Specifically, ECMC relies on its role as guarantor under the FFELP, the HEA, 20 U.S.C. § 1070 et seq., and the Department of Education regulations, specifically 34 C.F.R. 682.404(f) and 682.209(b). ECMC also argues that applying plan payments to principal first effectively discharges student loan debt without a finding of undue hardship. This argument is based on the arithmetic fact that a declining principal balance during the payment term will yield less interest accruing post-petition.
B. Student Loan Treatment Analysis

The Bankruptcy Code excepts student loan debt from discharge without a determination of undue hardship.19 But student loan creditors are no different from other unsecured creditors in that they cannot include unmatured or post-petition interest in their allowed claim.20 Chapter 12 and 13 debtors are not required to pay interest on general unsecured claims. Chapter 12 and 13 debtors may only provide for paying post-petition interest on student loan claims if they have sufficient disposable income after paying all other allowed claims in full.21 Because student loans are excepted from discharge, the debtors will remain personally liable for paying any post-petition interest that accrues during the pendency of the case, even if the principal portion of a non-dischargeable debt is paid in full under the plan. That interest remains a personal liability of the debtor that the student loan lender can collect after the bankruptcy case is completed.22

The Duensings' plan proposes to repay the allowed amount of the student loan claims in full under the plan. They concede their continuing liability for any post-petition interest. ECMC objects, relying on two regulations that address administration of student loans and application of payments by the lender and guaranty agency—34 C.F.R. § 682.404(f) and § 682.209(b). Part 682.404(f) governs a guaranty agency's application of payments on a defaulted student loan while Part 682.209(b) governs application of payments by the holder of a student loan that is not in default. ECMC states that the Duensing student loans are not in default.23

Except in the case of payments made under an income-based repayment plan, the lender may credit the entire payment amount first to any late charges accrued or collection costs and then to any outstanding interest and then to outstanding principal.24

Part of this regulation, 682.209(b)(2)(i), permits borrowers to prepay. It states: "The borrower may prepay the whole or any part of a loan at any time without penalty." Further, Part 682.209(b)(2)(ii) permits the borrower to direct how the prepayment is to be applied:

If the prepayment amount equals or exceeds the monthly payment amount under the repayment schedule established for the loan, the lender shall apply the prepayment to future installments by advancing the next payment due date, unless the borrower requests otherwise. The lender must either inform the borrower in advance using a prominent statement . . . that any additional full payment amounts submitted without instructions to the lender as to their handling will be applied to future scheduled payments . . . 25

The regulation is silent how prepayments are applied if the prepayment amount is less than the monthly payment amount under the repayment schedule.
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**Student loan regulation vs. Debtors' Chapter 12 plan**

ECMC argues that the student loan regulations control how student loan payments should be applied, even in bankruptcy cases, and that non-bankruptcy student loan law and regulations trump the Bankruptcy Code. While federal regulations may have the same preemptive effect as federal statutes, traditional preemption analysis, having its roots in the Supremacy Clause, applies where state law conflicts with federal law. It doesn't apply where two federal statutes appear to be in conflict.

There is no express conflict between the student loan regulations and the Bankruptcy Code or the debtors' Chapter 12 plan. First, the lender's and borrower's substantive rights arise out of the Notes which are, in turn, subject to the HEA and the regulations. This is no different than any other lender-borrower relationship: its parameters are governed by the parties' contract (the notes, etc.) and the governing law. Second, the lender's application of payments is permissive in nature. Third, the regulations expressly permit prepayment of any part of a loan (i.e. the principal) without penalty. Fourth, the terms of the Notes specifically refer to "other applicable federal statutes." The Bankruptcy Code is an "applicable federal statute" that expressly permits any debtor, including one with student loans, to modify the terms of repayment of the student loan obligation. Section 1222(b)(2) allows debtors to modify unsecured claims through their Chapter 12 plan and nothing in the Code insulates student loan claims from that treatment. The Bankruptcy Code controls the substantive rights of debtors and creditors with respect to claims and their treatment, including student loan claims in bankruptcy plans, cases and proceedings.

Courts are not free to enforce one congressional enactment to the exclusion of another. If two statutes can coexist, and Congress has expressed no intention to the contrary, it is the duty of the courts to regard each as effective. Here, the student loan regulations and the bankruptcy statute coexist comfortably. The regulations deal with general servicing concerns while the Code regulates the allowance and modification of the claims in bankruptcy and insulates the debts themselves from being discharged.

As required by the Bankruptcy Code, the debtors' Chapter 12 plan deals with all of the creditors' claims in bankruptcy. Nothing in the Code elevates the HEA's or FFELP's interests in administering student loans above the rights of other creditors. Congress has enacted a comprehensive and uniform statutory scheme for the adjustment of debtors and creditors rights in bankruptcy that includes the treatment of creditors' claims. The operation of the Bankruptcy Code in adjusting a debtor's debts is unaffected by student loan regulations except to the extent those regulations bear on the allowance of the creditor's claims. The regulation plainly provides for debtors prepaying their principal; that's precisely what these debtors propose.
The unsecured student loan claims can be modified in bankruptcy.

Chapter 12 debtors may propose to modify a secured or unsecured claim under § 1222(b)(2) whether it is dischargeable or not. Eve Duensing's student loan debts will be excepted from her eventual discharge—§ 1228(a)(2) and § 523(a)(8) make that plain—but non-dischargeability does not immunize the student loan claim against modification. Congress knows how to prohibit claim modification—§§ 1123(b)(5)'s and 1322(b)(2)'s prohibitions of principal residence lien modification are apt examples.

It placed no such restriction on student loans. Permissible modifications are limited only by what is confirmable under § 1225. If the plan provides for the payment of all unsecured claims in full or for the payment by debtors of their disposable income for five years, depending on the situation, those treatments are confirmable under § 1225(b), provided the plan complies with all other applicable confirmation requirements.

Nothing about the debtors' proposed treatment will result in the "discharge" of any debt. You can't discharge a debt that hasn't yet accrued. The debtors intend to leave unaffected the interest that accrued prior to the date of the petition—that interest is part of ECMC's allowed claim by virtue of § 502. Instead, the debtors intend to pay the student loan claims pro rata with the other unsecured claims and direct that those payments be applied to principal only, at least until the unsecured creditors are paid in full. Any prospectively accruing post-petition interest is not discharged under Bruning and Eve Duensing will be liable for it upon completion of the plan. None of it will be discharged as a result of the plan's confirmation.

Section 1222(b)(11) precludes the treatment ECMC seeks.

ECMC asserts that the Duensings' plan payments must be applied first to payment of post-petition interest that accrues during the plan term. Section 1222(b)(11) regulates how and when a debtor can pay post-petition interest on a nondischargeable claim during the plan term. It is permitted but comes with conditions. Enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act in 2005, it states that a plan may provide for such payment only if the debtor has sufficient disposable income to pay the post-petition interest after providing for payment of "every other claim in full." In their Chapter 13 treatise, Judges Lundin and Brown describe this ability to pay a non-dischargeable creditor post-petition interest as a "limited license" at best. In this case, by their own admission the Duensings lack sufficient disposable income to pay the post-petition interest in addition to repaying all allowed claims in full during the plan's term. They could not satisfy both conditions of § 1222(b)(11). Accordingly, they did not propose to make any post-petition interest payment during the plan term. A plan proposal to do what ECMC wants is prohibited by § 1222(b)(11), would detract from full payment of all other claims, and would be denied confirmation.

Kielisch doesn't apply.
Decided in 2001, before § 1222(b)(11) was enacted, the Kielisch case fails to provide the panacea ECMC hopes for. It argues that the plan's provisions are a veiled effort to discharge accruing interest by reducing the principal and, therefore, limiting how much interest will accrue. ECMC says that this effort violates § 523(a)(8) by permitting that "discharge" without requiring the debtors to demonstrate the undue hardship that is a predicate to student loan discharge. ECMC heavily relies on language in Kielisch to argue that the Duensings' proposed modification is prohibited. In Kielisch, the Fourth Circuit considered a Chapter 13 case in which the debtors' plan provided for the student loan claims (meaning principal and prepetition interest) to be paid in full. The trustee paid the student loan claims in full and, at plan completion, the debtors received their discharge. When the student loan guarantor sued to collect the post-petition interest from the debtors, the debtors sought to reopen their Chapter 13 cases to argue that the creditor had misapplied the plan payments to post-petition interest rather than principal.

ECMC argued in Kielisch that it was entitled to apply plan payments to the accrued post-petition interest prior to principal. The issue on appeal was "[w]hether the application of plan payments [estate payments] to post-petition interest on non-dischargeable student loans violates § 502." The appellate court ultimately held that § 502 did not bar the student loan creditor from applying the debtors' estate payments to accrued post-petition interest because the debtors' Chapter 13 plan did not direct the application of those payments. The court also stated that allowing debtors to prepay principal effectively discharges (in advance) the interest the creditor would prospectively earn.

Several things make Kielisch inapplicable here. First, the debtors in Kielisch were looking backward. Not having provided in their plan for principal prepayment, they relied on § 502(a)(2) in their effort to force the creditor to reapply the payments to the principal. Unlike the Kielisches, the Duensings propose to modify the student loan claims by expressly directing application of payments to principal first, a modification that § 1222(b)(2) plainly permits. Second, the Duensings concede that the student loan claims will continue to accrue interest post-petition and that the accrued interest will be excepted from discharge. Where the Kielisches looked to modify their student loans' treatment retrospectively, the Duensings propose their modification prospectively. Finally, § 1222(b)(11) had not yet been enacted when Kielisch was decided. The Duensing plan presents a pure modification question that was not in play in Kielisch. This Court is not bound by Kielisch and neither its reasoning nor result are persuasive in this case.

If the plan otherwise complies with § 1222(c), curing and maintaining these claims under § 1222(b)(5) is permissible.

Though § 1222(b)(2) permits modification of ECMC's unsecured claim, § 1222(c) limits the duration of a Chapter 12 plan to five years. One exception to that limitation is § 1222(b)(5)'s permissible treatment of claims whose last payment is due after the final plan payment. So-called "long term" debts
can be cured and maintained over periods longer than five years. Nothing in Chapter 12 or elsewhere in the Bankruptcy Code prohibits treating student loan claims in this manner. Indeed, Judges Lundin and Brown suggest that "[n]ondischargeable, long-term, unsecured claims for support or an educational loan are candidates for treatment under § 1322(b)(5)." Section 1222(b)(5) is identical to that section. As discussed above, the Duensings cannot provide for the payment of post-petition student loan interest during the plan's duration because they do not have sufficient disposable income to do so and § 1222(b)(11) "conditions the payment of postpetition interest on full payment of 'all allowed claims.'" The payment of all other claims must be completed before the plan can also pay a student loan creditor post-petition interest.

Nothing in the record tells us when the last payment on the claims was originally due or when it is due now. ECMC did not make a § 1222(c) objection to confirmation. It seems likely that under even the most rigorous available payment program, these student loans will pay out after the plan is completed. Indeed, ECMC's objection to principal payment can only mean that it supports, if not intends the debtors to pay these claims over a very long term. Therefore, I find that not only

may these claims be modified as the debtors propose, but also that they may be cured and maintained under § 1222(b)(5). All of these findings are, of course, conditioned upon finding that the plan meets the other requirements of §§ 1222 and 1225, including § 1222(c). The Trustee's objection to confirmation on that basis is discussed below.

II. The Chapter 12 Plan Trust

A. Plan Trust Facts

Before they filed this case in 2018, the Duensings filed a Chapter 12 petition in 2015. After disposing of encumbered assets and paying secured claims, they dismissed that case, filing this one later to take advantage of § 1232's favorable tax claim treatment that became available in 2017. In this case, the debtors proposed an amended plan that pays secured, priority, and unsecured claims ($575,578) in full. Mr. Duensing testified that the operation can support the payments the plan proposes. To meet their obligations under § 1225(a)(4), the Chapter 7 liquidation test (a/k/a the "best interests of creditors" test), the Duensings must pay their unsecured claims in full. They concede they cannot do that within five years after confirmation.

The debtors bridge the "best-interests" gap by proposing that, at completion, the unpaid unsecured creditors' claims be excepted from discharge. They will transfer their farm equipment, inventory and products to themselves as Plan Trustees of the Plan Trust. The Plan Trustees will "use the Trust assets to make the payments set forth in Class 8 following discharge." The Plan Trustees cannot sell the trust assets without distributing their proceeds to the trust beneficiaries or lienholders. After the second five years' of payments are
complete, the Plan Trust's assets will revert to the Duensings personally and the Plan Trust will terminate. The Chapter 12 Trustee objected to this treatment on a variety of grounds that now narrow to one—that the plan's payment period exceeds the five-year limit imposed by § 1222(c).

B. Plan Trust Analysis

Trusts are permissible in Chapter 12.

In Chapter 12, the debtor has the burden to demonstrate that the plan meets the requirements of §§1222 and 1225 if a creditor or party in interest objects. The trustee's objection raised several legal issues but, at oral argument, narrowed his concerns to two, that the effect of the trust is to evade the § 1222(c) five-year limit and that the plan is not legally sufficient to create a trust. The debtors respond that Chapter 12 allows them to repay creditors with their property or the property of the estate and that vesting the trust assets in the trust before discharge, while unusual in Chapter 12, is routine in Chapter 11 cases, not contrary to Title 11, and not expressly prohibited in Chapter 12 cases.

Chapter 12 was enacted in 1986 in response to the 1980s farm crisis. It became permanent in 2005. It permits family farmers and fishermen to reorganize under the supervision of a trustee, but without the burdens of Chapter 11. Farmers are to propose a plan within 90 days of filing and the court should have a confirmation hearing 45 days after that. Because Congress incorporated concepts from Chapter 11 and Chapter 13 in Chapter 12, its text is similar to corresponding Chapter 13 provisions and cases interpreting those sections are useful. Chapter 12 allows debtors some degree of flexibility. None of the statutes relevant to the Trustee's Plan Trust objection, §§1222, 1225, or 1227, prohibits creating the trust the debtors propose.

The Duensings rely on several § 1222(b) provisions. First, they note that § 1225(b)(7) allows a debtor to propose to pay a claim with property of the debtor or the estate. Second, § 1222(b)(8) allows the debtor to sell property and distribute the proceeds to creditors having an interest in the property or, in the alternative, to distribute property to the respective interest-holders in kind. Third, § 1222(b)(10) provides that the estate's property can vest in the debtors or "any other entity" at confirmation or "at a later time." Fourth, § 1222(b)(12) allows any other provision that is "not inconsistent" with the provisions of title 11.

The Duensings need time to meet their § 1225(a)(4) obligations while retaining control of their property. As they note, § 1227(b) allows the estate's property to vest in the debtor at confirmation or as the court otherwise orders. They assert that conveying the estate's property to the Plan Trustees has the legal effect of equitably transferring it to the creditors and that they are paying the unsecured claims by using estate property as § 1222(b)(7) plainly contemplates by having the Plan Trust make the second five-year tranche of payments.
The trustee responds that while § 1123(a)(5)(B) allows creditors' trusts in Chapter 11 plans, the lack of a parallel position in Chapter 12 bars using plan trusts there. That argument ignores Chapter 12's provisions that allow for vesting in others and permit any other plan provision that is "not inconsistent" with the provisions of title 11. Section 1123(a)(5) requires the plan proponent to provide "adequate means" for implementation of the plan "such as ..." suggesting that the ten subsections that follow are examples, without limitation, of means of implementation. Subsection (a)(5)(B) allows the transfer of any or all the property of the estate to one or more entities. That is like § 1222(b)(10)'s provision that allows the plan to vest property in "any other entity" at confirmation or "at a later time." Section 1227(b) provides that estate property revests in the debtor, "except as provided in the plan or the order confirming the plan." The payment of claims with property other than cash is contemplated by § 1222(b) as is the use of "not inconsistent with title 11" provisions. The trustee's "no trusts" argument fails.

**The Plan Trust transfer is not a balloon payment.**

The debtors say that when the Plan Trust receives the assets, their property is vesting in "any other entity" as permitted by § 1222(b)(10) and is a "balloon payment" in kind to the unsecured creditors. But that ignores § 1222(c). That section prohibits plans that provide for payments longer than 3 years unless the court approves a longer period, but the court cannot approve a plan period longer than five years. In this case, the debtors argue that all payments under the plan will be completed in five years, consistent with § 1222(c), with the final payment being the transfer of the operating assets to the trust. The plan itself recites that the unsecured creditors' payments will extend over 10 years with the Plan Trust making the final five years of payments.

Is the Plan Trust transfer really a "balloon payment?" A balloon payment is typically defined as a final payment "that discharges the principal balance of the loan." If making the payment is feasible, courts generally approve Chapter 12 and Chapter 13 plans that include balloon payments as the final plan payment. Those cases typically address secured creditors' treatment and consider numerous factors—

...including the future earning capacity and disposable income of the debtor, whether the plan provides for the payment of interest to the secured creditor over the life of the plan, and "whether the plan provides for substantial payments to the secured creditor which will significantly reduce the debt and enhance the prospects for refinancing at the end of the plan."  

Whether the Plan Trust transfer is a balloon payment turns on what the unsecured creditors will receive when that transfer is made. Will they be paid in full? No. The Plan Trust provides for the unsecured creditors to receive another five years of quarterly payments after the plan's completion. Will they own or possess the Plan Trust's corpus? No. The unsecured creditors become the beneficiaries of the trust with all attendant rights, but they are plainly not entitled to possess or sell the Plan Trust assets. All they will receive is a further promise: the promise of continuing payments.
and a cause of action for breach of trust "in the event that debtors misuse the Trust Assets." It is not clear that the creditors have any other recourse against the Plan Trustees or the debtors should they fail to pay. And, unlike a typical Chapter 11 liquidating trust scenario, no "liquidating" is in prospect. Rather, when the ten-year payment period ends, the Trust's assets will revert to the debtors. Calling the Plan Trust transfer a "balloon payment" is a stretch.

**The plan exceeds the § 1222(c) term limit.**

As the Plan Trust transfer is not the final payment, I am forced to conclude that the plan exceeds five years in duration. Section 1222(c) is similar to § 1322(d) in the Chapter 13 context. Judges Lundin and Brown note that § 1322(d), like § 1222(c), has only two statutorily-prescribed exceptions. One is in § 1322(b)(5) that allows for secured and unsecured claims to be paid over a period longer than five years (as does § 1222(b)(5)) and the other is in § 1322(b)(7) which allows the debtor to treat a lease that has been assumed under § 365 (as does § 1222(b)(6)). Courts uniformly reject Chapter 13 plans or modifications that propose payments after the five year period has expired. The Tenth Circuit Bankruptcy Appellate Panel has held that a modification that treated the first two years of Chapter 13 plan payments as a "lump sum" and then provided for an additional payment period beyond the initial five years could not be confirmed. Another court held in a Chapter 12 case that a plan modification that added on an additional five years of payment and extended the payment period beyond five years after the first payment was due under the confirmed plan violated § 1222(c) and couldn't be confirmed. Even closer to the case at hand is *In re Stone*, where the Chapter 12 debtor sought to modify a plan to make direct payments to creditors beyond the five-year period. Admittedly, we do not deal here with a modification, but the same confirmation requirements apply.

One can question the policy behind Chapter 12's five-year limit, but one cannot ignore the limit. Imposing the term limit in Chapter 13 "has been described as a protection for Chapter 13 debtors." Before modern Chapter 13 was enacted in 1977, former Chapter XIII debtors languished in plans for many years, "the debtors functioning in a sort of quasi-voluntary servitude to creditors." When Congress used Chapter 13 as a model for Chapter 12 nine years later, it hoped for prompt confirmation of a family farmer's plan while avoiding the expense, complexity, and delay that Chapter 11 posed for farm debtors and creditors alike. It isn't clear that

Congress sought to protect family farmers from "quasi-voluntary servitude." After all, farmers are no strangers to incurring and paying long-term debt in the ordinary course of their business. Nonetheless, because the Trustee has objected, the language of § 1222(c) requires me to deny confirmation of the Duensings' plan even though the debtors and their unsecured creditors might well benefit from the extended payment period it proposes.
III. Conclusion

The plan's proposed treatment of ECMC's student loan claims by directing plan payments be applied to principal is a permitted modification under § 1222(b)(2). Curing and maintaining payments on those claims beyond the five-year term is permitted by § 1222(b)(5). ECMC's objection to confirmation is overruled. But, as the plan's ten-year payment proposal violates the five-year limitation of § 1222(c), the plan cannot be confirmed over the Trustee's objection. The Trustee's confirmation objection is sustained, and confirmation is denied without prejudice to the debtors filing an amended plan within 21 days from the date of this order. Failing that, the case may be dismissed.

SO ORDERED.

SIGNED this 22nd day of February, 2019.

/s/
Robert E. Nugent
United States Bankruptcy Judge

Footnotes:

1. All statutory references are to the Bankruptcy Code, Title 11, U.S.C., unless noted otherwise. The Duensings appeared by their attorney David P. Eron. The Chapter 12 Trustee, Carl B. Davis, appeared in person. Educational Credit Management Corporation (ECMC) appeared by its attorney Larry Bork.

2. § 1222(b)(2).

3. § 1222(b)(11).

4. Doc. 78, p. 11. The student loan claims are therefore subject to the Plan Trust described above.

5. Id.

6. Id.

7. Claim 14 is in the amount of $3,907.72. This claim is comprised of $3,606.42 in principal and $301.30 of prepetition interest at 8.5%.

8. Claim 15 is in the amount of $21,407.69. This claim is comprised of $19,533.17 in principal and $1,874.52 of prepetition interest at 6.88%.

9. See Doc. 96-1.

10. See OMB No. 1845-0036 (FFELP Consolidation Loan Application and Note) at https://ifap.ed.gov/dpcletters/attachments/FP0705AttBCORRECTEDAppPNoteCustom.pdf, viewed Feb. 20, 2019, and OMB No. 1845-0069 (FFELP PLUS Loans Application and Note) at
According to the U.S. Department of Education Federal Family Education Loan (FFEL) Program website at https://www2.ed.gov/programs/ffel/index.html, "loans are no longer being made under this program."

11. See 34 C.F.R § 682.209(b)(2)(i).

12. OMB No. 1845-0036, p. 4; OMB No. 1845-0069, p. 2.

13. The Governing Law section of the Consolidation Note and the PLUS Note provide for "the terms of this Note" to be interpreted according to the Act [Higher Education Act of 1965 of which the FFELP is a part], other applicable federal statutes and regulations, and the guarantor's policies. OMB No. 1845-0036, p. 4; OMB No. 1845-0069, p. 2. Other "applicable federal statutes" would necessarily include the Bankruptcy Code. But here, the Court is not being asked to interpret the Notes.

14. OMB No. 1845-0069.

15. See 34 C.F.R. § 682.209(a)(7)(i).


17. See 34 C.F.R. § 682.209(e)(2)(iv).

18. Doc. 82.

19. § 523(a)(8) and § 1228(a)(2).

20. § 502(a)(2).

21. § 1222(b)(11) and § 1322(b)(10).

22. Bruning v. United States, 376 U.S. 358, 362-63 (1964) (nondischargeable tax claim). See also Leeper v. Penn. Higher Educ. Assistance Agency, 49 F.3d 98, 104 (3d Cir. 1995) (applying Bruning to nondischargeable student loan claim in Chapter 13); In re Cousins, 209 F. 3d 38 (1st Cir. 2000) (Chapter 12 debtors remained liable for postpetition interest on nondischargeable prepetition tax debt after completing plan payments); In re Williams, 253 B.R. 220, 227 (Bankr. W.D. Tenn. 2000) (Chapter 13 case recognizing that student loan creditor can't compel the payment of post-petition interest on its claim from the bankruptcy estate, but can compel payment from debtor after completion of the plan).


24. 34 C.F.R. § 682.209(b)(1).

25. 34 C.F.R. § 682.209(b)(2)(ii) (Emphasis added.).

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27. *Cerveny v. Aventis, Inc.*, 855 F.3d 1091, 1097-98 (10th Cir. 2017). Moreover, regulatory preemption is evaluated under a different standard than statutory preemption and courts are cautious in inferring an intent to preempt from the comprehensive nature of regulations. *Integrity Mgmt. Int'l, Inc.*, 836 F.2d at 492 (noting that regulations are specifically intended to flesh out the detail for implementing the legislation).


29. See *Kielisch v. Educational Credit Mgmt. Corp. (In re Kielisch)*, 258 F.3d 315, 324 (4th Cir. 2001) (referring to FFELP regulation on application of payments, 34 C.F.R. § 682.404(f) as "standard accounting practices").

30. 34 C.F.R. § 682.209(b)(1) provides that "the lender may credit . . . ."

31. See OMB No. 1845-0036, p. 4; OMB No. 1845-0069, p. 2.


33. See *In re NextWave Personal Communications Inc.*, 244 B.R. 253, 266 (Bankr. S.D.N.Y. 2000) (in finding the FCC violated stay by canceling Chapter 11 debtor's license under federal regulation, court stated the Federal Communications Act didn't preempt the Bankruptcy Code, which regulated conduct of FCC in its capacity as creditor, with debtor that has filed for bankruptcy relief).

34. U.S. CONST. art. I, § 8, cl. 4.

35. See *In re Woods*, 465 B.R. 196 (10th Cir. BAP 2012) (permitting Chapter 12 debtors to extend repayment term of secured creditor's loan beyond the life of the plan), rev'd on other grounds, 743 F.3d 689 (10th Cir. 2014); *In re Citrowske*, 72 B.R. 613, 617-18 (Bankr. D. Minn. 1987) (Chapter 12 debtor is not required to treat nondischargeable debt differently than dischargeable debts in plan); *In re Burnett*, 408 B.R. 233 (8th Cir. BAP 2009) (confirmed Chapter 13 plan determining principal amount of prepetition child support arrearage but reserving allowance of interest until after completion of payments did not preclude former spouse from returning to state court after discharge to determine and collect interest), aff'd in part, rev'd in part and remanded, 646 F.3d 575 (8th Cir. 2011); *In re Biege*, 417 B.R. 697 (Bankr. M.D. Pa. 2009) (where confirmed plan providing for payment of student loan in full but didn't provide for or prohibit accrual of postpetition interest, creditor's claim for postpetition interest was not discharged and confirmation did not prevent collection).

36. The Court's independent research found analogous payment modifications in Chapter 13 cases that courts have upheld as not violating § 1322(b)(2)'s anti-modification provision. See *In re Winston*, 416 B.R. 32, 39-40 (Bankr. N.D. N.Y. 2009) (permitting plan that required mortgage lender to apply direct mortgage payments to the month in which they were received (to prevent incursion of late fees) and noting that provisions dictating how the creditor shall administer the debt and apply payments were surplusage); *In re Emery*, 387 B.R. 721, 722, 725 (Bankr. E.D. Ky. 2008) (requiring mortgage lender to apply subsequent plan payments as though mortgage was current on date of confirmation did not impermissibly modify lender's rights in violation of anti-modification provision); *In re Watson*, 384 B.R.
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697, 704-05 (Bankr. D. Del. 2008) (permitting provision governing mortgage lender's allocation of payments); In re Collins, 2007 WL 2116416 at *14 (Bankr. E.D. Tenn. 2007) (permitting provisions requiring creditor to deem prepetition arrearage current as of confirmation as "merely procedural," and addresses the creditor's claims, not its rights).

37. Bloomberg Law: Bankruptcy Treatise, Pt. VI, Ch. 209, § IV.C. (Samir D. Parikh et al., Eds. 2018) (stating that only material limitation on modification is debtor's necessary compliance with § 1225's confirmation provisions).

38. 11 U.S.C. § 1225(b)(1)(A) and (B). See In re Rowley, 143 B.R. 547, 553-54 (Bankr. D. S.D. 1992) (once § 1225(b) is triggered by an objection from an unsecured creditor, one of two options must be incorporated into the plan to attain confirmation), aff'd 22 F.3d 190 (8th Cir. 1994). See also 11 U.S.C. § 1225(a)(1) requiring that the plan comply with all other provisions of Chapter 12 and Title 11 to be confirmed.

39. See note 22, supra.


41. This deficiency was the reason for creating the Plan Trust at the end of the 5-year plan term. See Doc. 98, p. 2.


43. Id. at 319.

44. Id. at 325.

45. ECMC also relies on dicta in Kielisch that leans on § 523(a)(8) to suggest that principal prepayment somehow "discharges" interest that has yet to be earned. While there's no question that accrued interest on nondischargeable debt is also nondischargeable, see Bruning, that interest must actually accrue in order to be so protected.


49. Doc. 78, p. 2.


51. §§ 1221, 1224.
§ 1227(b).

Payment, BLACK'S LAW DICTIONARY (10th ed. 2014).


Id. at 906.

Doc. 78, p. 2.

It is likely that the beneficiaries could obtain a court's order enforcing the terms of the trust and directing the trustee to perform its duties. See KAN. STAT. ANN. § 58a-1001(b)(1) (2005).

CHAPTER 13 BANKRUPTCY, 4th ed., § 202.1, at ¶ 3, Sec. Rev. June 15, 2004, www.Ch13online.com. Chapter 12 has one additional exception to the five-year term limit as expressly recognized in § 1222(c). Long-term secured claims may be paid over a period exceeding five years under § 1222(b)(9), but it is unavailable for paying unsecured claims.

In re Black, 292 B.R. 693, 700-01 (10th Cir. BAP 2003).


See § 1229(b)(1) and (c).


Id.


Having concluded that the plan as proposed cannot be confirmed, I do not reach the trustee's trust validity argument.
Chapter 6

Presentation Slides: Rethinking Cramdown Interest Rates in Chapter 11

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Disclaimer

The ideas in this presentation are offered to encourage discussion. They do not necessarily represent the views of any individual panelist and do not represent the views of the panelists’ institutions, colleagues, law firms or clients.
Introduction

- Key area of dispute in chapter 11 cramdowns is the plan interest rate on claims that the debtor proposes to pay over time.
- Very similar issues arise in cases under other chapters, especially chapter 13.
- Area is characterized by a mass of confused and confusing case law.
- Key case is Supreme Court’s decision in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) – a chapter 13 case involving a claim of $4,000 secured by a used pickup truck.
- Our presentation, which is based on our forthcoming article in the *American Bankruptcy Law Journal*, will review the current state of the law, then discuss problems with it and possible better approaches.

Statutory Provisions – Fair and Equitable Requirement

- In order for a plan to be crammed down (i.e., confirmed over the objection of a class of creditors that is impaired and has not accepted the plan), the court must find that the plan is “fair and equitable” to each such class. §1129(b)(1).
- Section 1129(b)(2) provides that the condition that a plan be fair and equitable to a class of secured claims includes meeting one of these tests:
  - Creditor retains its lien and receives “deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder’s interest in the estate’s interest in” the collateral; or
  - The collateral is sold free and clear of liens with the creditor’s lien attaching to the proceeds; or
  - Creditor receives the indubitable equivalent of its claim.

- "of a value, as of the effective date of the plan, of at least the value of such holder’s interest in the estate’s interest in" the collateral.

- This embodies a present value concept.

- Present value concept is captured in a plan by payment of interest.

- The cases generally speak in terms of interest rather than present value; however, it is helpful to remember that the statute refers to present value rather than interest rates.


- Chapter 13 case involving a claim of $4,000 secured by a used pickup truck.

  - Debtors’ proposed plan provided for 9.5% interest (arrived at by adding 1.5% risk premium to 8% prime rate).

  - Creditor argued it was entitled to 21% interest (the rate it claimed it could obtain by relending the amount of the secured claim in a loan of equivalent duration and risk).
Lower court decisions:

- Bankruptcy court followed the debtors’ “formula” or “prime+” approach and approved the plan’s 9.5% rate.

- On appeal, the district court reversed, following the creditor’s “coerced loan” approach and holding that the 21% rate was appropriate.

- On appeal to Seventh Circuit, a 2-1 majority followed a modified coerced-loan approach, holding that that the original contract rate should be the presumptive interest rate for cramdowns, subject to the parties’ presenting evidence that a lower or higher rate should apply.

Supreme Court – three opinions:

- Justice Stevens’ plurality (4 justices):
  - Adopted debtors’ formula approach, adding a “risk premium” to the prime rate. Noted lower courts have used a risk premium of 1 – 3%.
  - Rejected the presumptive-contract-rate, coerced-loan, and cost-of-funds approaches, primarily on the grounds that “[e]ach of these approaches is complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor’s payments have the required present value.”
  - Stated that the coerced loan approach “overcompensates creditors because the market lending rate must be high enough to cover factors, like lenders’ transaction costs and overall profits, that are no longer relevant in the context of court-administered and court-supervised cramdown loans.”
Till v. SCS Credit Corp. (cont’d.)

- Justice Thomas’s concurrence (1 justice)
  - Agreed that the debtor’s proposed rate was not too low, but for different reasons.
  - Argued that:
    - Cramdown interest payments need only compensate secured creditors for the time-value of money and inflation risk; therefore, “the appropriate risk-free rate should suffice.”
    - Relevant statutory language refers to the value of “property to be distributed under the plan,” rather than the value of the debtor’s promise to distribute such property in the form of future cash payments.

Till v. SCS Credit Corp. (cont’d.)

- Justice Scalia’s dissent (4 justices)
  - Argued that the cramdown rate should presumptively be the prepetition contract rate.
    - This is “generally a good indicator of actual risk” because it is the bargained-for rate for the very transaction that generated the claim.
    - Acknowledged that courts may make adjustments as needed based on the facts and circumstances of the case.
  - Harshly criticized the idea that there is any principled way for courts to make risk adjustments to the prime rate.
Till v. SCS Credit Corp. (cont’d.)

- The prime + approach is “a methodology that tells bankruptcy judges to set interest rates based on highly imponderable factors.”
- The 1.5% risk premium approved by the bankruptcy court is impossible to view “as anything other than a smallish number picked out of a hat.”
- “Today's judgment is unlikely to burnish the Court's reputation for reasoned decisionmaking.”

Recall that Till was a chapter 13 case. So what is Till's precedential value in chapter 11, if any?

- Plurality opinion refers to various present value provisions in the Code: “We think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions.”
- But, footnote 14 to the plurality opinion suggests in dicta that, in chapter 11, a court might determine whether there is an efficient market for loans similar to the secured claim in question and, if so, use the prevailing market rate or, if no such market exists, use the formula approach.

• "Till was a splintered decision whose precedential value is limited even in chapter 13. While many courts have chosen to apply the Till plurality's formula method under chapter 11, they have done so because they were persuaded by the plurality's reasoning, not because they considered Till binding.” In re Tex. Grand Prairie Hotel Realty, L.L.C., 710 F.3d 324, 331 (5th Cir. 2013).

• “…the opinion of five Justices makes the law of the land, but the opinion of four Justices makes interesting reading.” In re Cook, 322 B.R. 336, 344 (Bankr. N.D. Ohio 2005).
Circuit Court Cases after *Till*

- **In re American HomePatient, Inc.,** 420 F.3d 559, 567 (6th Cir. 2006)
  
  - Use the prevailing market rate to the extent that there exists an efficient market for lending a similar loan to a chapter 11 debtor; when such a market does not exist, use the *Till* prime+ formula approach.
  
  - Court gave no indication of what would constitute an efficient market, what evidence would be sufficient to establish that an efficient market existed, or how similar the loans available in the market would have to be to the creditor’s claim. Very few courts following *American HomePatient* have found an efficient market.
  
  - Also did not address the fact that a market rate would likely include components that both the *Till* plurality and concurrence believed should not be included—such as profit, transaction costs, and the lender’s cost of funds.

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Circuit Court Cases after *Till* (Cont’d.)

- **In re Tex. Grand Prairie Hotel Realty, L.L.C.,** 710 F.3d 324, 327 (5th Cir. 2013)
  
  - “We will not tie bankruptcy courts to a specific methodology as they assess the appropriate Chapter 11 cramdown rate of interest; rather, we continue to review a bankruptcy court’s entire cramdown-rate analysis only for clear error.”
  
  - “[W]e do not suggest that the prime-plus formula is the only—or even the optimal—method for calculating the Chapter 11 cramdown rate.”
Circuit Court Cases after Till (Cont’d.)

- *In re MPM Silicones, L.L.C.*, 874 F.3d 787, 793 (2d Cir. 2017)

  - Second Circuit held “that the lower courts erred in categorically dismissing the probative value of market rates of interest” and proceeding directly to the formula approach rather than first determining whether an efficient market rate existed.

  - Ultimately, although the legal reasoning may be different, all of the post-*Till* circuit court cases have concluded that *Till* does not require use of a formula approach based on the prime rate in determining cramdown rates in chapter 11 cases.

What about here in the 9th Circuit?

- In the Ninth Circuit, courts and litigants considering chapter 11 cramdown rates tend to dutifully discuss *Till*. See, e.g., the recent Ninth Circuit decision *In re Sunnyslope Hous. Ltd. Partnership*, 859 F.3d 637 (9th Cir. 2017), which gave a clear nod to the *Till* plurality’s formula approach.

- But many also point to one or more of three pre-*Till* Ninth Circuit decisions, all of which embrace various other iterations of a market rate approach:

  - *In re Camino Real*, 818 F.2d 1503 (9th Cir. 1987),

  - *In re Fowler*, 903 F.2d 694 (9th Cir. 1990), and

What about here in the 9th Circuit? (cont’d.)

- *In re Camino Real*, 818 F.2d 1503 (9th Cir. 1987):
  - Chapter 11 case involving rate to be paid on a federal tax claim.
  - The Ninth Circuit advanced a “case-by-case” analysis of “what interest rate the reorganizing debtor would have to pay a creditor in order to obtain a loan on equivalent terms in the open market.”
    - To make the necessary determination, a court “must consider the prevailing market rate for a loan of a term equal to the payout period, with due consideration of the quality of the security and the risk of subsequent default.”
    - “The debtor’s characteristics determine the interest rate. The creditor’s characteristics are irrelevant.”
    - Congress presumably intended the phrase [value as of the effective date of the plan] to have a single meaning all cases.”

What about here in the 9th Circuit? (cont’d.)

- *In re Fowler*, 903 F.2d 694 (9th Cir. 1990):
  - Chapter 12 case.
  - The Ninth Circuit explained that courts should “start… with a base rate, either the prime rate or the rate on treasury obligations, and add… a factor based on the risk of default and the nature of the security.”
  - The court echoed its earlier declarations in *Camino Real*, noting that “evidence of market interest rates for similar loans is relevant in arriving at the appropriate risk factor.”
  - Finally, the court recommended consideration of loan-to-value ratios, the location and type of property involved, the amount of the project that is leveraged, and even the cyclical nature of the real estate market.

- A B.A.P. decision in a chapter 11 case involving a commercial construction loan.
- The panel accepted a blended rate of 9.035%, which was based on two tranches:
  - a first level comprised of “market rate” loans made on then standard terms at 8.25% up to 70% of the $15,020,000 collateral value (70% loan-to-value ratio), and
  - a mezzanine level with a rate of 12% on amounts exceeding 70% of the collateral value.
- Neither party challenged the interest rate on appeal. The appeal was as to collateral valuation and other issues.

What about here in the 9th Circuit? (cont’d.)

- In a 2011 unpublished decision, the B.A.P. seemed to embrace Till’s famous footnote 14, explaining that, in deciding on an interest rate in a chapter 11 case, “a bankruptcy court should apply the market rate of interest where there exists an efficient market. And, when no efficient market exists for a Chapter 11 debtor, then the Bankruptcy Court should employ the formula approach endorsed by the Till plurality.” In re VDG Chicken LLC, 2011 WL 3299089, at *8 (9th Cir. BAP April 11, 2011).
- More recently, the B.A.P. cited VDG Chicken and applied the same analysis in a 2014 unpublished decision, In re Dunlap Oil Co., Inc., 2014 WL 6883069 (9th Cir. BAP Dec. 5, 2014).
- So how are trial courts in the Ninth Circuit wading through the morass?
9th Circuit Trial Court Decisions

- *In re North Valley Mall, LLC, 2012 WL 1071646 (Bankr. C.D. Cal. 2012)*, was especially detailed in its discussion of cramdown rates:
  
  - “[T]he plan cannot impose uncompensated risk upon the bank by paying too low an interest rate.”
  
  - “Of course, determining a sufficient rate of interest in any individual case depends on quantifying risk, which in turn depends on issues such as collateral value, credit history, term of the loan and the market rates.”
  
  - “A fixed rate such as proposed here creates its own quantum of risk because…a fixed rate of interest creates the possibility that, aside from risk of default, the market…may move to a more inflationary environment where the crammed-down creditor may be left illiquid and thus without the ability to reinvest its capital at currently prevailing rates.”

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**In re North Valley Mall, LLC (cont’d.)**

- “All risks must be identified and compensated to a reasonable degree; what the law seeks is that elusive equilibrium between the value of the funds invested in the plan through interest vs. the value to the creditor of being able to retrieve its capital for reinvestment elsewhere, or stated differently, the non-consenting creditor must receive a value under the plan not less than the value of its right to immediately foreclose upon its collateral.”

- “In both the literature and in many of the cases there is much unfortunate discussion of ‘market rates.’”

- “Markets such as they exist are but one reference point among many.”

- “Whatever implication could be drawn from the Till discussion of a possible 1-3% over the prime rate is tenuous at best in this case.”
In re North Valley Mall, LLC (cont’d.)

• The court mentioned Fowler and Camino Real only in a footnoted string cite, and, in the body of the opinion, questioned Till’s precedential value for Chapter 11 cases (whether in the Ninth Circuit or elsewhere).

• Nonetheless, the court agreed that it was necessary to utilize “some kind of a formula approach in order to approximate as nearly as is possible compensation for the risks that are proposed to be imposed upon the bank.”

• The court then turned to the “blended rate” approach used in Boulders, which it argued was most appropriate for commercial real estate cases.

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In re North Valley Mall, LLC (cont’d.)

• The court preferred the analysis advanced by the debtor’s expert, complimenting him for remaining “true to the blended rate approach...[by] extrapolat[ing] from other data including reference to the Korpacz Real Estate Investor Survey,” and for breaking the claim into three tranches, thereby making a “reasonable attempt to recognize that the level of risk changes depending upon whether a lender is at the 66% mark on the collateral, or the 99% mark.”

• These analytical steps were important because, as the court reminded the parties, the “blended rate approach is not merely a mirror of market conditions; rather, it is a principled derivation from current data of a proxy rate where no market currently exists.”
**In re North Valley Mall, LLC (cont’d.)**

- The exercise yielded a blended rate of 8.512% (which the court rounded to 8.5%), made up of the following three tranches:
  - Senior tranche (65% LTV ratio) at a 6.25% interest rate
  - Mezzanine tranche (20% LTV ratio) at an 11.18% rate
  - Equity tranche (15% LTV ratio) at a 25.18% rate

**9th Circuit Trial Court Decisions (cont’d.)**

  - The crammed down secured lenders pointed primarily to Fowler and Camino Real, arguing, among other things, that the debtor’s proposed plan interest rate of approximately 15% was too low.
  - However, the court sidestepped the cramdown rate question altogether, denying plan confirmation on feasibility grounds and for other violations of the fair and equitable standard, such as the fact that the debtor’s proposed plan would stretch out repayment of the secured claim over twenty years (the initial loan was for a two year term).
9th Circuit Trial Court Decisions (cont’d.)

  
  - The court cited *Till* and *Fowler*, concluding that it was required to apply the formula approach.
  
  - It approved a final interest rate of 4.5%, based upon an analysis that began with the prime rate (then 3.25%) and added total risk adjustments of 125 basis points, as follows based on the testimony of the debtor’s expert:
    - Nature of the security: Upward adjustment of 50 basis points,
    - Plan feasibility: Upward adjustment of 25 basis points, and
    - Plan duration: Upward adjustment of 50 basis points.
  
  - Apparently, the expert gave no explanation of how he arrived at these adjustments.

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A Possible New Approach to Cramdown Rate Determination

The balance of our presentation introduces a possible new approach that we describe in more detail in our forthcoming article.

This is NOT the current law.
Chapter 6—Presentation Slides: Rethinking Cramdown Interest Rates in Chapter 11

What should be addressed by the plan interest rate?

- What risks, costs, etc. should a secured creditor be protected against by the plan interest rate?
  - It is clearly appropriate for the rate to address:
    - Time value of money
    - Inflation
  - Others are not so clear:
    - Risk of deterioration in value of collateral
    - Risk of default in plan payments
    - Cost of foreclosing on collateral after default
    - Lost opportunity costs to re-lend at a market rate

What risks, costs, etc. should be addressed by the plan interest rate (cont’d.)?

- Time value of money and inflation.
  - A risk-free Treasury rate for a term equivalent to the plan term addresses these risks.
  - Compare rates on Treasury constant maturity securities vs. Treasury Inflation Protected Securities (“TIPS”). As of February 26, 2019:
    - 5 year Treasury constant maturity rate is 2.45%
    - 5 year TIPS rate is 0.63%
    - Suggests the market views the pure time value of money as 0.63% and the risk of inflation over 5 years as 1.82% per year.
  - Compare prime rate as of February 26, 2019 – 5.50%
What risks, costs, etc. should be addressed by the plan interest rate (cont’d.)?

- Other risks:
  - Deterioration in value of collateral
    - Why not address via adequate protection comparable to Bankruptcy Code Section 363?
    - Adequate protection payments can be applied to principal of claim rather than to interest.
    - If adequate protection fails, creditor can be given relief from stay to foreclose and it will have received payment of:
      - the principal amount of the secured claim (via foreclosure), plus
      - the time value of money for the delay in receiving it and for inflation during the delay (via the interest payments).

What risks, costs, etc. should be addressed by the plan interest rate (cont’d.)?

- Default in plan payments – why address via interest rate?
  - A higher interest rate increases rather than decreases the risk of nonpayment!
  - As long as the collateral value is sufficient, secured creditor’s receipt of its principal is assured.
  - Higher rate reduces the funds available to pay other creditors.
  - Why not address by allowing foreclosure on collateral if there is a plan default?
  - Note that, in risky lending markets, high interest rates on loans that do not default must compensate the creditor for losses on loans that do default. Why is that appropriate in the cramdown context?
### What risks, costs, etc. should be addressed by the plan interest rate (cont’d.)?

- **Costs of foreclosure:**
  - The risk that the creditor will have to incur costs of foreclosure should not be considered in setting the plan rate.
  - The plan could provide at the outset that the collateral will be abandoned by the estate on the effective date and the creditor would have to incur those costs. 7 COLLIER ON BANKRUPTCY ¶ 1129.04[2][c][i] (16th ed. 2018) (citing Sandy Ridge Dev. Corp. v. La. Nat’l Bank, 881 F.2d 1346, 1350 (5th Cir. 1989); In re Pennave Props. Assocs., 165 B.R. 793 (E.D. Pa. 1994)).
  - If it has to incur them after a plan default, as long as the collateral value has not deteriorated, the creditor is not harmed.

### What risks, costs, etc. should be addressed by the plan interest rate (cont’d.)?

- **Lost opportunity costs to re-lend at market rate:**
  - How does this risk apply to creditors that are not in the business of lending (e.g., tort creditors, tax creditors, consumer deposit creditors)?
  - Favors lenders that lend to high risk borrowers at high rates.
  - Ignores fact that high risk lenders are compensated for the risk by the high rates paid by performing borrowers (and defaulting borrowers prior to default).
  - Also ignores fact that statute refers to cash payments received under the plan, not on the value of the promise to make those payments.
  - Consider text of statute ("of a value, as of the effective date of the plan, of at least the value of such holder’s interest in the estate’s interest in” the collateral) - if Congress intended to require a plan rate equal to the market rate (or a prime plus rate for that matter), it could have said so much more clearly.
Is there a principled way for a court to set an appropriate risk premium within the 1% - 3% range?

- Justice Scalia’s dissent in Till argued that the 1.5% risk adjustment used in that case was nothing more than “a smallish number pulled out of a hat.”

  - Expert witnesses for the debtor and the creditor purported to evaluate the same five factors bearing on risk and came up with plan rates of 4.25% and 10.38%, respectively. If either expert had any way of determining the amount of the adjustment for each factor, the lengthy reported opinion does not describe it.

Is prime an appropriate base rate from which to adjust for risk?

- Most of the cases follow Till in using the prime rate as the base for the formula approach. This is problematic, for the following reasons:
  - In the financing market, the prime rate is used to price loans where the interest rate adjusts each time the prime rate changes; however, Till suggests using it to set a long-term fixed rate for the term of the plan.
    - A Treasury rate for a term equivalent to the plan term would be a more logical base rate. That approach was used by the bankruptcy court in In re MPM Silicones, L.L.C., but the Second Circuit rejected it. 874 F.3d 787, 798 (2d Cir. 2017).
  - The prime rate includes factors for profit and transaction costs, which the Till plurality said should not be included. It also includes some level of risk premium, whereas Treasury rates are the closest we have to risk-free rates.
  - Comparing the Treasury rate (2.45%) to the prime rate (5.50%) suggests that profit, transaction costs and risk premium more than doubles the risk free rate.
Is there a better approach?

- The Code requires that the plan be “fair and equitable.” It does not expressly require a formulaic approach.

- The phrase “fair and equitable” was used in several sections of the Bankruptcy Code’s predecessor statute, the Bankruptcy Act of 1898, as amended. The requirement was interpreted by the Supreme Court as intended to be flexible in nature and applied on a case-by-case basis in light of all relevant facts of a particular case.

  - “Practical adjustments, rather than a rigid formula, are necessary. The method of effecting full compensation for senior claimants will vary from case to case . . . [and] will be dependent on the facts and requirements of each case. So long as the new securities offered are of a value equal to the creditors’ claims, the appropriateness of the formula employed rests in the informed discretion of the court.” Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510, 529-30 (1941) (Douglas, J.), citing N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 508 (1913).

A possible new approach

- Ensure that the plan preserves the right of the creditor to foreclose on its collateral via adequate protection of collateral value, as appropriate.

- Set the plan interest rate using: (a) a risk-free base rate, such as the yield rate on a Treasury security with a term equivalent to the plan term, plus (b) an upward adjustment to the base rate based on express findings supported by appropriate evidence in respect of one or more relevant factors.

  - While the adjustment has some of the same uncertainty as the risk premium used in the prime plus approach, it has the following advantages:

    - It starts from a more appropriate base rate.

    - It excludes an amorphous concept of “risk” from the calculation.
What factors should be relevant to whether the plan rate includes an increase over the base risk-free rate?

- **Term of the plan:**
  - The longer the term of the plan (especially if it extends beyond the original maturity date of the debt), the fairer it seems to set a plan rate approximating the rate the specific debt would bear outside bankruptcy (such as a market rate, judgment rate, rate on tax claims, etc.).
  - A short term plan providing for the debtor to sell the collateral may not require any upward adjustment.

- **Inclusion of yield maintenance or default interest in principal amount of the claim:**
  - Such amounts may represent additional return to the creditor (especially in the case of yield maintenance, which assumes the creditor will only reinvest the loan proceeds at a Treasury rate of return). If these are included in the principal amount of the secured claim, a smaller upward adjustment is indicated.

Valuation of the secured claim based on replacement cost of the collateral:
- Note Justice Thomas’s argument in his *Till* concurrence that the creditor may also have benefited from the valuation of its secured claim at the replacement cost of the collateral to the debtor rather than at the liquidation value the creditor could obtain after foreclosure. *Till*, 541 U.S. at 489, citing *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997).
- The claim could be valued at a different valuation for purposes of setting the plan interest rate than for purposes of establishing the principal amount of the claim. See 4 *COLLIER ON BANKRUPTCY ¶ 506.03 (16th ed. 2018).*

- **How well-capitalized the debtor is:**
  - If the debtor is solvent and appears to be using bankruptcy process primarily to reduce its interest costs for the benefit of equity owners, it may be appropriate to require a plan rate equal to the prepetition contract rate.

- **Others?**
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Chapter 7

Chapter 7 and 13 Trustee Hot Topics

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DRAFTING AND CONFIRMATION ISSUES AS SEEN THROUGH
THE EYES OF THE CHAPTER 13 TRUSTEE

(The common errors discussed below are issues that will likely draw an objection to confirmation by the Trustee. Most of the errors are simple and should be corrected before the plan is filed with the court. Filing a plan that includes these problems will cause unnecessary work for both the debtors’ counsel, the Trustee’s office, and in some cases, creditors. Failure to correct by the initial confirmation hearing will likely result in an adjourned setting for the plan. Adjourning the confirmation hearings slow the payment for creditors and attorney fees. Eliminating these common errors will result in speedier disbursements, including attorney fees)

Revised January 14, 2019

CHAPTER 13 PLAN

(Numbers correlate to LBF 1300.17 & LBF 1350.17)

1. Use the correct plan form:
   a. For cases filed before 6/1/14 use 1300.05 (12/1/12)
   b. For cases filed after 6/1/14, use 1300.14 (12/1/16)
   c. For cases filed after 12/1/17, use 1300.17 (12/1/18) (new plan form)

   If you are filing a modified plan you must use the same plan form with which you started.

2. Be sure to date or include the docket number on the plan.
   Sometimes a debtor will file several plans, some pre and some post confirmation. Calendar dates have been and will continue to be used on the face of all plans. However, for 1300.17, the docket number for that plan must be used on the OCP. The plan date or docket number is simply an identifier so that when you are talking about a plan, there is no confusion about which plan you are talking. Make sure each succeeding plan has a new & different date or docket number. The date or docket number of the plan you wish to have confirmed, must be found on ¶ 1 of the Order Confirming Plan.

   REMEMBER: For the new plan 1300.17, docket numbers on the OCP will be used in place of the old calendar date system.
3. Issues concerning **feasibility** and **liquidation**. There are programs available to check for feasibility and liquidation (paragraph 4(h) best interest number). These programs are essential for proper drafting of Chapter 13 plans. Obtain copies by contacting Hung at hungn@portland13.com.

4. Use the **Standard Language Paragraphs** when an appropriate version is available. They are offered to facilitate consistency, commonality and ease of administration by the Trustee. While they should be tailored to meet your specific facts, they should retain as much of the original language as possible. Do not chop it to the point that it becomes useless or unrecognizable. The Standard Language Paragraphs are available at the Trustee’s web site: www.portland13.com. And, please do not attach a separate unrelated idea at the end of a Standard Language Paragraph. For that, use an additional paragraph number. If nonstandard provisions won’t fit on the plan form, you can reference an attached (“See Para. 12-15 on Attachment A”) and each attachment page should include the names of the debtors and case number (e.g. “In re Lotta Debts, Case No. 12-34567”).

**Plan Paragraph 1**

5. **Four boxes in the caption:** Always check the appropriate box. If the box is not checked, the relief sought will not be granted and an amended plan will likely be required. Checking a box when it is not warranted will require correction, i.e., do not mark “**motion to value collateral**” unless you are actually cramming down the value of collateral.

**Plan Paragraph 2**

6. Paragraph 2 sets the **“applicable commitment period”** If the plan is under median and will exceed 36 months, state the reason after “as follows”. If the plan is over median and will extend to the full 60 months, insert “applicable commitment period”

**Plan Paragraph 3(a)**

7. **Do not write confusing plan payments:** It is difficult to predict the exact time a plan will be completed. Consequently, leave plan payments open ended. For example, instead of $500 x 60, simply add $500; instead of $500 x 24, $600 x 36, simply add $500 x 24, $600 thereafter. If an expense found on 106J will be extinguished during the life of the plan, a step up
(increase of plan payment) of the amount of that no longer needed expense should be included. (See # 33 below)

8. Do not include pennies in any of the payments, both plan and creditors. Use whole dollar amounts only.

9. Paragraph 3(a) plan payment must include sufficient funds to pay the monthly scheduled payment of ¶ 4(b). The total per month (permo) payments in any given month cannot exceed the amount being paid into ¶3(a) for that month - Remember you must first deduct the Trustee's statutory commission from ¶3(a) before you begin. We see this error often when there is a change in either the plan payment or permo in ¶4(b), but it is not followed by balancing the plan payment and the permo together so they match up.

10. With a below median case, paragraph 3(a) plan payment must match at least the Schedule 106J (line 23c) disposable income. (If not, be ready to explain) Be careful of “trickle down” permo cases where all obligations under the plan have been met EXCEPT for a set permo claim which will carry on well past any other plan requirement. This will cause the plan length to extend longer that would otherwise be necessary.

Plan Paragraph 4 (b)

12. Define AAFAAF What does it mean? – Creditors don’t know. Spell it out with an asterisk: (*All available funds after attorney fees)

13. If you are curing an arrearage, you must put the amount of the arrears in the “Estimated Arrearage if Curing” column. If you are cramming down collateral, it must be in the “Collateral Value if Not Paying in Full” column. Do not put a collateral value in that column unless you are actually cramming it down. Use the correct column, i.e., don’t put a cram down in column labeled “Estimated Secured Claim if paying Secured Claim In Full” because you will be required to pay the full amount of the secured claim...AND you must include an interest rate. If it is zero, then add “0”.....AND you must include a Monthly Plan Payment.

14. Portland Only: Do not use a “permo” and “all available” or “all available after attorney fees” as one “periodic payment” in ¶4(b) (Use the split claim example, # 9 in the Standard Languages)
15. You cannot have a zero permo payment for collateral that has an interest rate. Each month’s permo must include enough to at least pay the interest due for that month. (Using the feasibility program will greatly assist you with this issue)

16. Impaired collateral (more is owed than its value - except principal residences *) must be paid through the plan in ¶4(b)(1). Paragraph 7 of the plan is for fully secured collateral paid outside the plan.

17. If there is negative equity in a ¶ 4(b)(2), 910 vehicle, be sure to account for it and use the formula set out in the Standard Languages #10.

18. “Paragraphs 4 (g) (h) & (i) should be completed. All blanks in the plan must be filled in, even if only with n/a.

19. If you decide to surrender collateral after it has been noticed out as being retained on the original plan, you must give notice to the creditor by adding it to ¶4(b)(4) and add 21 days to further object in ¶5 of the Confirmation Order.

Plan Paragraph 4(c)

20. Amount of fees and expenses remaining unpaid in the plan must match the attorney fee disclosure - LBF 1306........ and any fee agreement with the debtors must be attached. Be sure to check one of the boxes concerning supplemental compensation. Always check one of the other 2 boxes on how fees are to be paid. If you check the “other” box, it signifies you are requesting a monthly permo payment. In that event, you must disclose the amount you wish to be paid monthly.

21. Improper Service. Service upon certain creditors found in Paragraphs 4(b)(1) (under the “Collateral Value if Not Paying in Full” column) and 4(b)(2) (under the “Amount of Claim as Modified” column), and Paragraphs 5 and 6 must conform to FRBP 3012, 4003(d), 9014, and LBR 6006-1(b). For insured depository institutions, see FRBP 7004(b) & (h). Follow the instructions found at the bottom of the form plan under CERTIFICATE OF SERVICE.
Chapter 7—Chapter 7 and 13 Trustee Hot Topics

Schedule 106A/B

Part 1:
22. If a debtor owns a percentage of realty, include the full value under the “Current value of the entire property” and the value attributable to the debtor under “Current value of the portion you own?” Mark the boxes.

Part 2:
23. Always provide descriptive and accurate information, i.e., if an account receivable has no value, state the amount actually owed but say it is uncollectible and why. Make sure you list all bank accounts under 17 and their account numbers so the Trustee can match up the amounts with the provided bank statements. (Some listings call for assets that will be supported by documents – if you have an item listed under one of those numbers, bring the documents to the 341, i.e., if there is an annuity, the Trustee will be obliged to investigate that asset)

Schedule 106C

24. Use the full amount of all of your exemptions even if the value appears to be less than the exemption allowed. Be sure to note the recent changes in exemptions. You now may use either State or Federal exemptions. If you do not list an exemption, you cannot claim it. If you don’t possess the item to be exempted you can’t claim it. You cannot mix and match Federal and State exemptions. If using State, be sure to check the 2 year residency rule to find the correct exemptions. Some states require that the person using their exemptions actually be residents of the state when using. In such a case, the exemptions default to Federal Exemptions found in §522 of the Code.

Schedule 106D

25. The treatment of all secured creditors listed on Schedule 106D must be found somewhere in the plan. They should be somewhere in paragraphs 4b, 6, 7 or an added paragraph of the plan. Values of collateral should be consistent throughout Schedules 106A/B, 106D and the plan.
Schedule 106E/F

Part 1:
26. Be sure to list the entities and amounts entitled to priority and be sure to list the IRS and ODR to insure that they get service even if no claim.

Part 2:
27. Be sure to list all unsecured claims in alphabetical order and identify it in a way that it can later be matched with the claim that will be filed by that creditor.

Schedule 106I

28. There must be complete occupation information, including the complete address for any employer, and data concerning all wage earning members of the household and household dependents on Schedule 106J. If a debtor is self-employed, be sure to describe the occupation in the employment section.

29. Information regarding line 4 monthly gross income must closely match the pay stubs provided. Line 5 payroll deductions should closely match the pay stubs. If a debtor is self-employed, state whether the income is net or gross if there is no Exhibit D-2.

Schedule 106J & D-2

30. An Exhibit D-2 or detailed business statement attached to Schedule 106J is required if the debtor is self-employed or has income not reported on Schedule 106I. Filing one prior to the “first meeting” is very helpful. (Remember you are required to attach the most recent IRS 1040, Schedule C, to the D-2 or attach an explanation why it is not there and if you list a business expense on Schedule 106J, you must “attach a detailed list”)

31. If more income than is shown on pay stubs is discovered during the Trustee’s initial review, do not file an amended Schedule 106I with the added income and a Schedule 106J with the newly discovered expenses and the exact same bottom line unless instructed to do so. (That is viewed by the trustee as prima facie expense and plan payment manipulation)

32. DSO, auto, 401K loan repayments or other payments that might complete before the applicable commitment period should be identified with the balance and number of months remaining to completion. The Trustee
will be looking for a stepped up ¶3(a) payment or explanation why not. Come to the 341 prepared with this information.

33. Do not list an auto payment or other collateral on both Schedule 106J and in ¶4(b). You cannot pay both inside and outside the plan on the same collateral. That would constitute “double dipping” from the disposable income.

34. If collateral is being paid outside in paragraph 7 of the Plan, the payment must appear on Schedule 106J.

35. Large charitable contributions must be accompanied by #14 of the Standard Languages. If there is any question about whether the added language is required, it will be discussed at the 341 meeting.

**Form 107 SOFA**

36. Information regarding closed accounts, potential avoidable transfers and fraudulent transfers, i.e., must be specific. If there is a potential preference, come to the 341 prepared with the proof of the garnishment, the actual dates and the name and address of the transferee along with any relevant pay stubs.

**Form 122C-2**

37. Use the current Means Test numbers. They can be found at: http://www.justice.gov/ust/eo/bapcpa/meanstesting.htm

**ORDER CONFIRMING PLAN**

38. Use LBF 1350.17 (12/1/17)

39. Plan Docket # in paragraph 1 must match the docket number on the plan you wish to have confirmed.

40. The numbers in paragraph 3 - attorney fees - must match the Debtor’s Attorney’s Disclosure of Compensation - LBF 1306 (12/1/17)

41. Paragraph 2 must include the name and service address of any creditors whose liens are being avoided in paragraph 6 of the plan.
42. Send the OCP as a fillable PDF file to precon@portland13.com. New LBR 3015-3 (c)(2) requires the OCP to be submitted to the Trustee no later than 21 days after the 341 is concluded. REMEMBER: We now have a “fast track” option to eliminate the need for counsel to appear in court. If you are sending OCPs with an “/s/” you are representing to the court that you possess an image of the signature or an electronic signature (see LBR 9011-4(b)).

Other Issues

43. Tax certificates: If the Oregon Department of Revenue (ODR) has filed an objection to confirmation and no withdrawal has been filed, a tax certificate may be filed in lieu of a withdrawal IF the attorney signing the certificate has seen the returns, can verify that the returns have been filed and can state the amount of any liabilities. Be sure to identity both the priority and non-priority amounts.

44. Do not email, call, fax or send documents shortly before the 341 meeting. If they haven’t been sent at least one week before the meeting, bring them to the meeting for inspection. In addition, if you have not sent us the required documents before the 341, wait until after you get our objection before you send anything additional.

45. Do not forward anything but $ to the lock box in Memphis, Tennessee. All the $ goes to Memphis and everything else comes to the Portland office.

46. Do not send documents directly to the Trustee or one of the Trustee’s staff unless specifically requested to do so. For pre confirmation matters, use precon@portland13.com and for post confirmation matters, use postcon@portland13.com Any 341 reset requests must be in writing and sent to the Precon email address only.

47. Read any materials before you send them to the Trustee’s office. Too often materials (pay stubs, bank statements and tax returns) are sent when it is obvious that they have not been previously reviewed by debtor attorneys. And be mindful that the Trustee’s mail server will not accept emails that exceed 5MB in total w/attachments. And separate each category, i.e., tax returns; bank statements; paystubs into individual PDFs.

48. Communicate with your client. Too many debtors arrive at the 341 having no idea when the first plan payment is due or what questions will be
asked. This process is stressful enough. Your clients will be far more at ease if they have an understanding of what is about to occur. Coach them before they appear. You will relieve stress and the 341 will be much smoother for everyone. If you are using a “substitute attorney” be sure that substitute understands the case and can answer any questions that might arise. If the substitute cannot effectively answer questions, the meeting will be reset causing needless issues with your debtors and the trustee’s office.

49. Use the feasibility and liquidation programs! Those attorneys who do are far more successful than those who do not. And they are free,...just ask. Obtain copies by contacting Hung at hungn@portland13.com.

50. Don’t send documents or anything requested by the trustee’s office late Wednesday or Thursday mornings before Thursday morning initial confirmation hearings. When they are received that late, they may not be reviewed in time for court and the case likely will require a set over.

**USE MY WEB SITE: www.portland13.com**
SUGGESTED LANGUAGE PARAGRAPHS

Revised Date: February 1, 2019

The following additional paragraphs are offered as examples for specific factual circumstances that require additions to a Plan as separate paragraphs. They are offered to facilitate consistency, commonality and ease of administration by the Trustee. While they should be tailored to meet your specific facts, they should retain as much of the original language as possible. In some instances, the Trustee will insist they be used exactly as written below. The suggested text is set out in bold.

Do not add an additional non related idea into one of the Suggested Paragraphs. If you have an additional concept, to avoid confusion and the possibility it will be missed, set it out with an additional and separately numbered paragraph.

Definition:

“Permo” means per month. Commonly used to define a particular monthly payment

1. SPECIFIC INSTRUCTIONS FOR PARAGRAPHS 3(d) & (e)

A. Paragraph 3(d) is for the inclusion of a lump sum when the amount and approximate date of receipt is known. The Trustee's office must know the source of the funds which must be included in the text, either in a separate paragraph at the end of the plan with reference to paragraphs 3(d) or in 3(d) itself. For example, “$8,000 on 8/2010 through a withdrawal from debtor’s 401k fund” or “$8,000 to be provided by a gift from debtor’s uncle.”

B. Paragraph 3(e) is for funds not found in any other part of Paragraph 3. For example, funds that may be brought into the plan but the certainty and timing are unknown at confirmation. Again, the Trustee's office will require information disclosing the source of the funds, i.e. “and any nonexempt proceeds from personal injury suit detailed on Schedule B.”

NOTE: Unless specific directions to the contrary are included in the confirmed plan, all of paragraph 3(b) - (e) receipts, will be disbursed to paragraphs 4(c) - (e) if balances are owed. If it is the intent that any funds from paragraphs 3(b) - (e) are to be disbursed to 4(b) secured creditors, “All available funds” must be used (either before or after attorney fees) or
specific directions that will not create an administrative burden on the trustee.

NOTE: Once specific set amounts (permos) are paid in paragraph 4(b), the plan dictates that any additional funds each month are to be paid to paragraphs 4(c) – (j)

2. SALE OR REFINANCE OF REAL PROPERTY

If the Plan proposes a sale or refinance of real property, a separate paragraph with specific language outlining the sale details and distribution of the proceeds must be added. If the sale or refinance is expected to net a distribution from paragraph 3 of the Plan, subsection (e) of that paragraph should so state. Individual creditors may require additional language as a condition to the withdrawal of Objections to Confirmation.

EXAMPLE:

Paragraph 3(e) "proceeds from the sale or refinance of real property as outlined in paragraph 14"

Paragraph 14 "The debtor(s) shall sell or refinance (adequately describe property) not later than (date) and shall pay to the Trustee from the proceeds at closing, funds sufficient to pay all creditors secured by the subject property remaining in the plan. Secured creditors are _______________. Debtor(s) shall also pay to the Trustee for distribution through the Plan, non- exempt proceeds to the extent required by the Trustee’s payoff quote. The debtor(s) shall obtain the Trustee’s permission prior to any sale or refinance and to obtain that permission, provide copies to the Trustee of a preliminary closing statement and title report. The debtor(s) shall provide the Trustee with a copy of the final closing statement within 15 days following the close of the sale or refinance. “

REMEMBER: If the sale or refinance is to complete the case and it occurs within the “applicable commitment period”, it will require a 100% payoff.

3. SALE OF PERSONAL PROPERTY

If the Plan proposes sale of personal property, the proceeds of the sale should be referenced in one of two ways. 1) in Paragraph 3(e) with a corresponding separate paragraph providing specific details of the sale (see
example below); or 2) if funds have already posted to the debtor’s receipt ledger or receipt of the funds are imminent, simply include the sale amount in paragraph 3(d)

**EXAMPLE:**

Paragraph 3(e): "proceeds from the sale of horses as outlined in paragraph 14."

Paragraph 14: "The debtor(s) shall sell their six horses and pay all nonexempt proceeds of the sale to the Trustee. Within fifteen (15) days of the sale, debtor(s) shall file a report with the Trustee detailing the property sold, the selling price, the name, phone number and relationship, if any, of the purchaser, along with details of any retained proceeds claimed as exempt.

4. **LIEN STRIPPING**

When it is the intention of a plan to “strip” off a fully under secured lien on the debtors’ residential property, the following language should be added to the plan by separate paragraph.

“Pursuant to §506, and within 60 days after confirmation, debtor(s) will file an adversary proceeding or motion to avoid the junior lien held by _____________ in the real property located at _____________ . Entry of the Order Confirming Plan is not res judicata with respect to this lien. Any Judgment or Order avoiding such lien shall be void and such lien shall be reinstated if the case is dismissed or converted. If the lien creditor has filed a secured claim and the lien is avoided, the claim will be treated as an allowed unsecured claim.”

In the event the junior lien payment is included on Schedule J, the following language must be added:

“Any payments scheduled for the junior lien shall be paid into the trust fund of debtors’ attorney until such time as the adversary is decided. In the event that the junior lien is stripped off, those funds shall immediately be paid to the Trustee for distribution through the plan, pursuant to paragraph 3(e) and an amended schedule J filed without the payment listed and the plan payment increased accordingly. In the event that the junior lien is not stripped off, the appropriate
funds shall be forwarded by debtors’ attorney to the lien holder with any excess forwarded to the Trustee.”

If this language is added, paragraph 3(e) of the plan must include the following: "any proceeds from the attorney trust fund account as outlined in paragraph ____.

5. **EXEMPTING EARNED INCOME CREDIT**

You must either exempt the EIC on Schedule C pursuant to §18.345(n) or, add the following as a separate paragraph:

“Notwithstanding the provisions of Paragraph 3(c) of this Plan, debtor(s) shall not be required to pay any Earned Income Credit funds to the Trustee during the life of the Plan.”

6. **OVERTIME, BONUS OR COMMISSION INCOME**

(To be used where the debtor or the trustee feels that the inclusion of the additional funds should be added as projected disposable income)

NOTE: Use only whichever of the three possibilities fit the circumstances of your case. If the debtor will receive only overtime, just add overtime, if only bonuses add only bonuses and so forth. Do not copy all three possibilities if they are not present in the case. Also be aware that there are differences in the amount to be paid into the plan between overtime, bonuses, and commissions.

**OVERTIME**

"During the life of the Plan, the debtor(s) shall pay to the Trustee, during the month of receipt one third (1/3) of any gross overtime wages. Debtor(s) must make such payments by separate money order or cashier check and state on the check “Overtime”. At the end of each calendar year during the life of the Plan, the debtor(s) shall provide the Trustee with a copy of the year end pay stub for each employment during that year. Should the debtor not provide this information, the Trustee may calculate the additional overtime amounts based upon the difference between the tax returns and the most recent Schedule 106I and add the calculated amount to the plan base. Debtor(s) must pay the amount of this calculation into the plan prior to receiving a discharge."
BONUSES

(Note: There is a difference in the amount to be paid if the bonus is based upon the performance of the company as a whole or based upon individual performance)

1. Company as a Whole

"During the life of the Plan, the debtor(s) shall pay to the Trustee, during the month of receipt all bonuses, less any tax obligations. Debtor(s) must make such payments by separate money order or cashier check and state on the check “Bonus Earnings”. At the end of each calendar year during the life of the Plan, the debtor(s) shall provide the Trustee with a copy of the year end pay stub for each employment during that year. Should the debtor not provide this information, the Trustee may calculate the additional bonus amounts based upon the difference between the tax returns and the most recent Schedule I and add the calculated amount to the plan base. Debtor(s) must pay the amount of this calculation into the plan prior to receiving a discharge.”

2. Individual Performance (The 1/3 division is to provide incentive to debtors to perform well. (1/3 to taxes, 1/3 to creditors and 1/3 to the debtors)

"During the life of the Plan, the debtor(s) shall pay to the Trustee, during the month of receipt one third (1/3) of all gross bonuses received. Debtor(s) must make such payments by separate money order or cashier check and state on the check “Bonus Earnings”. At the end of each calendar year during the life of the Plan, the debtor(s) shall provide the Trustee with a copy of the year end pay stub for each employment during that year. Should the debtor not provide this information, the Trustee may calculate the additional bonus amounts based upon the difference between the tax returns and the most recent Schedule I and add the calculated amount to the plan base. Debtor(s) must pay the amount of this calculation into the plan prior to receiving a discharge.”

COMMISSIONS

"During the life of the Plan, the debtor(s) shall pay to the Trustee, during the month of receipt one third (1/3) of all gross commissions.
Debtor(s) must make such payments by separate money order or cashier check and state on the check “Commission Earnings”. At the end of each calendar year during the life of the Plan, the debtor(s) shall provide the Trustee with a copy of the year end pay stub for each employment during that year. Should the debtor not provide this information, the Trustee may calculate the additional commission amounts based upon the difference between the tax returns and the most recent Schedule I and add the calculated amount to the plan base. Debtor(s) must pay the amount of this calculation into the plan prior to receiving a discharge.”

Note: If any of the three possibilities (overtime, bonuses and/or commissions) are already included on Schedule I, insert the following additional language in the paragraph above at the end of the first sentence. “over and above the ___________ of $ ______ already listed on Schedule I.”

7. REQUIREMENT TO PROVIDE TAX INFORMATION TO THE TRUSTEE

Quarterly returns:

“Debtor(s) shall provide to the Trustee copies of quarterly IRS Form 1040ES, 941, along with proof of payment. Copies shall be submitted to the Trustee within 30 days of filing with the IRS.”

All returns:

“During the life of the plan, the debtor(s) shall timely file all required tax returns or valid extension and provide to the Trustee, not later than May 15th of each year, copies along with proof of payment. Should the debtor(s) fail to provide said proof to the Trustee, the Trustee may file a Motion to Dismiss pursuant to §1307(c), which will be duly considered by the Court after notice and a hearing.”

8. PAYING LESS TO CREDITORS THAN TO ATTORNEY FEES

In some instances, the amount proposed for attorney fees exceeds the proposed amount paid to creditors. If the debtor has a previous Chapter 7 that, due to the time restraints §727(a)(8), prevents the debtor from a subsequent Chapter 7 filing, and the plan proposes to pay more for attorney fees than the amount to creditors, such a case is perceived as a disguised
Chapter 7. Such a scenario will draw an objection to confirmation from the Trustee. The objection will read essentially as follows:

*The Trustee objects to a Plan that proposes to pay $4,000 in Administrative fees and only $1,330 to the creditors.*

In such a case, add a paragraph to the plan that corrects the imbalance or reduce the attorney fees to the amount being paid to the creditors.

Example paragraph: “The debtors shall pay not less than $4,000.00 to the non-administrative creditors during the life of the Plan”.

9. **SPLIT CLAIMS IN PARAGRAPH 4b FOR PAYMENT OF ADEQUATE PROTECTION AND ALL AVAILABLE FUNDS ON A SINGLE PIECE OF COLLATERAL**

In some instances, attorneys feel it necessary to pay adequate protection payments on collateral that is being paid through paragraph 4b(1) and, at the same time, facilitate early payment of attorney fees. The attorneys may also want to provide that any tax refunds or other “extra” funds paid into the plan go to that same collateral in order to expedite payment. Under the current computer configuration, the Trustee is unable to administer a single periodic payment that calls for a fixed permo (per month) payment and all available funds, i.e. “$100 and then all available funds”.

To remedy this dilemma, the Trustee can administer a “split claim” that splits the collateral into two separate claims, one to guarantee adequate protection at a rate agreed upon and one that will allow all other funds to go to that creditor as quickly as possible after paying the allowed attorney fees.

Example:

Creditor: United Finance - Collateral: 1997 Honda – Value $10,000 – Post confirmation Interest Rate 9%

Paragraph 4b(1) should read:

<table>
<thead>
<tr>
<th>Creditor</th>
<th>Collateral</th>
<th>Estimated Arrangement if Curing OR Collateral Value if Not Paying in Full</th>
<th>Estimated Secured Claim if Paying Secured Claim in full OR Post-confirmation interest rate</th>
<th>Monthly Plan Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Finance</td>
<td>1997 Honda (Same Vehicle)</td>
<td>$2,000 $8,000</td>
<td>$6%</td>
<td>AAF AAF *</td>
</tr>
</tbody>
</table>

* All available funds after attorney fees
It is critical that the Trustee be informed that the split claim is for the “same vehicle” and not two different vehicles with the same creditor. It is also critical that the periodic payment for the fixed “permo” payment be open ended as in the example above. DO NOT set the number of months.

10. **NEGATIVE EQUITY**

If a “910” vehicle (purchased within 910 days before filing) has “negative equity” factored into the retail sales agreement (an amount paid by the dealer for the balance owed on a trade-in at purchase of a replacement vehicle), it must be brought into the plan in paragraph 4(b)(2). In re Penrod, 611 F3d 1158 (9th Cir. 2010)(cert. denied, 132 S. Ct. 108 (2011)). See also, In re Riach, 2008 WL 474384 (Bankr. D. Or.) The “negative equity” amount must be deducted from the claim and the amount to be paid on the claim appropriately reduced.

The following example illustrates the formula:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount financed</td>
<td>$25,000</td>
</tr>
<tr>
<td>“Negative equity”</td>
<td>$3,000</td>
</tr>
<tr>
<td>PMSI percentage</td>
<td>88%</td>
</tr>
<tr>
<td>Amount of claim on filing date</td>
<td>$21,000</td>
</tr>
<tr>
<td>Actual PMSI debt (PMSI % x Debt at filing)</td>
<td>$18,480</td>
</tr>
<tr>
<td>Replacement value</td>
<td>$17,500</td>
</tr>
</tbody>
</table>

When negative equity is present, and the actual PMSI debt is more than the current replacement value of the automobile, the amount paid (in the example above, $18,480) should be included in paragraph 4(b)(2) under the column “Amount of Claim as Modified (Value of Collateral)” with a notation that states: “Amount of claim reduced to 88% for negative equity and the remainder treated as an unsecured claim”.

11. **FUTURE EMPLOYMENT**

For debtors who are unemployed at the first meeting, but are seeking or foresee the possibility that they will become employed during the life of the plan, the following should be added to the plan:
“Debtor(s) shall provide the Trustee with one (1) month of pay stubs and amended I & J Schedules within 60 days of gaining employment.”

12. FUTURE AUTOMOBILE PURCHASE

If the debtors propose to purchase an automobile within 6 months of confirmation and need to budget the funds to accumulate a down payment, the following paragraph must be added to the plan along with the proposed auto payment on Schedule J.

"Debtor(s) shall pay ($       ) per month, for a maximum of (6) months, into the trust fund of debtor(s) attorney for the future purchase of a necessary automobile. Any purchase must be made from those funds within (6) months from the date the first payment is due under the Plan. If for any reason the purchase is not consummated within that time, the budgeted funds so set aside will be forwarded to the Trustee for distribution under the Plan and the debtor(s) plan payment in paragraph 3(a) will be recalculated and increased in an amount equal to the amount of the proposed automobile payment. The Trustee is authorized to submit an Order Modifying Plan to account for any such adjustment. Debtor(s) attorney will monitor the payments and inform the Trustee immediately should the debtors fail to make any such payment."

13. FUTURE CHARITABLE CONTRIBUTIONS IN A PLAN

“Debtor(s) shall provide to the Trustee proof of any charitable contributions made during the life of the Plan. Proof shall be in the form of debtors' cancelled checks, or receipts/statements provided by the recipient and shall be presented to the Trustee no later than each March 1st during the life of the Plan. In the event such proof cannot be provided, in whole or in part, the debtor(s) shall pay to the Trustee for distribution through the Plan, a sum equal to the difference between the charitable contributions listed on Schedule J and those contributions which can be proven.”

14. HIGH HOME MAINTENANCE EXPENSES (repairs and upkeep)

If the Schedule J home maintenance expenses are unusually high, the Trustee may request that the following language be added to the plan:
“Debtor(s) shall provide to the Trustee before discharge, proof of expenditures made for the home maintenance found on Schedule J. That proof shall include supporting documents for the expenditures actually made. In the event such proof cannot be provided, in whole or in part, before any discharge is granted, the debtor(s) shall pay to the Trustee for distribution through the plan, a sum equal to the difference between the maintenance expenditures claimed and those expenditures which can be proven.”

15. **DISCOVERED INCREASED INCOME**

If unreported increased income received by the debtors during the applicable commitment period is determined by the Trustee to be a necessary addition to the plan base, the following language should be added to the plan by separate paragraph:

“To account for unreported increased income received by the debtor(s) during the period of ____ through ____ , the debtor(s) shall pay an additional $_____ to the Trustee for distribution through the plan. Debtor(s) shall make such payment(s) by separate money order or cashier check stating the paragraph to which it applies.”

Add to paragraph 3(e) “plus proceeds as set out in paragraph ____”

16. **FAILURE TO MAKE PLAN PAYMENT “DROP DEAD”**

On those occasions where it is Ordered that the debtors shall make all scheduled plan payments and failure to do so will result in dismissal upon the filing of a “Trustee’s Statement Of Failure To Comply,” the following language should be added to the OCP, Amended Plan or Stipulated Order:

Add as paragraph__: “Debtor(s) must make all payments which are due under the current Chapter 13 Plan, for the (number of months) period beginning (month) (year), or the Court shall dismiss this Case upon the filing, by the Chapter 13 Trustee, of a *Statement of Failure to Comply* reciting to the court that Debtor(s) failed to make the required Plan payment(s). If Debtor(s) are on a wage order, the Trustee will give Debtor(s) and Debtor(s’) counsel 10 day’s notice prior to filing the *Statement of Failure to Comply*. During this period, the debtor(s) personally are to pay the required plan payments to the Chapter 13 Trustee for any month where any employer, required to so pay, fails to do so.”
17. ALTERNATIVE TO THE TRUSTEE’S PURSUIT OF A PREFERENTIAL or FRAUDULENT TRANSFER

“The Trustee will not pursue the preferential or fraudulent (choose appropriate) transfer to ___________ if debtor(s) pay an additional $_________ to the Trustee for distribution through the Plan to unsecured creditors. This amount shall be in addition to any paragraph 4(h) distributions projected for the unsecured creditors pursuant to the confirmed plan and shall be in addition to any tax refunds due. Additionally, the transferee must sign and return a tolling agreement extending the statute of limitations period for recovery of the preference. As a condition to confirmation, the debtor will assist the Trustee in obtaining the tolling agreement.”

If the debtor(s) are willing to reduce a budget already deemed “reasonable” by the Trustee, and will increase their plan payment to account for the preference or fraudulent transfer over the life of the plan, substitute the following language:

“The Trustee and debtor(s) agree that in exchange for the Trustee not pursuing the preferential or fraudulent (choose appropriate) transfer to ___________ the debtor(s) will increase their plan payment by $_________ to pay the amount of the transfer over the life of the plan. In doing so, the amount of the transfer will not be included in the plan base.”

18. CO-SIGNED CLAIMS

If you intend to protect a co debtor pursuant to Section 1301, you must add a separate paragraph to the plan as follows:

“To protect a co-debtor, the Trustee shall pay the allowed unsecured claim (state amount of claim) of (name of creditor) in full with (%) in the amount of $_____ per month concurrently with any secured creditors. In the event there is a “best interest number” in paragraph 4(h), that number will be distributed to all unsecured creditors, including (name of creditor) pursuant to §1325(a)(4) notwithstanding any distribution to the co-debtor payments”

If you elect to use this section, prior to the first meeting of creditors, send the Trustee evidence that the co debtor is in fact, liable on the debt with the debtor pursuant to §1301(a). And be prepared under the BAP case of In
re Renteria, 470 BR 838 (9th Cir. BAP 2012), to justify why this paragraph does not unfairly discriminate against the other unsecured creditors.

19. §1305 CLAIMS IN PLAN

If the claim is to be included in the original plan, add the following:

“Trustee shall pay any allowed claim through the plan filed pursuant to §1305 for (name of creditor) in the same manner as if the claim had arisen before the filing of the petition.”

In the event the debtors desire to include a §1305 claim in any post confirmation modified plan or when added to an original OCP where no prior notice been given to creditors or parties in interest, add the following to the above:

“This claim is to be paid after all paragraph 4 creditors are paid in full pursuant to the confirmed plan. This claim shall not diminish any paragraph 4(h) distributions projected for the general unsecured creditors pursuant to the confirmed plan.”

20. AGREEMENT TO RETAIN OBJECTIONABLE INCOME AND/OR BUDGET ENTRIES IN EXCHANGE FOR 100% NON-MODIFIABLE PLAN OR ADDITIONAL AMOUNT TO UNSECURED

Under certain circumstances, the Trustee may waive objections to otherwise excessive and objectionable income and/or budget items if the debtors are willing to propose a Paragraph 4(g)(2) “minimum” 100% non-modifiable plan. In that eventuality, the trustee will require that the debtors agree to the following non modifiable paragraph to guarantee that the debtors will not later renege and file a modified plan which reduces the 100% minimum. If, after this language is added, the debtors propose a modified plan that is less than 100%, the Trustee will enforce this provision to the extent that the unsecured creditors be made whole and receive at least as much as they would have received had the objectionable item(s) been removed in the original plan. (Fill in the parenthesis)

“In exchange for the waiving of the Trustee’s objection to Confirmation due to (i.e., excessive budget items, retained collateral not necessary for reorganization, _________) the debtor(s) agree that the provision of ¶ 4(g)(2), “100%” is non-modifiable”
If the Trustee objects to a particular expense deemed not necessary for reorganization and the debtor(s) wish to retain the expense, if the Trustee is in agreement, the following additional paragraph may be added to insure the unsecured creditors are made whole.

“In exchange for the waiving of the Trustee’s objection to confirmation regarding the (insert description of the expense), the debtor(s) agree to pay and additional (state the agreed amount) to the non-priority unsecured creditors over and above the amount determined at confirmation. The amount determined at confirmation is (state amount determined for the unsecured at confirmation). If that amount is later changed by an amended plan, the (state the agreed amount) will still be required over and above any amount determined by any amended plan.”

21. IMPROPER PERFECTION

Whenever there is a § 547 perfection issue (usually a car), the following language should be added as a separate paragraph:

“Pursuant to §547, the Trustee may proceed to avoid the alleged improperly perfected lien of (lien holder). Payments scheduled in paragraph 4 shall be paid to the trust fund of debtors’ attorney and held in trust until such time as the 547 action is determined. Payments scheduled in paragraph 4(b) will be held by the Trustee until such time as the 547 action is determined.

If the Trustee is successful, the debtor(s) will amend the plan to increase the best interest of creditors test accordingly and to provide payments to the Trustee in lieu of (lien holder). If the Trustee is not successful, any payments held in the debtor attorney trust fund or being held by the Trustee, will immediately be forwarded to the lien holder.”

22. ONGOING MORTGAGE PAYMENTS THROUGH PLAN

On those occasions where the ongoing mortgage payment is proposed to be paid through the plan, add the mortgage payment to the paragraph 3a plan payment, remove any reference of the payment from paragraph 7, make the reference in paragraph 4b1 shown below and add an additional paragraph to the plan using the paragraph below as a guide: (Fill in the parenthesis)
Example:

<table>
<thead>
<tr>
<th>Creditor</th>
<th>Collateral</th>
<th>Estimated Arrearage if Curing OR Collateral Value if Not Paying in Full</th>
<th>Estimated Secured Claim if Paying Secured Claim in Full OR Post-confirmation interest rate</th>
<th>Monthly Plan Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wells Fargo</td>
<td>Residence</td>
<td>(leave blank)</td>
<td></td>
<td>(See Paragraph 15)</td>
</tr>
</tbody>
</table>

Additional paragraph example: (Fill in the parenthesis)

Paragraph 15: “Provided that an allowed claim has been filed, the trustee shall disburse each month from the regular plan payment as adequate protection, the debtor(s) current ongoing mortgage payment in the amount of ($1,500) for loan or account (#9325440) to the address listed on the filed proof of claim. Payment through the trustee shall begin with the regular (January 2009) disbursement by the trustee, which will be deemed to pay the debtor(s) (February, 2009) mortgage payment. The debtor is responsible for all payments prior to (February, 2009). In the event the ongoing mortgage payment increases, the debtor(s) shall be responsible to insure that any difference is paid directly to the mortgagee until such time an amended plan may be filed and approved.”

Note: The debtor is responsible to alert the trustee to any changes to this treatment, including any request to send the payments to an address different than the one found on the proof of claim. Be sure that a claim with proper security documents is filed either by the creditor or the debtor on behalf of the creditor. The Trustee cannot pay unless and until such a claim is filed.

23. PAYMENT OF A PORTION OF A LONG TERM AUTO OBLIGATION AFTER DISCHARGE

On occasion, it may be necessary to pay part of a 910 long term auto contract (or co signed obligation) through the plan and the remainder after discharge. Under those circumstances, the auto should be put in paragraph 4b2 under “Estimated Total Debt if Paying Secured Debt in Full” with the following words added as a separate paragraph:

“The claim of __________ is not being modified. It will be paid per §4(b)(2) of the plan during the life of the plan in the monthly amount of $____ commencing with the payment disbursed by the Trustee at the end of ______. The debtor(s) will make the payments
directly to ________ up through the payment due ________. Upon discharge, the debtor(s) will re-commence making the remaining contractual payments directly to _______.”

Note: If you are using this method to pay for the automobile, the Trustee will not be paying interest through the plan. Any interest due under the contract will be included in the final amount due the creditor and will be paid as part of the final balance to be determined when the total debt is paid outside the plan and after discharge.

24. PENDING LOAN MODIFICATION

Pre Confirmation:

In the event a loan modification is not finalized but remains pending at confirmation and there are arrears that the modification would absorb, the following language should be added to the plan:

“The debtor has applied for a loan modification with ________ to cure the loan arrearage. In the event debtor(s) are offered an ongoing loan modification, they shall submit the loan modification agreement and any supporting documents to obtain Trustee’s approval or Court Order prior to the loan modification going into effect. If the loan modification is not approved within six months of confirmation of the Chapter 13 plan, the debtor will amend the plan to provide for cure of the loan arrearage or will either immediately sell or surrender the property.”

Be sure to include the arrears in paragraph 4b1 of the Plan and at the “monthly plan payment” spot, add an asterisk that says…”see paragraph (insert the paragraph # that is pertinent”)

Post Confirmation:

“The debtor(s) have applied for a loan modification with _________. Any payment on any arrears are being removed from the plan to be absorbed by the modification.”

The actual arrears should remain in paragraph 4b1 with the following language under the payment column:

“to be satisfied by loan modification.” In the event debtor(s) are offered an ongoing loan modification, they shall submit the loan
modification agreement and any supporting documents to obtain Trustee’s approval prior to the loan modification going into effect. If the loan modification is approved by both the lender and the Trustee, the debtor shall file a modified plan within 60 days of approval to provide for the new terms of the loan. If the modification is not approved, the debtor will file a modified plan within 60 days of denial, to either immediately sell or surrender the collateral or provide for post-petition payments on the arrears.”

25. **RECIPROCAL CLAIM CASES**

There may be occasion when two debtors: 1) are joint and severally liable on the same claim (usually priority taxes); 2) have filed separate Chapter 13 cases or the cases have been severed; and 3) where the debtors each agree to pay one-half or some portion of the claim through their respective cases. The following language is necessary in each Plan. (IRS used as example)

"This case is related to and shall be the companion case of (insert other case name and number). The priority tax claim of the Internal Revenue Service is a priority tax claim for both cases. One-half of the allowed priority tax claim shall be paid through the Plan in this case and one-half through the companion case. The debtor(s) in this case is not entitled to a discharge until the entire amount of the allowed priority claim of the IRS is paid in full. If the companion case is dismissed, converted, hardship discharge is granted or a claim is not filed in that case, the debtor(s) in this case shall immediately file an amended plan to provide for payment in full of the remaining allowed priority tax. If the debtor fails to file the required amended plan, the Trustee may attribute the entire claim to the case in which a claim was filed."

26. **SECTION 1322(B)(5) “LONG TERM” STUDENT LOANS THAT ARE NONDISCHARGEABLE AND IN DEFAULT**

In certain situations, student loans may be paid during the life of the plan. There are four elements that are required and if all four elements are present, you may include ongoing student loans payments on Schedule J and have the default paid through the plan. All four elements must be present and proof of them must be presented to the Trustee: 1) The loan must be in default, 2) the regular monthly payments, if made, would extend beyond the
life of the Chapter 13 plan, 3) the loan must be non dischargeable and, 4) the regular ongoing maintenance payment must be included in the budget (Schedule J) as a reasonable and necessary ongoing expenses. If all four elements are not present, the claim cannot be paid in this manner. If you elect to use this section, prior to the first meeting of creditors, send the Trustee evidence that the loan is non dischargeable, that it is in default and that the last payment on the loan is due after the date on which the final payment under the Plan. Include information about paying the default through the plan as an additional paragraph as follows:

“The default of the long term student loan to (name of creditor) in the amount of (default amount) shall be cured and paid by the Trustee in full with (___%) interest as if a priority claim.”

BEFORE YOU CAN USE THIS PARAGRAPH, YOU MUST BE PREPARED TO PROVE THAT PAYING THIS UNSECURED CLAIM OVER OTHER UNSECURED CLAIMS IS “FAIR” DISCRIMINATION PURSUANT TO THE 4 PART TEST FOUND IN IN RE WOLFF, 22 BR 510 (9th Cir. BAP 1982); and IN RE SPERMA, 173 BR 654 (9th Cir BAP 1994) See also: In re Colley, 260 BR 532, 538 (Bankr. M.D. Fla. 2000)

27. SEPARATE CLASSIFICATION OF STUDENT LOANS (OR OTHER CLAIMS) AFTER THIRTY SIXTH PAYMENT
(Available only for below median debtors)

“Class I - student loans of (name of creditor – be specific as to what creditor) Class II - All unsecured claims. All funds due unsecured claims from the first 36 payments and tax refunds during that period shall be prorated among Class II claims. Subject to below, all funds available for unsecured non-priority claims after the 36th payment shall be paid to satisfy Class I claims. If any paragraph 4(h) “best interest of creditors” number has not been satisfied during the first 36 months, that number shall be satisfied before any funds are distributed to Class I after the 36th month. Class I will receive approximately ____%. Class II will receive approximately ____%.”

Note: Using the separate classification may lead to a finding of “unfair discrimination”. Be prepared if, your judge feels that this addition “looks or feels” unfair, to reflect some dividend to Class II.
28. RETENTION OF TAX REFUNDS

On occasion, debtors need to retain all or a portion of a particular year’s tax refund for a reasonable and necessary expense not included on Schedule 106J. To retain all or part of a particular tax refund, the request must undergo a two-step process:

First, the Trustee must be convinced that the expense(s) are in fact justified. Second, if the Trustee agrees, and the resulting reduction of funds paid to the trustee makes a difference to the unsecured creditors, “notice” and an opportunity to object must be given to the creditors, either in the original plan or by a modification of the original plan using LBF 1300.17)(pre confirmation), or LBF 1355.10.(post confirmation)

Second, you must be prepared to justify any retention that does not include a specific expense that may be confirmed by receipts or invoices. If, for example, you state that the expenses are for “ongoing living expenses or slim budget”, be prepared for the Court to require an affidavit of explanation on the record or an appearance by the debtor(s) in court to explain to the court the specific need.

Either method of Notice will require the following paragraph be added to the plan:

“Debtor(s) shall be permitted to retain up to $_________ from tax year(s) _______refund(s) over and above any Earned Income Credit for the following expenses: _______________. This retained amount shall not be included in the base amount of the plan.”

NOTICE: If you wish to exempt EIC, you must do that separately either by a separate paragraph or on Schedule C.

Monetary Limitations:

Life of the plan: Debtors whose actual disposable income would qualify as below median may include the necessary paragraph in their plans allowing them to retain up to $2400 of their tax refund over and above any Earned Income Credit each year in the plan provided they have good reason for retaining it, i.e., extremely slim budget or projected yearly expense not included on Schedule J. You must be prepared to discuss the reasons for this retention with the Trustee at the first meeting of creditors. The Trustee will not require them to provide proof that they spent the money for the purpose
indicated. (This provision is subject to modification by the Trustee in the event the income of the debtors increases during the life of the plan)

**One time retention:** Both below and above median debtors may provide for one-time retention of tax refunds up to $3,000 provided they have good reason for retaining it by including the necessary paragraph in the plan to that effect. The reason for the retention should be in the paragraph, but proof will not be required. If more than that is requested, the debtor(s) will have to provide proof to the Trustee that the money was spent for that purpose. The $3000 figure is over and above any EIC for that particular year.

For an amount over $3,000, the following must be added to the necessary paragraph:

“Debtor(s) will provide proof for the expenses in the form of supporting documents. Failure to provide necessary proof will cause discharge to be delayed until such time proof is provided or a like amount is paid into the plan in lieu of proof.”

29. **PROSPECTIVE LANGUAGE FOR §1329 POST CONFIRMATION MODIFIED PLANS**

Defaults on previous approved plans may not be excused by the filing of a modified plan. Whenever filing a modified plan, be sure to include the prospective language in the plan:

“This plan is prospective only and shall not alter or affect the debtors’ obligations under any previously confirmed plan.”

30. **ACCOUNTING FOR DISPOSABLE INCOME ARISING FROM THE NON PAYMENT OF MORTGAGE EXPENSES OTHERWISE LISTED ON SCHEDULE J**

On some occasions, debtors continue to live in property that will be abandoned without making further mortgage payments. In most of those instances, there is an expense listed on Schedule J for future rent or mortgage payments that are not being made. In such instances, the phantom payments constitute disposable income that should be paid to creditors. The trustee is cognizant of the need for funds necessary to secure a new
residence, such as first and last month rent, security deposit and moving expenses. When such facts are present, the following language should be added to the plan.

“Notwithstanding the amount of $______ found on Schedule J, it is acknowledged that the debtor(s) are not actually making that payment. Realizing that the debtor(s) will need funds to facilitate an ultimate move to a new residence, the debtor(s) will be permitted to set aside 3 (three) times that amount to facilitate that move. If the debtor(s) relocate within 3 months from the first meeting of creditors (341 meeting), they will notify the trustee and file a Change of Address with the clerk’s office. If the debtor(s) do not relocate within that period, by the addition of this paragraph to the confirmed plan, the debtor(s) acknowledge and agree that the trustee is authorized to file an Order Modifying Plan that increases the plan payment by the amount stated above. Once debtor(s) prove that the expense is actually being incurred, a second Order Modifying Plan will be submitted to adjust the plan payment accordingly.”

31. ACCOUNTING FOR DISPOSABLE INCOME DURING A MORTGAGE MODIFICATION PROCESS WHERE DEBTOR IS NOT MAKING ONGOING MORTGAGE PAYMENTS

On some occasions, during a mortgage modification process, mortgage payments listed on Schedule J as “anticipated loan modification payments” are not actually being made. In such instances, the phantom payments constitute disposable income that should be paid to creditors. When such facts are present, the following language should be added to the plan.

“The debtor has an “anticipated loan modification payment” listed on Schedule J in the amount of $_________. The debtor admits she is currently not making that payment. Accordingly, the debtor shall pay into the trust fund of her bankruptcy attorney a like sum each month beginning ________________. Those funds will accumulate and be held in said trust fund until such time as the loan modification is either approved or disapproved. At that time, an accounting will be held regarding those funds. If it can be proved that the funds are necessary to affect an approved loan modification, then they may be used for that purpose to the extent required. If the modification is not
approved within six months from ________, then those funds will be delivered to the Trustee for distribution through the plan and the debtor will amend the plan to provide for cure of the loan arrearage or will either immediately sell or surrender the property.”

32. **SCHEDULE J LINE ITEM FOR TAX LIABILITIES TO BE PAID OUTSIDE THE PLAN**

If the debtor has a tax liability that is necessarily paid outside the plan and is included as an expense on Schedule J, the following language will be added as an additional paragraph in the Plan.

“Debtor is earmarking an amount of $_________ on Schedule J for *(petition tax year)* Federal and State tax liabilities. Debtor will set those funds aside each month and insure that they are available to pay any *(petition tax year)* tax liabilities. Debtor will timely file the required returns and immediately forward the returns to the Trustee. The Trustee will calculate and determine the difference between the liabilities and the actual amounts set aside. Any difference between the amounts set aside and the actual liabilities will be paid immediately to the Trustee for disbursement through the plan and, at that time, the plan payments will be increased by an amount of $_________. The Trustee is authorized to calculate these amounts and, with debtor’s consent, submit an Order Modifying the Plan accordingly.”

Add to paragraph 3(e) “plus proceeds as set out in paragraph ____”

33. **PROOF OF POST PETITION MORTGAGE PAYMENTS**

In instances, where it is apparent that in a prior case, the ongoing mortgage payments were not being paid to the mortgagor and the debtor(s) file a new plan with substantially higher arrears, the following language should be added as a separate paragraph:

“Debtor(s) shall provide to the Trustee proof of post- petition mortgage payments made during the life of the Plan. Proof shall be in the form of debtors' cancelled checks, or receipts/statements provided by the recipient and shall be presented to the Trustee every January 1st and continuing during the life of the Plan. In the event such proof cannot be provided, in whole or in part, the debtor(s) shall pay to the Trustee for distribution through the Plan, a sum equal to the difference
between the mortgage payment listed on Schedule J and those payments which cannot be proven, or in the alternative, the Trustee may file a motion to dismiss or convert due to a material default with respect to a term of the confirmed plan.”
CHAPTER 7 HOT TOPICS

By Russell D. Garrett

I. Preparation of the Petition, Schedules, and Statement of Financial Affairs


II. Attorney fees


A. No Money Down

B. Splitting fees Pre-Petition and Post-Petition

In re Hines, 147 F3d 1185 (9th Cir 1998); See also In re Sanchez, 241 F3d 1148 (9th Cir. 2001) (no disagreement where post-petition fees were in ballpark of reasonable standard).

In re Michel, 509 B.R. 99 (Bankr. ED Mi. 2014).

In re Griffin, 313 B.R. 757 (Bankr. ND Ill. 2004) (rejecting rationale suggested by Hines).

In re Bethea, 352 F3d 1125 (7th Cir. 2003) (rejecting Hines' rationale of allowing payment of pre-petition agreed fee for post-petition work).

C. Unbundling


In re Seare, 515 B.R. 599 (B.A.P. 9th Cir. 2014).

D. Appearance Counsel


_In re Collmar_, 417 B.R. 920 (Bankr. N.D. Ind. 2009) (lawyer may not unbundle to exclude reaffirmation of pre-petition unpaid legal fees for filing bankruptcy).

III. Assisting the Debtor and Conflicts

_In re Cochener_, 360 B.R. 542 (Bankr. S.D. Tex. 2007).


_In re McIntosh_, 697 Fed. App. 569 (9th Cir. 2017).

IV. Navigating the 341 Meeting

A. How to Raise Red Flags at the 341 Meeting

1. You hand over copies of the debtor's Schedules and Statement of Financial Affairs to your client's at the first meeting of creditors after the case is called.

2. You discuss with your client, in the hallway, how to answer questions at the first meeting of creditors while everyone in the 341 room is listening.

3. You minimize the importance of the first meeting of creditors to your client to calm them down.

4. You prepare the debtor to be combative with the Trustee and with creditors.

5. You are actually combative with the Chapter 7 Trustee and with creditors.

6. You have never met debtors or reviewed their file.

7. You are unprepared to discuss why no documents were produced.

8. Your clients are surprised that their arch enemy appeared.
B. How to Look Really Good at the First Meeting of Creditors if You’re Debtor’s Counsel

1. You have a new lawyer that's going to be handling the first meeting of creditors. You appear with that lawyer and introduce the lawyer to the Trustee.

2. You are not able to attend the first meeting of creditors yourself and you let the Trustee know that you won't be there and who will be there in your stead.

3. You give the Trustee a heads up on any unusual issues, including documents that you anticipate the Trustee will want, including business dissolution documents, personal injury claim documents, prior litigation or current litigation documents, existing judgments that may be important, domestic support obligations and provide the Trustee with recent relevant events such recent marriages where a community property state may be involved.

4. You let the Trustee know if you will need an interpreter so that less time is taken filling out forms at the 341.

5. You file all amended schedules in advance of the first meeting of creditors and give the Trustee an advance heads up as to any changes.

6. You let the Trustee know if there is an LLC, partnership or other business entity that is operating and have, at your disposal, copies of the relevant business records in the event the trustee requests them or asks for them in advance.

7. You've identified in the schedules which claims are actually disputed, which claims are community claims and which are undisputed.

8. You give the Trustee heads up as to creditors that may appear who may be difficult or abusive.

9. You provide the Trustee with information, in advance of the first meeting of creditors, concerning any relevant restraining orders against the debtors or a creditor.

10. In the event that the debtor has any condition (one that is of a very sensitive nature) you let the Trustee know in advance so that the Trustee does not ask questions that would lead your client to extreme embarrassment.

11. The debtor understands how the valuation of real or personal property occurred.
12. The addresses for the creditors on the schedules are accurate.

13. Your Bankruptcy Rule 2016 disclosure matches the Statement of Financial Affairs, Disclosures for the debtor as to what the debtor paid you prepetition and from whom.

14. The 4002 documents have been timely transmitted and are complete. Bank statements identify the debtor, all account numbers, the financial institution, all transactions and balances and include the date the petition was filed.

15. You dress like a lawyer in court.

C. **341 Meeting Conduct**

1. Bring your entire file.

2. What do you do if the client’s testimony is known to be inaccurate?

3. What do you do if, after the 341 meeting, your client discloses that she settled that PI claim the Trustee was asking about and was paid the day before the 341 Meeting but did not disclose any of that?

4. What do you do if after the 341 meeting your client discloses that her testimony was inaccurate or false, and you now know that the schedules or statement of financial affairs is inaccurate?

D. **Post 341 hearing**

1. Turnover of documents to the Trustee

2. Turnover of information to the Trustee

E. **How to look good at the creditors meeting if you are creditor’s counsel**

1. Be prepared, polite and professional.

2. Select questions that can be answered and that apply to the case.

3. Keep a respectful distance from the debtor.

4. Remember that you are on the record.

F. **How to create problems at the 341 Meeting if you are a creditor**

1. Sit next to the debtor and debtor's counsel and tell everyone that the debtor is a liar.
2. Proudly display your copy of "The Art of War" and tell the Trustee you have pages and pages of questions so he or she'd better sit back and take a rest.

3. Ask the debtor about something unrelated to any claim you have and unrelated to any disclosure made by the debtor.

4. Be disrespectful, arrogant, demanding and/or abusive.
Chapter 7 Hot Topics
Northwest Bankruptcy Institute
April 5, 2019

Presented by
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In re Wilson

- Post petition appreciation of property is property of the bankruptcy estate
- The debtor’s exemption is measured by the equity as of the date of the bankruptcy
- The case applied Washington law using the federal bankruptcy exemptions
Preparation of the Petition, Schedules, and Statement of Financial Affairs


**In re Grimmett**

- Debtor’s counsel fee agreement identifies both pre petition services and post petition services and corresponding fees for each.
- Agreement provides that if payment is not made, case can be dismissed, default interest will be charged and agreement will be sent to collections.
- 2016 disclosure was inaccurate twice.
- Styled as an unbundling case but it is not.
- 2016 multiple disclosures are inaccurate and provide a basis for total disallowance of compensation.
- Conflict of interest because the agreement created the impression that withdrawal could occur in violation of local rules and through use of coercive collection efforts.

**Grimmett conclusion**

- Agreement cancelled by the court
- Disgorgement ordered
- Attempts to unbundle fees created conflicts with the debtor
- Collection efforts against debtor discouraged debtor from complying with court’s fee order
Grimmett conclusion cont

- Use of adobe signature instead of “wet signature” violates court rules
- In re Biggar 110 F.3d 685 (9th Cir 1997) is reinforced by In re Hines, 147 F3d 1185 (9TH Cir 1998). Pre petition fee agreements are discharged. Post petition work cannot be enforced with a pre petition agreement. Quantum Meruit, if applicable, must be established by debtor’s counsel.

Attorney Fees

- In re Seare, 515 B.R. 599 (B.A.P. 9th Cir. 2014).
Attorney Fees

- No Money Down
- Dividing Fees
- Unbundling

In Re Seare

- Fee agreement limited services including representing the debtor in any adversary proceeding
- Matter forcing the bk was litigation that would likey be filed as adversary proceeding
- Improper to limit services where the service removed is essential to achieve the client’s objectives. -- defense of 523 in this case.
In re Michel 509 BR 99

- Pre petition written flat fee agreement and 2016 disclosure for $900 fees
- Debtor paid $450 pre petition (sofa) and orally agreed to pay the rest post petition
- Oral agree is void and unenforceable 528(a)(1)– disgorged $450.
- Rejects Hines concept that fees not due until post petition work complete.

In re Walton

- Fee agreement segregates pre petition work from post petition work
- Post dates checks required for post petition work
- Fee agreement discloses need to seek advice of separate counsel re post pet check
- The fee agreement itself identifies that “to counsel’s knowledge...post dated check ok”
In re Walton cont

- Pre petition agreement is discharged
- Post dated checks are time instruments/ constitute pre petition claims - discharged
- Follows Waldow (rejecting Hines) – flat fee to pay for postpetition services does NOT create a post petition claim.
- Contract based claims arise at the time the contract is entered into

In re Walton cont

- Depositing post petition checks violates 362 or 524
- Seeking payment of the unpaid prepetition flat fee violates 362 or 524
- Entering into that kind of an agreement is a conflict of interest --
- Consider who would advise the debtor to claim violation of 362 or 524???
Assisting the Debtor and Conflicts

- *In re McIntosh*, 697 Fed. App. 569 (9th Cir. 2017).

Cochner

- Initial debtor’s counsel surprised with possible 523.
- New counsel filed motion to dismiss
- New counsel advised debtors to ignore trustee’s request for documents and info
- New counsel advised debtors to skip continued 341 meetings
**Cochner result**

- Trustee objected to dismissal and asked for sanctions
- Court awarded trustee sanctions against debtors $50,000 under 105 for damage inflicted upon the real properties
- Sanctions against debtors for $1k for abuse
- Sanctions against 2nd counsel for over $25k (trustee’s atty fees, disgorgement)

**Veran**

- Undisclosed LLC interest
- Debtor’s counsel filed amendments knowing of LLC but omitting LLC from amended sch.
- Debtor’s counsel’s 329 and 2016 disclosures were materially inaccurate
- UST filed motion for sanctions and disgorgement
Veran result

- Court found 3rd and 4th amended schedules were known by counsel to be materially false and counsel willfully and intentionally violated 329(a) and BR 2016(b)
- Disgorgement of all fees
- Reimbursement of UST fees and costs
- Completion of a prof resp course within year

In re Morey

- Debtor’s divorce provides that she transfer Blackacre to ex spouse for 25k. Debtor transfers property pre-petition but receives substantially less than 25k and instead works out new arrangement with ex.
- Trustee seeks to avoid transfer as fraudulent
- Debtor’s counsel appears for ex spouse in order to keep the post divorce deal going
Morey conclusion

- Trustee moves to exclude debtor’s attorney on the basis of a conflict
- Court disqualifies counsel for spouse. Counsel for debtor must counsel debtor to cooperate with trustee and fulfill debtor duties. That obligation conflicts with defense of ex spouse.

In re D’Arata 587 BR 819

- Material errors in sched and sofa
- Debtor never met with lawyer
- Appearance counsel for multiple 341 meetings unfamiliar with case and/or debtor
- Amendments filed day before cont. 341 and were still inaccurate.
- Debtor’s signature improperly placed at least twice.
In re D’Arata cont.

- Appearance counsel is usually selected by lawyer not debtor and from outside office
- Appearance counsel violated RPC involving “limiting the scope of work” which requires informed consent and failing to “provide informed consent”
- Appearance lawyers are rarely listed as counsel of record

In re D’Arata

- The court and others have an interest in knowing who is authorized to speak for the debtor and
- The court needs to know who to hold accountable for any improprieties.
Navigating the 341 Meeting

- How to Make a 341 Meeting Take Longer
- How to Look Really Good at the First Meeting of Creditors if You’re Debtor’s Counsel
- 341 Meeting Conduct
- Post 341 hearing
- How to look good at the creditors meeting if you are creditor’s counsel.

Any Questions?

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Chapter 8A

Presentation Slides: The Highs and Lows of Marijuana Businesses and Bankruptcy: Banking and Finance Issues

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The Highs and Lows of Marijuana Businesses and Bankruptcy: Banking and Finance Issues
Susan S. Ford
Sussman Shank LLP

Brief History of A Risky Business

- The Controlled Substances Act – Schedule 1 (See 29 U.S.C. §§ 856, 863)
  - It is a violation of federal law to:
    - Engage in the production, sale or processing of marijuana;
    - Lease or maintain real property used for manufacturing or distributing marijuana

- Penalties include:
  - Incarceration;
  - Heavy fines
  - Civil forfeiture of real property, money, and equipment used in connection with a violation
Brief History of A Risky Business

- 2012 -- Colorado and Washington legalized commercial production, processing and recreational sale of marijuana, followed by Oregon in 2013.
  - State-legal businesses would not be subjected to federal prosecution or forfeiture of revenue and property.
  - Fueled investment in the industry locally and nationally.
  - Had Relatively Little Effect on Banks
    - Majority of federally insured banks still refused to serve the cannabis industry
    - Accounts opened by only a handful of state-chartered credit unions.

January 2018: Attorney General Jeff Sessions rescinds all prior “Guidance” related to enforcement of the Controlled Substances Act, including the Cole Memorandum.

- Banks even more fearful
- Leases and contracts contained provisions that provided for termination upon rescission of the Cole Memorandum
- Questions whether investment in the new industry would be chilled.
**Brief History of A Risky Business**

- **Recent Developments:**
  - **Federal:**
    - The Farm Bill of 2018 passed, the effect of which is to legalize industrial hemp (a non-psychoactive form of cannabis) nationwide;
    - The U.S. Attorney for Oregon, Billy Williams named Chair of the U.S. Attorney’s Marijuana Working Group, composed of federal prosecutors from states which have legalized cannabis;
    - Billy Williams has announced enforcement priorities for Oregon, focused on overproduction and interstate trafficking.
  - **State:**
    - Bill introduced in Oregon to provide a legal avenue to export Oregon cannabis to adjacent States where cannabis is legal

**Industry Growth and Financing for Cannabis Businesses**

- Legalization has Outpaced Projections for U.S. Cannabis Markets
  - 10 States plus District of Columbia have legal recreational markets
  - 30 total medical and/or recreational markets
  - Canada legalized recreational marijuana nationwide in 2018
  - Investors are anticipating continued national and global expansion

- New Products and Uses – Hemp and CBD
  - Health and Wellness
  - Non-prescription pharmaceuticals
  - Food & beverage
  - Pet products
  - Trend toward products subject to less regulation on federal and state levels?
Industry Growth and Financing for Cannabis Businesses

Market Projections – Long Term Outlook Appears Strong

- Global cannabis market expected to grow to $200 billion
- Canadian (legal) market capitalization is currently estimated at $15 billion
- U.S. Market:
  - $11 billion in sales in 2018
  - $21 billion in sales projected for 2020
  - California alone is anticipated to be $31 billion per year for recreational and medical by 2020
  - Oregon is projected to have sales of $1.04 billion in recreational and medical sales by 2020
  - Washington is number 2 behind California with $2.28 billion in projected sales by 2020

Sources of Capital for Cannabis Businesses

- Not From a Bank;
- Mom and Pop Growers use their own land and family farms;
- Mom and Pop Retailers Use Life Savings and partner with other individuals;
- Rapidly Expanding Trend – Sophisticated Large Investors and Private Equity Firms
  - Buy up failed Mom and Pops at low prices
  - Explosion of investment in recreational and, more recently, the CBD industry
Start-up Cost for Mom and Pop – Portland, Oregon

- **Retail Dispensary**
  - Total start-up cost for a retail store is in the hundreds of thousands to millions of dollars.
  - “Bare Bones” small dispensary minimum average start-up cost (as of 2018) was $40,000-$50,000 including:
    - OLCC License: $4750 annually
    - City of Portland Fees: Initial Application ($975) and License ($4975) = $5950
    - Product: $100-700 per pound x 10 pounds = $1000-$7000 (Note: based upon mid-2018 wholesale prices)
    - Rental Real Estate:
      - $10,000-$20,000 security deposit
      - $3750-$7000 per month base rent

[continued on next slide]

Start-up Cost for Mom and Pop – Portland, Oregon

[continued from last slide]

- Wages (two full-time workers at minimum wage – one month): @ $3000
- Utilities: $750-1500 per month
- Other Equipment (security cameras, safe, scales, supplies, receptacles, refrigerators, cash register) $5000
- Seed to Sale Tracking System: $1500 set up, plus monthly fee of $200-500

- **Indoor 5,000 Sq. Ft Grow Facility** (Assumes land is owned – not leased):
  - $270,000 – including $20,000 per month in labor and operational costs.
**Sources of Capital for Cannabis Businesses – Deep Pockets**

- In Canada, there are more than 120 cannabis companies listed on Canadian stock exchanges, dominated by five companies, whose collective market value grew from less than $4 billion to nearly $40 billion in the past year.

*Other Recent Examples of Large Investment:*

- March, 2018: Snoop Dog’s venture capital company Casa Verde closed a debut round of financing -- $45 million, including $10 million in a UK cannabis research company (pain and inflammation therapies, cancer treatments and remedies for gastrointestinal diseases); and $2 million in “Trellis” a Canadian seed-to-sale software provider.

- Jimmy Buffett and William Wrigley backed U.S. marijuana startup Surterra Holdings (health and wellness cannabis products), which has raised $100 million since 2015.

- Acreage Holdings, which just completed a Canadian IPO in 2018, includes on its Board of Directors: John Boehner (former US Speaker of the House) and Brian Mulroney (former Prime Minister of Canada).

**Access to Banking: A Significant Industry Problem**

- Legal Barriers to Banking Relationships:
  
  - The Controlled Substances Act: in addition to direct activities, the CSA makes it a crime to knowingly aid and abet the manufacturing, distribution or dispensing of marijuana.
  
  - Penalties include incarceration and forfeiture of proceeds and property related to the crime.
  
  - The Cole Memorandum (now rescinded) issued “guidance” on federal enforcement priorities under the CSA, which did not exempt the banking industry. It essentially put the burden on states in which medical or recreational marijuana was legal to:
    
    - Enact appropriate regulations to ensure transparent tracking and reporting of business activities of cannabis business; and
    
    - Enforce those regulations.
Access to Banking: A Significant Industry Problem

FDIC Regulations. All banks – both national and state-chartered, are subject to federal law. Maintaining required FDIC insurance requires adherence to federal law.

Failure to do so subjects a Bank to loss of its charter.

The Bank Secrecy Act ("BSA"). Requires all banks to report to the federal government any suspected illegal activity, including any transaction associated with a marijuana business.

Suspected Activity Reports ("SARS") must be filed with respect to every transaction involving a state-authorized marijuana business.

Federal bank regulators have not issued guidance regarding the BSA. However, the Financial Crimes Enforcement Network ("FinCEN") a division of the Department of the Treasury, which oversees the BSA, issued Guidance in 2014 which sets expectations for financial institutions serving marijuana businesses, including offering bank accounts. [continued on next slide]

Guidance clarified the level of due diligence expected of Banks that offer banking services to marijuana businesses.

Simplified the initial SARS filing requirements, but still requires close monitoring of all banking activities to enable the DOJ to determine that federal enforcement priorities are adhered to on a continuing basis.

However, upon rescission of the Cole Memorandum, the U. S. Attorney General also made clear that financial transactions connected with marijuana businesses can still be the basis for federal prosecution.

Other Laws Impacting Banking Services to Marijuana Businesses:

USA Patriot Act

The Racketeer Influenced and Corrupt Organizations Act ("RICO")
The Impact of Federal Law on Banks Offering Financial Services to the Cannabis Industry

- Banks are subject to a level of scrutiny far in excess of what is expected in any other banking relationship.
- Relatively few serve cannabis businesses. Mostly state-chartered credit unions and, which are not supervised by the FDIC.
- Most cannabis businesses generate and maintain on premises large amounts of cash, creating major security risks, and leading to distrust of partners, employees.
- Cannabis businesses without banking services transact all business in cash, including payroll, rent, payment of taxes and fees to federal and state govt's.
- Customers cannot use debit/credit cards at cannabis businesses lacking banking services.
- Banks that do offer services must expend tremendous resources to comply with due diligence requirements, and pass the cost on to customers.
- Very little commercial lending is available to cannabis businesses.

The Impact of Federal Law on Banks Offering Financial Services to the Cannabis Industry

- Comments From the Banking Industry on application of Federal Banking Laws:
  
  - “A bank can be charged with …CSA violations, aiding and abetting such, money laundering, racketeering, BSA violations… And often charges can be brought against bank personnel. ‘We won't place tellers and others in that position.’”
  
  - “State ownership [of a Bank] doesn't help, other than conveniently aggregating pot deposits in one location for federal seizure.”
  
  - “So, despite our desire to promote public safety, facilitate the state’s ability to tax and regulate these businesses and be able to serve marijuana customers and businesses, we believe it literally takes' an Act of Congress' to attract banks to this business ....”
Chapter 8B

Presentation Slides: The Highs and Lows of Marijuana Businesses in Bankruptcy

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THE HIGHS AND LOWS OF MARIJUANA BUSINESSES IN BANKRUPTCY

Thomas Buford
Bush Kornfeld LLP

Northwest Bankruptcy Institute
April 5, 2019

Relevant Case Law

■ *In re Rent-Rite Super Kegs West Ltd.*, 484 BR 799 (Bankr. D. Colo. 2012) (where “because a significant portion of the Debtor’s income is derived from an illegal activity, §1129(a)(3) forecloses any possibility of this Debtor obtaining confirmation of a plan that relies in any part on income derived from a criminal activity”)

■ *In re Arenas*, 514 BR 887 (Bankr. D. Colo 2014) (dismissing case where debtors could not “under the present circumstances, feasibly propose a chapter 13 plan that does not depend on income from sources that are illegal under the CSA for the plan’s execution.”)

■ *In re MedPoint Management*, 528 B.R. 178 (dismissal of a Chapter 7 involuntary petition stating that a trustee could not administer marijuana assets without violating federal law)

■ *In re McGinnis*, 453 B.R. 770, 772 (Bankr. D. Or. 2011) (denying confirmation of chapter 13 plan where plan depended on cultivation and sale of medical marijuana)

■ *In re Arm Ventures LLC*, 564 B.R. 77 (Bankr. S.D. Fla. 2017) (holding that filing a Chapter 11 while relying on rental income from a marijuana business was bad faith)
**In Re Cook Investments, Case 16-44782 (W.D. WA)**

- Five jointly administered cases, four commercial real estate lessors, filed November 2016
- One debtor, Cook Darrington, leases property to I-502 producer (Green Haven)
- UST moves to dismiss for “cause” pursuant to Section 1112(b)(4)(B) on the basis that per se violation of CSA constitutes “Gross mismanagement of the estate”
- Motion Denied. Court holds that Debtors “may be able to propose a plan that does not rely on the income from the marijuana operation lease.”

**In re Cook Investments, Case 16-44782 (W.D. WA)**

- Debtors file plan
  - Eliminates all references to Green Haven, lease or lease income
  - Provides for rejection of Green Haven lease
- Debtors reject Green Haven lease
- UST objects to plan
  - 11 U.S.C. §1129(a)(3); “The court shall confirm a plan only if...[t]he plan has been proposed in good faith and not by any means forbidden by law.”
In re Cook Investments, Case 16-44782 (W.D. WA)

- Sole issue is 1129(a)(3)’s requirement that: “[t]he plan has been proposed in good faith and not by any means forbidden by law.”
  - Debtors: 1129(a)(3)’s intent is to evaluate manner by which the plan was proposed
  - UST: Debtor cannot satisfy 1129(a)(3) where any involvement of any marijuana asset in a bankruptcy case, even where plan implementation doesn’t rely on marijuana-related income
- Court Confirms Plan,
  - finds that 1129(a)(3) requires that a Plan not be proposed by any “means” forbidden by law
  - Plan is neither based upon violations of CSA, nor dependent on Green Haven lease income (lease rejected)

In re Cook Investments, Current Status

- UST appeals both denial of MTD and Confirmation Order to District Court
- Bankruptcy Court and District Court deny UST’s Motion for Stay Pending Appeal
- District Court Affirms, denies UST’s Motion for Stay Pending Appeal
- Appeal Pending at the 9th Circuit (Case No. 18-35119)
- Argument conducted Monday, December 3rd, 2018
Common scenarios where marijuana and bankruptcy meet

- Commercial
- Consumer

So, I own a...

- Dispensary
- Grow operation
- Processing business
- Commercial property
- Fertilizer business
- Bong maker
- Law Firm
So, I work for...

- Ownership does not matter
- Control does not matter
- Unclear that a trustee would be doing anything illegal by accepting proceeds
- *In re Stickles, W.D. Wa. 17-11424*

I need a little help here...

- *In re Skrzynski, W.D. Wa. 17-11437*
Let’s get absurd...

- The Debtor uses marijuana to control anxiety
- The Debtor has an automobile that does not meet federal emission standards
- The Debtor is in the country illegally

These seem like a lot of lows – where are the highs?

- State Court Receivership
- Pre-bankruptcy planning
- Judicial intervention
  - In re Olson (9th Cir. BAP, February 5, 2018) (Burden on party seeking dismissal to establish that Debtor is actually violating the Controlled Substances Act)
- Congressional actions
  - U.S. v. McIntosh, 833 F. 3d 1163 (9th Cir. 2016) (where Consolidated Appropriations Act prohibited DOJ from spending money on prosecutions of state-legal medical marijuana, burden on prosecutors to establish non-compliance with state law)
  - Proposed bipartisan legislation
Chapter 8C

Presentation Slides: State-Law Remedies for Creditors of Marijuana Businesses

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THE IMPORTANCE OF STATE-LAW REMEDIES

Creditors must rely on state-law remedies to recover
- No bankruptcy
- Limited or no possibilities for direct foreclosure

Availability of creditor remedies is crucial to the industry’s ongoing viability and ability to operate within the broader business community
FORECLOSURE — OREGON V. WASHINGTON

OAR 845-025-1275: Closure of Business

(2) The Commission may issue an order providing for the manner and condition under which:

(a) Marijuana items left by a deceased, insolvent or bankrupt person or licensee, or subject to a security interest, may be foreclosed, sold under execution or otherwise disposed.

Washington: No similar allowance

RECEIVERSHIP STATUTES

ORS § 37.010 et seq.

• Effective January 1, 2018

Washington:

• RCW 7.60: Receivers
• RCW 7.08: Assignments for the Benefit of Creditors
  • (ABCs in Washington automatically lead to the appointment of a receiver)
MARIJUANA REGULATIONS - OREGON

OAR 845-025-1260: Standards for Authority to Operate a Licensed Business as a Trustee, a Receiver, a Personal Representative or a Secured Party

(1) The Commission may issue a temporary authority to operate a licensed business to a trustee, the receiver of an insolvent or bankrupt licensed business, the personal representative of a deceased licensee, or a person holding a security interest in the business for a reasonable period of time to allow orderly disposition of the business.

...  
(b) The secured party must provide the Commission with the following information:
   * (A) Proof of a security interest in the licensed business;
   * (B) Proof of the licensee’s default on the secured debt;
   * (C) Proof of legal access to the real property; and
   * (D) A written request for authority to operate as a secured party listing the secured party’s address and telephone number.

MARIJUANA REGULATIONS — OREGON, CONT.

OAR 845-025-1260: Standards for Authority to Operate a Licensed Business as a Trustee, a Receiver, a Personal Representative or a Secured Party

(2) The Commission may revoke or refuse to issue or extend authority for the trustee, receiver, personal representative, or secured party to operate:

   * (a) If the trustee, receiver, personal representative or secured party does not propose to operate the business immediately or does not begin to operate the business immediately upon receiving the temporary authority;
   * (b) For any of the reasons that the Commission may revoke or refuse to issue or renew a license;
   ... or
   * (d) If a reasonable time for disposition of the business has elapsed.
MARIJUANA REGULATIONS — WASHINGTON

• WAC 314-55-140(1): “The appointed … receiver … must notify the WSLCB’s licensing and regulation division in the event of the … receivership … of any licensee.”

• WAC 314-55-140(2): “The WSLCB may give the appointed … receiver … written approval to continue marijuana sales on the licensed business premises for the duration of the existing license and to renew the license when it expires.
  * (a) The person must be a resident of the state of Washington.
  * (b) A criminal background check may be required.”

SPECIAL CONCERNS FOR RECEIVERS

Licenses Are Tied to a Specific Location
• ORS 475B.070(2): “A marijuana producer must have a production license issued by the commission for the premises at which the marijuana is produced.”
• WAC 314-55-135(6): “Marijuana licenses are associated with a physical location. Persons operating without a WSLCB approved licensed location to produce, process, or sell marijuana will be discontinued.”

WAC 314-55-050(16): WSLCB may “deny, suspend, or cancel a marijuana license” for “failure to operate in accordance with WSLCB approved operating plan.”

General compliance with marijuana regulations; best to have a receiver with pre-existing knowledge of regulations that will govern the operations and liquidation process
  * Inventory tracking; How to sell and who may buy; Who may be employed
MARIJUANA RECEIVERSHIPS IN WASHINGTON:
EXAMPLE

‘Landlord LLC”: an out-of-state landlord of a licensee v. “Tenant Inc”: a licensed marijuana processor

August 2016: Landlord evicts non-paying Tenant
- Obtains judgment ~$80K
- Tenant’s only valuable asset: its processor license
- Landlord cannot execute on assets

September 2016: Landlord seeks appointment of receiver
- Does not execute on writ of restitution
- Opposition by Tenant
- Receiver’s ability to sell license questionable

Keys to Success:
- Early communication with LCB / OLCC
  - Status of license
- Early communication with receiver
  - Plan for operation or liquidation?
- Pre-approval of receiver by LCB

MARIJUANA RECEIVERSHIPS IN OREGON

License has minimal or no independent value, unlike Washington

Potential for secured creditors to take possession and operate under existing license

As an alternative to bankruptcy, on the debtor’s own action?
- ORS 37.060(1) – Grounds for Appointment of Receiver
  - (g) When an entity has been dissolved or is insolvent or in imminent danger of insolvency, if receivership is reasonably necessary to protect the property of the entity or to conserve or protect the interests of the entity’s stockholders, members, partners, or creditors.
  - (i) In any situation in which, in the direction of the court, appointment of a receiver is reasonably necessary to secure justice to the parties.
- No equivalent to RCW 7.60.08 – Assignment for Benefit of Creditors
Chapter 9

Presentation Slides: Making Bank on Bankruptcy Using Social Media

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Making Bank on Bankruptcy Using Social Media

Presented By Daliah Saper

What Social Media Platform Do You Use Most Frequently?

- Facebook
- Twitter
- Instagram
- Pinterest
- LinkedIn
Fun Facts

- After the first quarter of 2018, Facebook had **2.19 Billion** monthly active users.
- The average user spends **50 minutes/day** on Facebook.
- **71% of consumers** are more likely to make a purchase based on a social media reference.
- **93% of marketers** use Facebook advertising regularly.
- Every second, on average, **6,000 tweets** are tweeted on Twitter, which corresponds to over **350,000 tweets** sent per minute, **500 million tweets** per day and around **200 billion tweets** per year.

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More Fun Facts

- If Twitter was a country, it would have the **3rd largest population** in the world.
- The fastest-growing group of Facebook and Google+ users is the **45-54 year old** age bracket.
- The Library of Congress now **archives all tweets** for research and preservation.
- **92% of companies and recruiters** use social media as a factor in their hiring efforts.

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Social Media Pros

- Can market to a broad audience quickly and economically
- Benefit from “viral” nature of the internet—reaching an audience you may never have anticipated/expected
- Engage with and monitor conversations with target consumer, client, end user, etc.
- Track all sorts of data in new and novel ways
- As lawyers, we encompass “social media” with the term “new media.” Our licensing contracts all refer to: “in any and all media now known or hereafter devised” ... 

Social Media Cons

- Social Media can also cause a lot of headaches for a company or law firm. Causes of Action Include:
  - **Defamation**: and false light family of claims
  - **Copyright infringement**: using/sharing something that’s not yours.
  - **Trademark infringement**: confusing consumers about a brand or source of products
  - **Interference with Business Relations, Unfair Competition**
Social Media Cons

- **Negligence**: assuming a duty, inadequate data security.
- **Contract**: ending up in an enforceable agreement (bad terms of use)
- **Discrimination**: especially as to hiring practices
- **Invasion of Privacy/Confidentiality breaches**: see non-exhaustive list

Privacy Acts that Employees Could Potentially Violate with the Wrong “Tweet”

- **Health privacy laws**
  1974—The National Research Act
  1996—Health Insurance Portability and Accountability Act (HIPAA)

- **Financial privacy laws**
  1970—Bank Secrecy Act
  1998—Federal Trade Commission
  1999—Gramm-Leach-Bliley Act (GLB)
  2002—Sarbanes-Oxley Act (SOX)
  2003—Fair and Accurate Credit Transactions Act
Privacy Acts that Employees Could Potentially Violate with the Wrong “Tweet”

- **Online privacy laws**
  1986—Electronic Communications Privacy Act (ECPA), pen registers
  1986—Stored Communications Act (SCA)

- **Communication privacy laws**
  1978—Foreign Intelligence Surveillance Act (FISA)
  1984—Cable Communications Policy Act
  1986—Electronic Communications Privacy Act (ECPA)
  1994—Digital Telephony Act - Communications Assistance for Law Enforcement Act (CALEA), 18 USC 2510-2522

- **Education privacy laws**
  1974—Family Educational Rights and Privacy Act (FERPA)

- **Information privacy laws**
  2001—USA Patriot Act, expanded pen registers

- **Other**
  1974—Privacy Act
  2005—Privacy Act, sale of online PII data for marketing

State Privacy Laws: for example, California alone has over 88 data privacy laws

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Most Are the Same, But...

- The context and application of the law poses challenges:

Ambiguity

- Are tweets copyrightable?
- Does embedding mean implied license
- Who owns social media contacts?
- Is linking copying?
- How much copying is considered fair use?
Immunity for ISPS

- Guess who you can’t sue
  - Section 230 CDA
  - DMCA

New Forms of “Identity” Theft

- We are already familiar with domain name squatting, now it’s username squatting, fake profile creation
- Need to register trademarks, authorized accounts, with social media sites
Social Media Sites Create Their Own “Laws”

- Have you read terms of use? Do you retain ownership of what you upload, post, etc. to a social media site?
- If you want to conduct a game, contest, etc. via Facebook, for example, do you know what Facebook will and won’t let you do?

Jurisdiction Issues Post Challenges

- Where can you sue someone?
  - Don'tdatehimgirl.com (where was harm directed?) vs
  - World Records Academy (Is the website passive or active in a specific jurisdiction?)
Anonymity

- How do you find out the identity behind an anonymous defamatory post or a copyright/trademark infringement?
- Free Speech issues

Statutes of Limitations May Surprise You

- Most states have a one year statute of limitations that starts from the date of posting—not the date plaintiff found out about the defamation
Education Is Key

- Legislatures are trying to keep up by creating new laws
- Companies scramble to draft all encompassing social media policies.
- Social Media Policies can’t replace good judgment and oversight.
  - Some companies don’t have them
  - Some have been deemed overbroad
  - Some merely serve as guidelines
- Better to understand the implications of certain behaviors.
- Know the laws!

Social media is key to growing your firm and building your brand

... but are you using social platforms correctly?
How to Properly Use Social Media

- Choose the correct platform for your firm
  - Determine what platforms your clients use and build your social media presence around those preferences
- Create measurable business objectives
  - Specific key indicators will help evaluate how well the content is performing
- To maximize reach and visibility, consider establishing a presence on most major platforms

What to Avoid on Social Media

- To avoid ethical misconduct on social media platforms, avoid:
  - Calling yourself a “specialist,” unless you have received formal certification from an accredited organization
  - Using specific details when discussing recent cases
  - Sending confidential information through social media platforms
  - Directly soliciting clients
  - Misleading or false advertisements
Firm Responsibility

- To extract the most benefits, your firm’s social media needs to be consistently updated
- It is the responsibility of your firm to assign the maintenance of social media to:
  ▶ A law clerk
  ▶ An assistant
  ▶ An associate
  ▶ A public relations department
  ▶ A third-party marketing company
- Your firm should create a social media policy - a set of guidelines for what should and should not be posted

Social Media Platforms

Now that we know how to properly use social media, we can explore the external advantages and internal problems, i.e. ABA restrictions, for the following platforms:

- LinkedIn
- Facebook
- Instagram
- Twitter
LinkedIn

External Advantages

- Easily create professional connections through social media
- Engage with the prospective clients
- Increase web exposure and traffic to website
- Improve firm credibility by gaining followers and receiving recommendations
- Attract prospective employees by posting career opportunities
- Differentiate from competitors by tailoring the LinkedIn profile to emphasize the firm's strong points
LinkedIn Maintenance

- Optimize your company page
  - Showcase what your firm does best
  - Write a powerful company description that describes your business and expertise
    - Include keywords as LinkedIn allows users to search for companies by keywords

- Upload media when possible
  - Daily uploads are best
  - Add links, photos, and other file uploads to showcase your firm’s work
  - Morning uploads are the most effective to increase site engagement

- Engage with your audience
  - Share and respond to comments from clients
  - Use LinkedIn’s Targeted Audience feature to tailor your updates to your targeted clients
LinkedIn Maintenance

- Join LinkedIn Groups
  - LinkedIn Groups allow you to connect with others in your industry
  - Widen your network by engaging in LinkedIn Group discussions
  - Join groups that correspond to groups your firm and attorneys belong to
  - Search for groups that include your target audience

LinkedIn Maintenance

- Biographies for your firm and attorneys
- Areas of practice
- Positive press
- True client testimonials
- Links to articles written by attorneys at your firm
- Updates from firm events and appearances
- Show, don’t tell your clients what you do best
ABA Restrictions

- LinkedIn is considered attorney advertising “only if is meets all five of the following criteria: (a) it is a communication made by or on behalf of the lawyer; (b) the primary purpose of the LinkedIn content is to attract new clients to retain the lawyer for pecuniary gain; (c) the LinkedIn content relates to the legal services offered by the lawyer; (d) the LinkedIn content is intended to be viewed by potential new clients; and (e) the LinkedIn content does not fall within any recognized exception to the definition of attorney advertising.”

NYCBA Ethics Op. 2015-7

ABA Restrictions

- However, as there are no uniform rules concerning LinkedIn, it is best to check your state’s requirements and restrictions and the ABA Model Rules of Professional Conduct
- In general, LinkedIn sites must not display false or misleading information
  - You must regularly delete any false or misleading LinkedIn endorsements or testimonials written by clients
Case Study Kirkland & Ellis

- Cover photo and icon are professional and easily identifiable
- Profile is optimized with keywords
- Link to other social media profiles
- Attorney advertising disclaimer

Case Study

- Frequent Updates
- Updates on recent activity in the firm
- Positive Press
External Advantages

- Largest social media platform
- Integrate other social media platforms using custom tabs
- Increase web traffic and exposure
- Use Audience Insights to learn more about the profiles that “like” your page
- Utilize the “Call-to-Action” button to encourage users to contact your firm or subscribe to your newsletter
Facebook Maintenance

- If the maintenance of Facebook is shared by a team, your firm can assign different roles to different employees
  - Admin - Complete access
  - Editor - Can edit the Page
  - Moderator - Can respond to and delete comments
  - Advertiser - Can create Facebook ads
  - Analyst - Can view insights

Facebook Maintenance

- Upload visual content
  - Facebook posts with visual content are ranked higher in news feeds
  - Posts with images receive 2.3x more engagement than posts without images

- Be consistent with content
  - Maintain a set posting schedule in order to keep your audience engaged and increase web traffic
Facebook Maintenance

- Utilize Audience Insights to Your Advantage
  ▶ Insights will tell you:
    ▶ Which posts are performing best
    ▶ Who are your main source of likes
    ▶ The demographics of page visitors
  ▶ The information provided by Insights can help you determine your target audience and create engaging posts

Facebook Maintenance

- Set-up Facebook Retargeting
  ▶ This tracks Facebook users who visit your website
  ▶ Facebook can give you the demographics of your site visitors, allowing you to determine your target audience
  ▶ Facebook will also show your ads to users who visit your site
- Customize your Facebook
  ▶ Change the URL to include your firm’s name
  ▶ Create a profile image and cover photo that are consistent with your firm’s image

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Appropriate Content

- “Liking” pages that resonate with your firm’s identity and location
- Law firm news and updates
- Commentary on legal issues that your firm handles
- Photos that show the human side of your firm

ABA Restrictions

- Check your state’s requirements and restrictions on social media and legal advertising and the ABA Model Rules of Professional Conduct
- It is important to avoid:
  - Making false or misleading statements
  - Prohibited solicitations
  - Disclosure of confidential information
  - Communications with represented parties
Chapter 9—Presentation Slides: Making Bank on Bankruptcy Using Social Media

Case Study Baker McKenzie

Important milestones that display the firm's accomplishments

Strong description that showcases the firm's strengths and areas of practice

Case Study

"Likes" pages that resonate with the firm's areas of practice

"Likes" pages that reflect the firm's charitable interests and community outreach
Case Study

Facebook posts that depict the "human" side of the firm

Photos from a firm party

"Behind the scenes" interview

Instagram
**External Advantages**

- The most personal of the different social media interfaces
- Uses visuals to showcase your law firm’s work
- Create a human side to your firm by showcasing life outside of the law firm
- Use “Repost” to share and comment on content from other users that resonates with your firm
- Use hashtags to grow your audience base and increase views

**Instagram Maintenance**

- Create a hashtag for your firm
  - The #firmname allows clients and potential employees to easily find your posts
  - Including other popular hashtags in the comments increases the views of your posts
- Showcase your firm’s culture outside of the law firm
  - Spotlight your firm’s community involvement and employees’ personal accomplishments
Instagram Maintenance

- Showcase high-profile clients
  - If your clients give you permission, showcase work that your firm has done for them
  - A few posts referencing work done for a client can increase your firm’s standing in the eyes of the public
- Engage with Instagram to increase
  - Follow similar accounts and “like” and comment on appropriate content to grow your followers

Appropriate Content

- Showcase your firm’s activities outside of the law firm
  - Leverage community and charity involvement
- Post photos of new office spaces, new associates, and new partners
- Spotlight a day in the life of an employee
  - Include interesting tidbits that appeal to clients and prospective employees
ABA Restrictions

- Consult your state's rules and opinions concerning Instagram and the ABA Model Rules of Professional Conduct
- It is important to avoid:
  - Giving legal advice
  - Forming Attorney-Client relationships
  - False advertising
  - Using social media in litigation to obtain evidence and “friend” witnesses, jurors, and other parties

Case Study - DLA Piper

- Visual posts that tell a story
- Attorney Advertising disclaimer
- Link to recent law firm news
Case Study

Post showcases charitable endeavor and community outreach

Use of popular hashtag to increase post visibility

Firm specific hashtags

Case Study

Informal, "behind the scenes" post that work well on Instagram
Twitter

External Advantages

- Twitter and LinkedIn accounts can be synced
  - Allows for LinkedIn updates to be easily shared with Twitter followers
  - Syncing accounts increases visibility across the two platforms
- Easy engagement with topics that resonate with your firm
  - Simply reTweet, favorite, or reply to appropriate Tweets
- Twitter is best used to grab user’s attention, attract industry influencers and press attention
Twitter Maintenance

- Utilize hashtags to your advantage
  - Engage with hashtags that are trending on Twitter to increase visibility
  - Use hashtags to engage in conversations about your firm’s areas of practice
- Create connections with related accounts by mentioning their username
  - In order to make tweets visible to everyone, not just followers of both accounts, do not start the tweet with @accountname
  - Include a period before the username to save characters

Twitter Maintenance

- Utilize Twitter’s analytics to determine how to best reach your followers and write more engaging tweets
  - Analytics allows you to measure your follower’s interests and demographics
  - Measure daily engagement to determine what time of day is the best for tweeting
- Monitor your feed daily
  - Respond to appropriate comments
  - Favorite and reTweet reasonable mentions of your firm by other Twitter users
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**Appropriate Content**

- Engage with the latest news in your firm’s areas of practice
  - Follow industry related news sources
  - Share and comment on the latest news to establish your firm as a thought leader in these fields
- Include related images in your tweets
  - Images stand out among text posts in a user’s feed
- Don’t tweet for the sake of tweeting
  - Make sure posts are meaningful in order to increase retweets and visibility

**ABA Restrictions**

- Consult your state’s rules concerning Twitter and the ABA Model Rules of Professional Conduct
- It is important to remember:
  - Attorney advertising and solicitation rules apply to social media
  - It is necessary to include the same information required in print advertisements in the 140 character Tweets
Case Study Latham & Watkins

Short video clips work well to engage followers

Engagement with other posts

Use of hashtags to increase post visibility

Commentary on industry-related issues to establish firm as a thought leader

Tagged other Twitter accounts to create connections

Attorney advertising disclaimer
Case Study

Visual posts with short descriptions that showcase community outreach

In Conclusion

- Social media platforms differ considerably and each offer unique advantages
- Take time to determine which platforms will work best with your firm’s brand
- To avoid repercussions, make sure to consult your state’s rules and regulations concerning social media and the ABA Model Rules of Professional Conduct before posting
THANK YOU!
Any questions?

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