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# Introduction to Bankruptcy and State Collection Law

## Introduction

* Bankruptcy is federal law, but includes a lot of state law
  + Long codified as title 11 of the U.S.C.
  + Supplemented by sections of title 18 (bankruptcy crimes) and title 28 (jurisdiction)
  + Bankruptcy Rules promulgated by SCOTUS governs procedure
* Substantive rights of debtors and creditors are largely governed by applicable state law
  + When in doubt, apply state law, especially regard to property – see *Butner*
* While early bankruptcy was seen primarily as a creditor's remedy, it has evolved as the most important remedy available to debtor's and an overwhelming majority of cases are filed voluntarily
* Don't need to be insolvent in order to file for bankruptcy
  + It is really hard to demonstrate solvency or insolvency at the outset of a case. Thought to be cumbersome, thus assumed to be insolvent
  + Even if not insolvent, bankruptcy can still be useful
* In the absence of bankruptcy, there would be an uncoordinated attempt to recover assets
  + Under Baird-Jackson Creditor's Bargain theory, bankruptcy should provide a collective forum for dealing with companies in financial distress
* Two main goals of Bankruptcy are:
  1. Equally situated creditors should be treated equally
  2. Promoting fresh start
* Usual bankruptcy length: 1-2 years
* Types of Bankruptcy
  + Chapter 7 – Liquidation: all property of the debtor owned at the date of bankruptcy becomes part of the bankruptcy estate. Individuals can exempt certain property. Personal debtor discharged from personal liability
  + Chapter 13 – Individual who owes unsecured less than $307,675 and secured of less than $922,975. Debtor gets discharge without losing nonexempt property. Must formulate plan over 5 years; doesn't have to be approved by creditors, but by bankruptcy court. Can't be confirmed over creditor objections unless certain requirements are met
  + Chapter 11 – individuals and business orgs. Debtor is normally allowed to keep assets and continue operation. Proposes plan where creditors paid over time. Confirmation of plan only after it has been voted on by various classes of creditors and shareholders. Then confirmed by court. Normally get discharge of all pre-confirmation debt

## Secured v. Unsecured Creditors

* Secured creditor: has a security interest (e.g., mortgage, collateral such as equipment, real property, real estate, etc.)
  + Debtor has committed property to the repayment of the loan
  + When the borrower defaults, the secured CR has a quick state remedy – foreclosure
* Unsecured CR: does not have a security interest/has no collateral for the loan
  + When the borrower defaults, an unsecured CR has to go to the court for relief – get a judgment and then enforce
* Benefits of obtaining a security interest:
  + Priority over those with unsecured interest
  + Skip litigation process if debtor defaults (saves an incredible amount of time)
  + Secures repayment. In the case of default, can seizure property to pay (foreclosure)
  + If collateral is sold, Art. 9 automatically gives secured creditor an interest in the proceeds of this sale

## Liens

### In General

* A lien is an interest in the debtor's property obtained by the creditor to secure payment of a debt or performance of an obligation. Bankr. Code § 101(37)
* Liens are of paramount importance in bankruptcy. Creditor whose debt is secured by a lien in the debtor's property has absolute priority over other creditors who have no lien or a lien with lower priority
* Liens are obtained in three ways
  1. By voluntary grant by the debtor (Consensual Liens)
  2. By judicial action taken by the creditor (Judicial Liens)
  3. By statute because of the status of the particular creditor (Statutory Liens)

### Consensual Liens

* Security Interests in Personal Property
  + UCC Article 9 Security Interest applies to "a transaction, regardless of its form, that creates a security interest in personal property"
  + All security interests in personal property are guided governed by UCC Article 9
  + Creation of the security interest under Article 9 - 3 Requirements
    - Uses the term “Attachment” to refer to creation (Note: can also be garnishing someone's wages)
    - First requirement: Value has been given
      * That the secured creditor (bank for example) has either made a loan or committed to make a loan to the debtor
      * Does not need to actually give it yet, suffices to have a contractual obligation to give it in the future
    - Second requirement: Agreement
      * There must be an agreement creating the security interest (normally a security agreement)
      * The debtor has to commit to giving the security interest. Must either authenticate the agreement describing collateral or agrees to security interest and transfers collateral to secured party
      * Most recent revision of Article 9 said that you can make your collateral description be as broad as you want—“all current and after acquired property”—as long as the debtor agrees
    - Third requirement: Rights
      * The debtor has to have rights to the collateral
      * Example: if the agreement purports to give security interest to neighbor's car, the debtor clearly has no rights to this
        + Ambiguous in case of timeshares (the only thing you could give a security interest in is the two-weeks you get, not the value of the whole property)
    - These events can occur in any order
    - Attachment continues even if the collateral is transferred unless the creditor agrees; and has interest in money or property received in exchange; and any property acquired by the proceeds
    - Scope of Security Interest - Can be really broad
      * Article 9 allows creditor to take security interest in current personal property owned and future property (“after acquired personal property”)
        + **After-Acquired Property Clauses**:

Creditors can include provisions in their credit agreements that say that the creditor has an interest in all of the debtor's property, including property currently purchased and that purchased after the agreement is entered into

* + - * + Can secure this loan as well as subsequent loans by this same creditor (future advances clause)
        + **Future Advances Clauses**:

Allows for subsequent loans by this same creditor to be secured

Future advances still have the priority of the original agreement

Note: Courts tend to be pretty generous that any future advances will be covered if there is a future advances clause

* + - * + If the collateral is sold, Article 9 automatically gives the secured creditor an interest in the proceeds of the sale. If the sale was unauthorized, the security interest may also continue in the original collateral itself

Note: Perfection may be temporary (See below)

* + Perfection of a SI – makes a SI good against the rest of the world
    - Perfection secures the security interest against third parties. Must perfect to have priority over subsequent creditors who also have a security interest in the same property. I.e. someone who gets a judicial lien. Unperfected interest is also subordinated to title of third parties who buy the collateral. Unperfected security interests, although enforceable against debtor, are given little protection against claims of third parties
    - UCC 9-303-perfection is attachment and applicable steps for perfection-action by secured party giving notice of the security interest
    - Two perfection methods:
      1. **Possession** (tangibles)
         * With respect to financial instruments/assets, can be obtained by taking "control of" the account where assets are held
      2. **Filing** in a designated public office of a notice of a secured transaction (intangibles or where possession unavailable)
         * Usually done with document called a financing statement
         * This notice is not informative (i.e. “notice filing”). It contains only name of debtor and SP and indicates collateral. Instead, the burden is on the third party to determine the nature of the transaction
         * Filing before making loan ensures perfection at time of attachment
         * Automatically granted attachment to proceeds 20 days after collateral is sold. Depending on the case, you may have to re-file after those 20 days
    - Some instances where this happens automatically
      * No need to file; no need to take possession
      * Purchase Money Security Interest (PMSI): Security interest is automatically given to a creditor if the creditor financed the debtor's purchase of the item. Where the credit itself made it possible for the debtor to obtain the property. Get other special perks as well
        + Consumer PMSI (for consumer goods) are deemed automatically perfected

Example: Go to Target and buy a microwave. Pay with a credit card (purchase on credit = loan). Target does not have to file a financing statement

Exception - Cars that must be perfected by compliance with state certificate of title laws (notice of security interest must be on certificate of title)

* + - * + Theory is that everyone would know there is a security interest on a consumer good; it would be stupid to impose the expense of a filing statement on creditors. Downside is that not everyone actually knows there is a security interest on these goods
    - Priority goes to the **first filer** of the financing statement under UCC
      * Exceptions: PMSI & Ordinary Course of Business
      * If the debtor sells the collateral in the ordinary course of business, then you do not retain a security interest in the collateral itself, but it attaches to the proceeds of the sale. A buyer who buys something in the ordinary course of business, then they can assume it is not subject to anyone else's interest in the property.
  + Default:
    - Unsecured creditor - Must sue for judgment; or may in some states sue for pre-judgment attachment (see below; not same as UCC attachment)
    - Secured creditor - No need for judgment; often gets paid w/o court intervention or summary procedure. UCC allows secured creditor to take possession of collateral w/o breach of the peace-this as a practical matter limits self help to voluntarily given possession or repossession of cars left in a public place where debtor is not there. Alternative is summary proceeding
    - Where creditor has possession, can sell or otherwise dispose of. If proceeds deficient, must sue for the deficiency
    - Secured party's remedies are cumulative-foreclosure, and/or judgment.
* Security Interests in Real Property
  + There are three types of prevalent real property security devices in the United States:
    1. **Mortgage**: Grants the mortgagee a security interest in the land
       - Some jurisdictions use the old definition of mortgage (title theory) – that a mortgage conveys title to the mortgagee with a right to take possession. But the “lien” view, in which mortgagee merely has security interest is much more popular
       - Modern mortgages are contracts that are enforced by courts according to contract law
       - Historically, default on mortgage lost all interest in land. In the present day, debtor's interest under a mortgage is described as the "equity of redemption", permitting them to redeem property by repaying debt
       - No more strict foreclosure (prohibited in most states), instead property sold and any surplus over debt returned to mortgagor
    2. **Deed of Trust**: The trustor (debtor) conveys legal title to a trustee in trust for the benefit of the beneficiary (creditor). This allows a trustee to sell the property for the benefit of the CR on default by the trustor
       - Nowadays the deeds of trust and mortgages have essentially melded together – mortgages normally contain enforceable powers of sale, and the trustor/beneficiary relationship largely parallels modern mortgagor/mortgagee relationships
    3. **Installment Sale Contract**: The seller sells land to the buyer on the condition that title will pass to the buyer only when the buyer has completed the installment payments called for by the contract
  + Security interest may arise only where there is an obligation to be secured
  + Perfection is done by recordation of the mortgage document. But the mortgagee has priority over third parties who know of the mortgage even if it is not recorded. Also a judicial lien creditor whether or not he knows of the mortgage, can take only subject to it
  + Open end mortgages where mortgagee may advance additional funds on request, or construction mortgages where funds are advanced with completion of the structure:
    - Advances made pursuant to a commitment take priority from date of commitment
    - Optional advances relate back to the date of the mortgage only if made by the mortgagee w/o knowledge of an intervening security interest. So second mortgagee assures priority by notifying first mortgagee
  + Default: States vary on whether remedies are cumulative as with personal property, or a choice by suing for a judgment or foreclosure, or one action-foreclose and ask for deficiency judgment at the same time
  + **Judicial Foreclosure** - Mortgagee sues to foreclose, junior lienholders are joined, court orders a sale; public sale occurs after statutory notice, proceeds pay the mortgage debt. Surplus goes to junior creditors and rest to debtor. If there is a deficiency, it is assessed as a personal judgment against debtor. If sale conforms to statute, it will not be able to be challenged for fetching too low a price
  + **Power of Sale** - Contained in the mortgage document. Gives mortgagee the power to do the foreclosure sale w/o judicial proceeding. Mortgagee forfeits right to any deficiency judgment. Does not resolve disputes by competing creditors
  + **Statutory Redemption** - Debtor may redeem from the foreclosure sale within a statutory period

### Judicial Liens

* Unsecured creditor remedies - sue for repayment **under state law**
* **Pre-Judgment Liens - Attachment Liens**
  + (1) Garnishment-go into accounts/payroll and take money
  + (2) Right of prejudgment attachment of property (if afraid debtor will move assets abroad). This is not creation of a security interest
  + These remedies have been curbed by SCOTUS and now are usually limited to cases of fraud, basis to believe debtor will conceal assets, debtor not a resident of the state, contract claims where amount owed is ascertainable, etc
  + Usually only if court decides on the probable validity of the creditor's claim
  + Debtor can usually prevent with a surety bond
  + These are not constitutional unless the debtor is provided with a hearing and notice.
* **Judgment Liens**
  + A general lien which arises after judgment is obtained in favor of the creditor
    - It applies to all of the property to which a judgement lien can apply
  + A judgment makes an unsecured creditor a judgment creditor
    - The judgment creditor can go after property and assets
  + Perfection - Sometimes perfection is automatic
    - Sometimes has to be docketed (up to creditor to make sure and notify debtor) and get a writ of execution (see below), but this usually only applies to real property
    - You need perfection to get priority
  + Attaches to all real property of the judgment debtor in the county where the judgment is docketed. Usually attaches to after-acquired property also. Life of the judgment is usually around 10 years. Can be renewed
  + In a few states it attaches to personal property also
  + Creditor can obtain sale of the property similar to judicial foreclosure
* **Execution Liens**
  + A specific lien which attaches to the property on which levy is made under the writ of execution
  + Writs of execution - Usually apply to personal property since judgement liens generally do not attach to this
    - You need to get a writ of execution to enforce the lien **in addition to** the judgment being obtained
  + Judgment: Lienholder obtains sale by levying property pursuant to a writ of execution. Levying officer records the writ or notice of levy in the land records. The execution lien arises when this recording occurs for real property (varies by state, might be additional sale procedures). For tangible personal property, it occurs with physical seizure, or notice of levy (depends on state). For intangible personal property, it is done by garnishment of accounts or wages
  + Perfection: for personal property, execution lien is inchoate until the levying officer levies the property in some states. Not perfected until the actual levy. Often difficult because levying officers work slowly or reluctant to size property due to elected status. Until perfected, you are like an unsecured creditor if the debtor goes into bankruptcy. Other states only require the writ of execution for perfection
  + CR could also seize the property themselves as long as there is no breach of peace
    - Breach of peace used to mean threat of violence, but now there can't be a scene – basically, DR needs to either not know or allow CR to take

## Priority

* General Rule: First to (1) file or (2) perfect gets priority
  + Exceptions:
    - Purchase Money Security Interest (PMSI) gets special priority above all
      * The PMSI's priority attaches only to that specific piece of the DR's property (even if that CR has interests in other pieces of DR's property). This is justified because a special relationship is formed between the DR and CR as to this specific piece of property – the PMSI CR gets priority because of this
    - Buyer in the Ordinary Course of Business: if the debtor is in the business of selling something, the consumer is going to assume that the debtor can sell/perform his business free of liens. Thus, if the debtor sells the collateral and the sale is authorized, a buyer who buys takes it free of any existing security interests (ie later buyer has priority over the earlier lender)
      * CR made it possible for DR to buy the item, or CR is selling the item
      * Car dealership example: the bank might have security interests in all of the dealership's cars, but the buyer's interest in the car takes precedence over the bank's when the car is purchased (despite the first in time rule). The bank can seize the proceeds from the dealership
* Basic Priorities **Outside** Bankruptcy:
  1. Perfected property interests
     + - If more than one, first in time rule
  2. Unperfected property interests
     + - Creditor still has rights against the debtor but has not gone through the perfection processes
       - Note: you would be an unperfected property interest holder if you make a mistake in the perfection process for instance
       - In many state real estate law, an unperfected mortgage has even more priority (over judicial liens for instance)
  3. General unsecured creditors
     + - Creditors that do NOT have any property interest
  4. Equity
     + - The debtor or shareholders of the corporation or whomever has ownership interest in the debtor
* Basic Priorities **Inside** Bankruptcy:
  1. Perfected property interests
  2. Administrative expenses /other special priorities
     + - I.e. attorney's fees etc.; Domestic Support Expenses; Employees; IRS and other enumerated priorities in Bankruptcy Code
  3. General unsecured creditors
     + - In bankruptcy, unperfected property interests are lumped in this category
  4. Equity
     + - Remaining is distributed among debtor's shareholders or equity holders
* Differences in priority inside/outside bankruptcy:
  + Inclusion of special priorities for administrative expenses second/right after perfected property interest holders
    - Attorney's fees, professionals, employees on paid wages
    - Domestic support obligations trump these admin expenses
  + Unperfected property interests get wiped out inside bankruptcy and turned into general unsecured claims. This does not mean that the claim disappears, only that the property interest does (The claim turns into an unsecured claim)
    - Trustee has power to ‘avoid' unperfected security interest
  + **Pro Rata Rule**: All remaining assets divided equally among pool of unsecured creditors

# Overview of Bankruptcy Proceedings

## Stages of Bankruptcy Proceedings

1. Commencement
   * §301 – voluntary bankruptcy filing (gate-keeping provision, very broad)
     + An entity that may be a debtor under a particular chapter (defined in §109) may commence a voluntary bankruptcy case… (loose requirement that you be a “debtor”)
     + Note: must say what chapter you are filing (must designate exit at commencement). So, when you file for bankruptcy, you must file under a particular chapter
   * §303 - Involuntary filing (very rare - 1% of cases)
   * §109 –provides who can be a “debtor” in a particular chapter and provides the debt ceilings for each chapter
     + Entities that do NOT fit within §109 (explicitly excluded from bankruptcy)
       - Commercial banks
         * Note: commercial banks are those that take deposits, issues loans. NOT an investment bank, which can file for bankruptcy
       - Insurance companies
2. Creation of Estate - (*aka the pie to be divided*)
   * Available assets for creditors = “property of the estate”
   * Basic rule: anything that the debtor has an ownership right in becomes part of the estate
   * Starts with everything and then has other provisions that either extend the estate or contract the estate
   * Provisions that expand the estate (add to the estate):
     + **§544** – Trustee's Strong Arm Provision (trustee has the power to avoid unperfected property interests –used to avoid a security interest, mortgage, unperfected judicial lien that is unperfected)
       - Note: does NOT remove the claim, just the security interest
     + **§547** – Preference Provision (payments to creditors within **90 days** before filing for bankruptcy must be returned)
       - Expands the estate by avoiding preferential transfers
     + **§548** – Fraudulent Conveyances
       - Allows transaction to be reversed (returned to the estate) if debtor enters into a transaction **within 2 years of a bankruptcy** either (1) intending to defraud creditors or actually defrauds creditors OR (2) receives disproportionally low amount for the transaction (less than reasonably equivalent)
         * Classic Example: Selling house for $1 while under financial duress, effectively defrauding creditors
         * Paying large bonuses prior to filing
         * Organization restructures itself shortly prior to filing for bankruptcy for the purpose of getting assets away from creditors
   * **§522** – Exemptions (Provision that protects property belonging to the estate from being seized by creditors)
     + Applies to consumer bankruptcies only – it is a list of property that consumer debtors get to keep when they file for bankruptcy
     + This is also regulated by state law (e.g., homestead exemption)
     + DRs sometimes get a choice between federal and state exemptions (though majority have states have taken this choice away by compelling use of state exemptions)
3. Executory Contracts - Falls between the “Estate Phase” and the “Claims Phase”
   * §365 - Requires that there is a mid-stream contract – i.e., an obligation that is ongoing and effective and is active at the time of the bankruptcy
     + There must be an obligation on the part of both parties for the contract to be executory – neither party has fully performed
     + Extremely important and gives the debtor a lot of power – although on its face the section seems to allow debtors to get out of any contract, judges have not interpreted it this way.
   * Executory Contract: ongoing contracts; contracts on which material performance is still due on both sides
   * If the debtor wants to keep the contract in place he can assume it and then it becomes part of the estate
     + Assumption of the contract is the default
     + Debtor can even assume a contract that has been defaulted on prior to bankruptcy
   * If the debtor does NOT want to keep the contract in place he can breach/reject the contract and the contract rights become an unsecured claim of the creditor
     + Great source of power. Allows the debtor to get rid of some contracts he would not otherwise be able to outside of bankruptcy
     + E.g., car makers were able to terminate many of their dealerships; celebrities sometimes try to use this provision to get out of contracts (see Korrupt)
     + Idea is also used to terminate CBAs – see §1113
4. Claims - (*aka who gets a piece of the pie and how big*)
   * §501 – Gate-keeping provision
     + Creditors may file a claim (like §301 in that it is extremely broad and not that informative)
   * §502 - Gives the court the power to set the amount of a claim
     + Sets forth the rules for when a claim has to be allowed or not
     + This section kicks in when somebody (usually the debtor) objects to a claim
     + Post-petition interest is not part of the claim for unsecured creditors
   * §506 – Property interest (secured creditor) section
     + If a secured creditor (someone with a property interest) has property interest worth less than they are owed, that property interest is both secured and unsecured
       - If secured creditor is under-collateralized, they have a secure claim up to the value of the collateral and an unsecured claim for the rest
     + Over-secured creditors get interest payments
5. Operations
   * §362 — Automatic Stay
     + Enormous level of protection for debtors
     + When the debtor files for bankruptcy, there is an automatic stay. This says that creditors have to immediately cease and desist the moment debtor files for bankruptcy. Cannot go to state courts (prevents creditors from suing to collect judgments); call debtor; solicit payment in anyway
     + Furthers the goals of bankruptcy: (1) prevent a race to the courthouse; (2) allow for a collective solution to the problem that is better for all creditors
   * Creditor's bargain theory: (Douglas Baird; Thomas Jackson) core purpose of business bankruptcy is to provide a collective solution to financial distress. Key is the automatic stay
   * §363 – Gives the trustee in a bankruptcy case the power to use, sell, dispose of property of the debtor outside of the ordinary course of business as long as there is notice, hearing, and court approval
     + This is the provision the court used in Chrysler to get through the bankruptcy process so quickly
     + Creditors have a chance to object to proposed 363 sales at a hearing
     + In the last 10-15 years, 363 has been used to sell major assets/pieces of the business prior to Chapter 11 reorganization making reorganization more theoretical (since the prime assets have been sold off).
     + §363(b) - Sale of assets of the corporation (most common)
       - Trustee must seek court approval (after notice and hearing) to do anything unusual
       - Turned into a go to provision although not intended to allow for sale of corporations
   * §364 – Financing Provision
     + Facilitates borrowing by debtors when they are in bankruptcy
     + Turns out to be one of the most important provisions in Chapter 11 (American business bankruptcy)
     + Gives the court a lot of discretion to approve lending. If the debtor wants to get debtor-in-possession financing the, court has privileges it can give to the loan
       - Not only can court give lender administrative expense status or a lien, it can give a lien that takes priority over all other liens (priming lien)
       - Chapter 11 debtor-in-possession is distinguishing provision of American bankruptcy
     + Recently (in the last year or so) the government has become the biggest debtor-in-possession lender. This has really been in the auto industry bankruptcies
6. Exit
   * Chapter 7 - Liquidation
     + Liquidation for both individuals and corporations (most commonly for individuals, but also for corporations that cannot use Chapter 11)
       - In many consumer bankruptcies, Chapter 7 is an immediate discharge because consumers have no assets that are not exempt
     + Trustee is appointed, who is responsible for selling off any assets and distribute proceeds among the creditors
     + §725 - Property interests gets paid off first
     + §726 - Priority interests below property interest
       - Directs you to §507 for priority rules
   * Chapter 11 - Restructuring
     + Primarily for businesses
   * Chapter 13 - Rehabilitation for individuals
     + Propose a 3-5 year repayment plan
       - You have to pay all of your disposable income for the next 3-5 years less reasonable expenses (costs you more than Chapter 7, in which you simply turn over your available assets)
       - You would effectively have to pay interest on any secured claims over the life of the plan, not on unsecured claims
       - If the plan FAILS, take away the discharge/the restructured obligations go back to original (aka owe 100 cents on the dollar even if restructure to owe 30 cents on the dollar)
     + Limitations: there are debt maximums (something like 1M secured; 350k unsecured). If you have more than that you, you cannot use Chapter 13
       - Examples: Mike Tyson; Michael Vic both filed for Chapter 11 because they had more debt than the maximum allowed under Chapter 13
     + Reasons to file for Chapter 13:
       1. You want to keep a house with equity in it or some other asset (main reason you would want to file for Chapter 13 over Chapter 7)
       2. Some types of debt that cannot discharge in Chapter 7 can be discharged in Chapter 13

## Major Players in Bankruptcy Proceeding

* Creditor and Unsecured Creditor's Committee)
  + Companies/individuals with claims on the DR's property
  + Unsecured Creditor's Committee:
    - (Only committee in the statute)
    - Composed of the 7 largest unsecured creditors who are willing to serve
      * Some might not want to serve because of the time commitment or fear of exposure to inside information that would bar future dealings with the DR
    - Serves as the “face” of the unsecured creditors
    - No committee for secured creditors because their interests are already protected and will likely get paid. They are typically fewer secured creditors, so less coordination problems
    - 3 Consensual Security devices that can be used to assure payment of a debt:
      1. Interest in property
      2. Personal guarantee
      3. Letters of credit
* Trustee/Debtor-in-Possession
  + The principal duty of the trustee is to collect the property of the estate, sell it, and use the proceeds to pay expenses and CR claims
    - Avoidance powers, recovering property transferred prior to commencement in order to exclude from estate, among most important in BR. In exercising it, trustee acts primarily for the benefit of unsecured creditors
  + In Chapter 7, the bankruptcy estate is administered by a trustee who can either be an individual or a corporation (§701)
    - Trustee is assigned by the U.S. Trustee who keeps a list of possible private trustees (usually private professionals)
    - If CRs want a different trustee they can vote to put a specific trustee in place
  + Under Ch. 11, management can ask for a trustee to be appointed but it is really uncommon – usually the managers continue to run the business
    - Thus DR continues in possession as a "debtor-in-possession" that exercise powers of a trustee
    - Requirements: Gross Mismanagement and Fraud
    - Frequently most of the old managers are gone before they file for bankruptcy. A bank may require new managers or that a “Chief Restructuring Officer” be put in place before giving the company a loan for the restructuring
    - If nobody will agree to be the trustee, the U.S. Trustee itself can be the trustee
  + US Trustee (government watch dog)
    - If no one is appointed or willing to serve. Preference to have a private party be the trustee
* Bankruptcy Judges (Article I) – have a tremendous about of power/discretion (§105 powers)

# Commencement

## Key Provisions

### §109 – Eligibility

* §109(a) - **General provision for who qualifies as a "debtor"**
  + "Only a person that resides in the United States, or has a domicile, a place of business, or a property in the United States, or a municipality, may be a debtor under this title
  + Thus any person that resides or has a domicile, place of business, or property in the United States is eligible to be a DR under the Bankruptcy Code
* §109(b) - **Who can file as a debtor under chapter 7**
  + Who qualifies for 7 (and therefore for 11)? A person can be a debtor under Chapter 7 unless it is a: (1) railroad; (2) a commercial bank or domestic insurance company; or (3) a foreign commercial bank or insurance company that does business in the U.S.
    - A **"Person"** (defined in §101(41)) includes individuals, partnerships, or corporations
    - A "**Corporation**'(defined in §101(9)) includes business trusts. Definition of "corporation" is expansive and includes most entities with the characteristics of a private corporation (except for limited partnerships)
      * A trust must actually be engaged in some sort of business to qualify as a "business trust" for bankruptcy purposes.Holding companies, land trusts, or trusts created solely to maintain assets do not qualify as "business trusts" and are not eligible for bankruptcy
    - **Exclusions in Chapter 7**:
      * Provision is designed to **exclude commercial banks and insurance companies from bankruptcy entirely**
        + Why? We already have a regulatory system that deals with banks and insurance companies; they also have possession of other people's money
        + Although commercial insurance companies are excluded from Chapter 11 and 7, any related/affiliate company is not excluded and could file for bankruptcy – when a subsidiary files the Bankruptcy Court ends up dealing with the holding company as a whole
      * Also excludes **Railroads**
        + Chapter 7 mandates liquidation and we don't want railroads liquidating in bankruptcy, we want them reorganizing – this was especially important when railroads were the primary mode of commerce/trade
* §109(c) - Who can file as a debtor under chapter 9? Insolvent municipalities
* §109(d) - **Who can file as a debtor under chapter 11?**
  + Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), an uninsured State member bank, or a corporation may be a DR under Chapter 11
  + You have to be able file for chapter 7 to file for chapter 11
    - Carve out for Railroads - they only go into Chapter 11
  + Exception for stockbrokers/commodity broker: stockbrokers/commodity brokers (i.e. an investment banks) are not allowed to reorganize, but can liquidate (can file for Ch. 7, but not 11)
    - Why? Logic is that investment banks have other people's money and it might be tough to sort out who gets what/customer money might get lost. Customers are vulnerable and need protection (highest priority) and chapter 11 would be messy and compromise those accounts. If IB fails, we don't want to go through re-org, but rather take out customer accounts and liquidate
    - Note that investment banks can put subsidiaries/holding companies in chapter 11. Example - Lehman sold its IB subsidiaries to Barclays and filed Chap. 11 for remaining non-IB subsidiaries. IB subsidiaries filed for Ch. 7 after sale to Barclays

### §301 - Voluntary Bankruptcy Filing

* §301 – Voluntary bankruptcy filing (gate-keeping provision, very broad)
  + An entity that may be a debtor under a particular chapter (defined in §109) may commence a voluntary bankruptcy case… (loose requirement that you be a "debtor")
  + Note: must say what chapter you are filing (must designate exit at commencement). So, when you file for bankruptcy, you must file under a particular chapter

### §303 - Involuntary bankruptcy filing

* §303(a) - Involuntary bankruptcy case
  + Have to be a "person"
  + You can file an involuntary petition against any person who can be a debtor in ch. 7, 11, but CANNOT file an involuntary petition against a non-profit (Catholic Church diocese)
  + Note: Non-profit corporations is a very important carve out of 303(a). Corp that "is not a moneyed, business, or commercial corp" is considered non-profit
* **§303(b) - Basic criteria:**
  + **303(b)(1) - If more than 12 creditors in total, need at least 3 entities on the petition with aggregated unsecured obligations >$15,775**
    - Policy justification: If 3 major CRs can agree that bankruptcy is the right call, it will likely benefit all CRs
  + **303(b)(2) - If less than 12 creditors in total, only need 1 entity with aggregated unsecured obligations >$15,775**
    - Note: the use of the word "such" transfers over the other requirements from (1)
    - Note: the word "entity" is used instead of person. This is a deliberate move to include the possibility a government entity is one of the creditors
    - Note: in counting the number of total creditors, we are not going to count an employee or an insider
  + **303(b)(3) – If a partnership**
    - By fewer than all of the general partners in such partnership; or
    - if relief has been ordered under this title with respect to all of the general partners in such partnership, by a general partner in such partnership, the trustee of such a general partner, or a holder of a claim against such partnership;
* **303(c)**: Allows unsecured claim holders that are non-contingent to join to the 303(b) filers
  + Note: The addition provision allows for the possibility of adding on a disputed claim after the initial filing
* **303(h)**: Additional Requirement - Is debtor not paying its debts as they become due?
  + Involuntary debtor has 20 days to file a responsive pleading. Significantly,§303(h) provides that if the involuntary petition "is not timely controverted, the court shall order relief against the debtor". However, if contested, can only proceed with commencement if "the involuntary debtor is generally not paying debts as they become due unless subject to a bona fide dispute"
  + 303(h) thus becomes a defense the debtor has to a properly filed involuntary petition
  + Note: this is just a general requirement, would expect that the creditors filing are those that are not being paid on time, but the creditors filing do not necessarily need to be the ones who are not being paid on time
* **303(i)**: Damages for bad faith filings
  + Potential penalties are pretty serious, potentially allowing for punitive damages

### 28 U.S.C. §1408 – Venue Provision

* A Chapter 11 bankruptcy can be commenced in any jurisdiction of:
  + (1) DR's domicile, residence, principal place of business in the United States, or principal assets in the United States have been located for the 180 days preceding commencement;
    - "Domicile" = state of incorporation (typically Delaware)
  + (2) Which a Ch. 11 case concerning an affiliate, general partner, or partnership is pending
    - This makes it possible for companies to file anywhere because technically all they have to do is set up a shell corporation in the jurisdiction they wish to file in, and put the new "affiliate" in bankruptcy

## How and Where to Commence

* To commence, must file petition with clerk (See Fed. R. Bankr. P)
  + Most difficult part is listing all creditors, in a big case (e.g. Lehman Bros), court will allow you to defer the list of creditors
  + Prepackaged case: When bankruptcy and the reorganization plan is filed at the same time (Works best if DR has few creditors, and wants end case quickly)
  + No formal requirement to be insolvent; possible to file where assets are greater than liabilities
    - Insolvency can come in as a defense in involuntary filings, DR can contest that they are generally paying debts to defeat involuntary petition
    - Exception is Ch. 9 municipal BR filing (e.g. Puerto Rico)
* Large companies can essentially file for bankruptcy anywhere in the United States because the Bankruptcy Code's venue provision is incredibly broad
  + The laws differ from jurisdiction to jurisdiction because law in different circuits differs and because bankruptcy incorporates a lot of state law
  + Thus, broad venue provision allows DRs to file strategically in jurisdiction that may be more favorable to them
* Bases for establishing venue:
  + Domicile, residence
  + State of Incorporation basis
  + Headquarters basis
  + Place of primary assets
  + Affiliate basis
    - The affiliate files and company piggybacks on case (If a subsidiary is in the state, you can file there)
    - Ex. IGM has car dealership in Harlem, so it can file in NY even though it is a DE corporation with PPB in Detroit
* Despite broad venue provision, most companies try to file in either Federal District Court of DE or SDNY
  + Access to hearings on short notice, particularly first hearing of case, during which first day orders are proposed – requests to have/hire a bankruptcy lawyer; requests to continue paying EEs; requests to approves DR-in-possession financing; requests to pay off key suppliers/critical vendors
  + Petitions automatically referred to Bankruptcy Court
  + Why New York?
    - Companies want to file here because the judges are experienced and sophisticated, easy access to experienced lawyers, and because it is easier to get professional fees in New York (fees charged to estate at normal NY rate, regardless of DR's origin)
    - New York used to have a reputation for letting DRs keep control of the case for as long as they wanted to – e.g., extending period during which only DR can propose reorganization indefinitely beyond initial first four months of case)
  + Why Delaware?
    - Delaware used to be the most popular venue (in '90s) because Delaware judges were known for first-day orders that signed off on everything you needed for the entire case. Prior to '90s, NY was most popular location to file, but now there is a split between NY and DE
      * Today, mega-cases go to SDNY while big cases go to Delaware
    - Likely able to file here under venue provisions since majority of large companies are incorporated in DE

## Voluntary Filing

* Percentage of BR cases filed voluntarily is 97-98%
  + However, this is a bit misleading, bc many debtors are “pushed” into bankruptcy
  + Some voluntary cases are really involuntary; Creditors pursues debtor, debtor files case before they do – if debtor files, has more control over case (e.g. choose where to file, which exit chapter to use)
* When you file, you must declare the Chapter you are filing under, thus exit is designated at the time of commencement
* Why don’t secured creditors want Chapter 11 Bankruptcy?
  + Creditors want their collateral as soon as possible, sell it and move on
  + In Chapter 11, there is no Trustee, so the debtor tries to reorganize and creditors don’t get their collateral quickly
  + So creditors want Chapter 7, bc there would be a Trustee to sell the assets and secured interest, so that creditors would get their collateral quickly
  + Secured creditors suspect that in Bankruptcy, they will not get every cent they are entitled to: interest rate
    - If under-collateralized --> get no interest at all
    - If over-collateralized --> if they do get interest rate…worried it might be less than a genuine appropriate interest rate. SCOTUS has provided for a mandatory interest rate, which is widely viewed as under-compensatory

### In re Treasure Island Trust

* Facts: Treasure Island Land Trust files for Ch. 11 bankruptcy. Creditors protest filing, arguing that Land Trust does not qualify as a proper debtor under §109
* Issue 1: Is Treasure Island a business trust?
  + Test: Does this trust have characteristics of a business trust? A business trust is created for carrying on business (similar to a corporation). A non-business trust is created to protect/preserve the trust
  + Held: No. The terminology of the trust instrument suggests it is a non-business trust, and is not similar to a corporation. In fact, it explicitly states the intention not to be transacting business of any kind. There is no evidence of any business activity in the trust to that end
* Issue 2: Whether a simple land trust could otherwise be a "person" under Ch. 11?
  + Held: No. Congress did not intend to expand the category of debtors eligible for relief
    - §301 in conjunction with §109(a) is clear that only a "person" may be a debtor and thus eligible for BR. Additionally §101(3) defines person as either an individual, partnership, or corporation (i.e. business trust). **In not performing any business functions and legally identifying as a non-business entity in the past in order to avoid regulations, there is no reasonable grounds on which TI could be identified as a business trust**
      * Ironically, the prior legal proceedings against the SEC in which TI argued it was not a business trust, but it failed here. However, the fact that it attempted to characterize itself as a non-business trust in the prior case (though unsuccessful) caused them to lose here as well
    - Other possible reasons to deny TI's petition
      * Ch. 11 is concerned with reorganizing business - there is nothing to reorganize here
      * Only 2 creditors, both of which are secured. Minimal risk of dismemberment or coordination problems in the absence of BR
  + Policy: There are policy reasons for excluding land trusts and the like from bankruptcy – these are really just two party disputes (the DR and its lenders) and bankruptcy is typically appropriate only when there is a potential collective action problem (lots of unsecured creditors). Ch. 11 bankruptcy is appropriate if there is some value outside of bankruptcy and there are leftovers for unsecured creditors
* Thought Question: Is the court right? Is this a problem that bankruptcy is intended to fix?
  + Ultimately, while the land trust may have a coordination problem, it is with equity holders rather than creditors and thus is really a two-party dispute not generally within the purview of bankruptcy
* Hypo: What if TI turned into a corporation and then filed for bankruptcy?
  + Argument that it is a valid filing: TI is now a corporation and as a strict statutory matter/matter of the code it should be eligible for bankruptcy
    - Transferring assets to corporation isn't fraudulent since mortgages follow with it and CR's are still protected
    - Nothing in Ch. 11 to forbid it from filing, but Courts can look at substance over form and kick it out
  + Argument that this is not a valid filing: This is a sham!
    - §1112(b): If there is cause, a case can be converted to another type of bankruptcy or dismissed (see analysis in Kingston Square)
    - §305: Courts can abstain from a case if interests would be better served by dismissing the case
    - §105: catch-all for all things Bankruptcy court doesn’t have clear authority to do
  + Courts tend to lean towards letting cases stand

### LTV Steel

* Facts
  + LTV Steel (parent corporation) sets up a few subsidiaries: Sales Finance and Steel Products
  + Each subsidiary enters into loan:
    - Sales Finance enters loan with Abby National (secured in accounts receivable – IOUs in the sale of steel products LTV is making)
    - Steel enters with Chase (security in inventory)
  + LTV files for Chapter 11, though subsidiaries do not follow it into bankruptcy
    - LTV seeks to use cash collateral (consisting of accounts receivable and inventory) from secured creditors Abbey National and Chase Bank
* Issue: Can the debtor use the cash collateral in the midst of bankruptcy?
* CR Argument: The cash collateral is not part of the debtor's bankruptcy estate because the loans were made through the subsidiaries, Sales Finance and Steel Products. This form of securitization involves setting up separate transactions that build a wall and keep the transactions outside bankruptcy
  + Creditor's want cash collateral outside the estate so it is not subject to automatic stay and they can foreclose directly instead of going thru bankruptcy
* Holding: Cash collateral is part of the estate (bankruptcy court not convinced it was a "true sale"); **Debtor can use cash collateral**
  + Court claimed this was in the best interest of the estate and all creditors of the estate
  + The fact that the loans are secured by the inventory suggest that it was not really a "true sale" because inventory is not really something you can sell (**cannot release interest in inventory**) (because LTV's labor and production capital was used to produce the inventory)
* This case was bombshell: first to call securitization into question; Bankruptcy courts will not just take these at face value
  + Can't use some arrangement that merely resembles a securitization and expect to receive the same benefits of remoteness from bankruptcy
  + Here, a securitization in inventory was going too far. Was not a true securtization transaction

## Involuntary Filing

* Occurs very infrequently; Only 2-3% are BR cases are filed involuntarily
  + Why? No guarantee that costs incurred by CR's in commencing will be recovered. Involuntary BR is also a public good that benefits all CRs, so better chance of full recovery if those CRs sue instead of commence BR
* Justification for filing involuntary petition
  + Creditor can then pick the bankruptcy courts that he/she wants
  + If creditors worry about not getting paid in full outside of bankruptcy
  + If there’s a fear that there’s fraud happening in debtor corporation
  + If creditor is worried that debtor has been paying back others creditors (making preferential payments), so you file in order to get the same treatment
* Must first determine if criteria are met
  + Is the appropriate amount of claim holders filing the petition met?
    - If 12 or more CR's, then 3. If less than 12, only 1
    - Partnerships have different rules - See §303(b)(3)
  + Is the aggregate amount of exposure met? (>$15,775)
    - Exposure: unsecured obligations
      * A fully secured creditor can count towards number of necessary claim holders, but secured obligations aren’t added to the sum
        + Why? Secured creditors are going to be compensated regardless and thus the involuntary petition was specifically designed to protect the interests of unsecured creditors
        + Exception: If a secured CR is undersecured, the amount by which it is undersecured contributes towards aggregate amount requirement
      * Claims cannot be disputed/contingent. Only non-contingent undisputed claims count towards the exposure threshold (Courts often allow CRs to petition if only part of the claim is disputed)
        + Contingent: debt/obligation that may or may not become due

Classic example: guarantee (unsure whether this obligation will be called on, claim doesn't come into existence unless debtor fails to pay)

Ex: if Bernie Sanders wins, I owe you $10k

* + - * + Disputed: debt/obligation there is a fight about what the claim is

Ex: tort action

* Once debtor is thrown into bankruptcy, what can debtor do to get out of it?
  1. Challenge §303(b) – maybe one or more claim is disputed; maybe there aren’t 3 creditors; maybe amount requirement is not met
  2. §303(h) – debtor can show that he/she is paying his debts as they come due
     + The easiest way for a debtor to defeat an involuntary petition is to show that he is solvent (can pay debts) and that he is currently/is willing to pay his debts on time
     + There can be disputes about what "pay as debts come due" means
     + Example: If debtor is paying all the little creditors, but not the 1 big creditor, then is debtor paying debts as they come due?

### *In re Kingston Square*

* Parties in this case:
  + Ginsberg: owner of the real estate partnerships (limited partnerships)
  + Chase/REFG: Commercial banks (made the original loans to limited partnerships. Give loan, get mortgage on each property back)
  + DLJ: Investment bank (orchestrate the purchase of the mortgages after the bank has made the loan, sets up Special Purpose Vehicle, sets up the mortgage securitization). Does everything but makes the initial loan, including servicing the bank loans, foreclosing on the properties (enforcer), setting up the board of directors, setting up SPV/dealing with investors
* Facts: Mortgages made were cross-default (if default on one, then defaults on the other). Mortgages packaged up and sold to SPV that was setup by DLG. A "bankruptcy remote" provision was included in the LP's charter as part of the mortgage loans, making voluntary BR filing require unanimous board approval. Independent director appointed by DLJ. Thus, DLJ (CR) able to prevent the LPs from filing bankruptcy by having appointed director vote no. Ginsberg circumvents the agreement by orchestrating involuntary bankruptcy from unsecured creditors
* Movant's argument: Rounding up creditor's to circumvent provision was bad faith on behalf of Ginsburg DLJ seek dismissal under § 1112(b) to throw out the petition for collusion in filing
  + DLJ doesn't want BR because it has more control outside of BR
* Holding: although it may look like bad-faith filing, **the court allows the filing to stand**
  + Bankruptcy is actually in the best interest of the creditors (1112(b) gives court the total discretion of whether to kick the case out)
    - Would preserve value for estate and CR's
    - Court's also not sympathetic to provisions in agreements effectively waiving rights to BR
  + Since there does seem to be equity in these properties, bankruptcy seems worthwhile
* Blackletter: **You cannot generally waive your right to file for bankruptcy as an individual or a corporation. Courts are very skeptical of waiving bankruptcy filing rights**

### Hypotheticals

* Hypothetical #1:
  + Setup: Debtor is a small family business. Corporation is in a little financial trouble. Corporation has 10 creditors in total. Two of the creditors file an involuntary petition
    - Creditor A: owed 10k (not secured)
    - Creditor B: owed 14k (partially secured, 5k)
  + Is involuntary bankruptcy an option here?
    - YES, assuming the debtor is not paying his debts as they become due and none of the claims are contingent/disputed, the exposure is 19k
    - Reason: this is because the corporation is not a non-profit. When there are fewer that 12 creditors in total, only one entity must file. The exposure amount/unsecured obligations (19k) is above the required aggregate amount
* Hypothetical #2
  + Setup Debtor is a small family business. Corporation is in a little financial trouble. Corporation has over 12 creditors in total. Three of the creditors file an involuntary petition
    - Creditor A: owed 10k (not secured)
    - Creditor B: owed 14k (partially secured, 5k)
    - Creditor C: owed 20k (27k secured)
  + Is involuntary bankruptcy an option here?
    - YES. When a debtor has over 12 creditors, 3 entities whose claims aggregate to meet the exposure amount are needed to file. Even though creditor C adds nothing to the exposure amount because his claim is fully secured, he is still allowed to count as one of the three necessary entities

# The Automatic Stay

## General Overview

* The automatic stay is a statutory injunction that takes effect when a BR petition is filed, regardless of whether it is voluntary or involuntary
* When debtor files for bankruptcy, all collection activities have to stop: aka creditors must stop seeking payments, suing debtor, etc
* Rationale:
  + Making bankruptcy process a collective action problem - if all creditors race to the court house, they won’t be able to save a business which may actually be worth saving from being dismembered
  + If there are lots of creditors, they may not all be able to coordinate/get together, so each creditor has an incentive to grab payment in full first
* Aims of the Automatic Stay:
  + Debtor protection: Safeguard against dismembering the bankrupt’s estate by stopping collection efforts. Permits debtor to attempt repayment/reorganization plan
  + Creditor protection: Provide orderly liquidation procedure under which creditors are treated equality (no race against debtor’s property, ratable distribution)
* The automatic stay is backward looking and only applies to pre-petition debts, contracts, etc. Any deal that is made after the petition is filed is not subject to bankruptcy restrictions
  + Even new deals can violate the automatic stay in certain situations
    - Example: The DR’s supplier (unsecured) says that he will only give the DR supplies if he pays pre-petition debt
    - Even though this takes place post-petition, it is still a collection effort that is stayed under the bankruptcy proceedings. This violates 362(a)(6), which forbids acts to collect claim against debtor that arose before commencement of the case
* **Critical Vendor Doctrine**
  + Permits repayment of vendors deemed to be critical to restructuring efforts
  + If supplier will walk away unless debtor pays back post-petition debts, then Courts allow debtor to unilaterally pay the supplier its unsecured claims to save the relationship during the bankruptcy proceeding
    - Normally, you are not allowed to as it would unfairly privilege one creditor

## Key Provisions

### §105: Discretionary Stay

* "The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title"
* Provides additional authorization to the court to provide relief as appropriate to carry out the provisions of the Bankruptcy Code
  + Example can be used to enjoin actions against the debtor or third-parties (Robins)
* This provision cannot be used to change/conflict with any other existing Code provisions
  + Ex: cannot stay the running of a statutory redemption period bc 108(b) covers this (Johnson)

### §362(a): Proceedings that are Stayed

* An injunction doesn’t need to be sought (it is automatic)
  + Notice is not required – all CRs are subject to the stay whether they have notice or not
  + When the DR files for bankruptcy she gives the court the names and addresses of her CRs and notice is sent to these addresses
    - Since a lot of DRs have “lockbox” addresses that they send their monthly bills to, many CRs have filed a “notice of address” with a bankruptcy court – all bankruptcy courts must then use this address to notify the CR. If a CR has filed an address with a court, notice will not be considered “effective” until it has been sent to this address.
    - §342(g)(2) - No monetary penalty may be imposed on a CR for acts violating the stay committed before the CR is given effective notice
* §362(a)(1)
  + Commencement or continuation of litigation intended to recover pre-petition claims or those that was/could’ve been commenced before filing
    - Note: Pre-petition claims may include causes of action that have resulted from pre-BK conduct and post-petition legal relationships
    - Note: aimed at staying judicial or administrative proceedings
* §362(a)(2) -- Enforcement of a pre-petition judgment
  + Creditor cannot enforce a judgment obtained before bankruptcy
* §362(a)(3) -- Act to obtain possession of/exercise control of property of estate
  + Creditor cannot take any action to re-possess the property of the estate (Not limited to pre-petition obligations)
    - Example: D stops paying lease and files for BR. Landlord cannot terminate the lease and retake the property. It can only file for relief
    - Example: Insurance company cannot cancel policy
* §362(a)(4) -- Creating/perfecting/enforcing a lien against property of the estate (Not limited to pre-petition obligations)
  + Foreclosure is stayed
  + Acts of perfecting SC/mortgage are stayed
    - Exception under §362(b)(3), which incorporates exceptions from 546(b) (cases of automatic perfection-PMSI’s) and 547(e)(2)(A) (30 day grace period to perfect after transfer, aka the transfer date is the perfection date if perfected within 30 days)
* §362(a)(5) -- Creating/perfecting/enforcing a lien against property of the debtor (when such lien secures a claim that arose pre-petition)
  + Property of the debtor: inclusion of (5) and use of this term suggests that it involves property that is not part of the estate
  + Example: Property acquired after bankruptcy (if in a chapter (Ch. 7) /jurisdiction does not include after-acquired assets in the estate) OR property that is exempted from the estate (sentimental value)
* §362(a)(6) -- Acts to collect, assess, or recover a claim against debtor that arose before commencement of case
  + Note: this can include irate phone calls harassing the debtor or even withholding future services because of a prior debt (Q5 (p. 163))
* §362(a)(7) -- Setoff (of mutual debts)
* §362(a)(8) -- Commencement/continuation of Tax proceedings

### §362(b): Exceptions to the Stay

* **§362(b)(1)** -- Criminal suits (for true crimes, not ones that are simply seeking payment of a fine)
* **§362(b)(2)** -- Cannot interfere with the rights of spouses and children to receive domestic payment from debtor spouses
* **§362(b)(4)** -- Government exercising police/regulatory power (Penn Terra, see below)
  + Requirements: (1) Actions must protect public welfare, and (2) Must be a nonmonetary judgment (or be forward looking)
  + But can’t enforce money judgment (exception to exception). Prevents gov’t units from using the police/regulatory power to gain preferential treatment over other creditors
    - “Money judgments” do not have to be literal money judgments – an act that is analogous to a money judgment will also be stayed
    - Rule: If the purpose is to remedy a backward-looking (past) harm, then it is a money judgment (not exempted). If the purpose is forward-looking (seeks to prevent future harm), then it falls under the regulatory power exception
    - Key question: does the regulatory agency look like a CR in this situation?
* **§362(b)(7/17/27) -- Exception for derivatives and other financial contracts**
  + Favors Wall Street for dealings with financial instruments like swaps and derivatives
  + **§362(b)(7) -- Repurchase Agreements**
    - Like a secured loan
    - Debtor sells securities to a lender/buyer in connection with contract
  + **§362(b)(17) –- Swaps**
    - Contract where you are swapping obligations
    - Ex: currency swap (at the end of the period, contract would be worth the difference in the two currencies); interest rate swap --one party promises to pay a fixed interest rate, other party promises to pay a variable interest rate (at the end of the period, contract would be worth the difference); credit default swap (key issue in 2008 financial crisis)?
    - **§362(27) -- Netting arrangements**
    - The exercise by a master netting agreement participant of any contractual right (as defined in section 555, 556, 559, or 560) under any security agreement
    - Arguments for/against special treatment:
      * For Exception: this market can take care of itself (self-clearing market); domino effect failure; promotes liquidity in the system; protects hedges; otherwise would make these contracts undesirable
      * Against Exception: Worry about race to the courthouse (makes bankruptcy useless for DR bc there is nothing the DR can do to protect itself from posting collateral for these contracts)
    - Skeel: The fact that these are volatile contracts, time-sensitive, and have the potential to leave non-debtors exposed are good reasons for the stay, but the stay should be very short

### §362(c): Termination of the Stay in the event of repeated filings

* Sections preventing abuse of repeated filings
* §362(c)(3) - If debtor had a prior case dismissed in the preceding one-year period, the automatic stay in the second case terminates without respect to the debtor within 30 days after filing unless debtor rebuts heavy presumption that her case was not filed in good faith
* §362(c)(4) - If D has two or more filings within the previous year, there is no stay at all unless bad faith presumption in preceding sentences is rebutted

### §362(d): Lifting the Stay

* §362(d)(1) -- Cause/reason to lift the stay (mainly lack of adequate protection)
  + Adequate protection means protection of value of a secured creditor’s collateral or mortgage holder’s collateral
  + Normally dealing with secured creditors whose collateral is deteriorating in value
* §362(d)(2)— For property…if the debtor has no equity in the property and the property is not necessary vital to reorganization efforts

### §362(k)(1): Willful Violation

* An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys fees, and where appropriate, punitive damages

## Violations of the Automatic Stay

* If a creditor has done something that in form violates the automatic stay, it will be deemed a violation unless it is clear that the creditor acted without notice of the filing or the debtor acted in bad faith
* When there is a willful violation, the bankruptcy court is free to award the debtor actual damages (§362(k)(1))
* Void v. Voidable:
  + Void: act itself is no good/invalid (and must be undone somehow)
    - Void means it just doesn’t exist. It is impermissible, invalid from the get go
    - (Pro-debtor) likely to conclude the stay is violated bc the burden is on the creditor to validate the action
    - Court’s Definition: not permissible action. Strong presumption against the creditor
    - *Soares* court claims that actions in violation of the stay are presumptive void. The burden is on the creditor to show compelling reason for exception (lack of notice or debtor acted in bad faith). Bar is high
  + Voidable:
    - (Pro-creditor) likely to conclude the stay is not violated because the burden is on the debtor
* What would it take for creditor to get the stay to be retroactively lifted?
  + Showing of bad faith by debtor
  + Showing lack of notice to creditor

### *In Re Soares*

* Timeline:
  + March 22, 1995 – Creditor seeks order of default and judgment of foreclosure
  + March 24, 1995 — Debtor files for bankruptcy (automatic stay goes into effect)
  + April 10, 1995 – State court issues a default order
    - Note: This is the key moment
  + June 14, 1995 – creditor seeks relief from automatic stay and debtor's lawyer fails to contest
  + November 29, 1995 - foreclosure sale
* Issue: Were default order and foreclosure sale a violation of automatic stay?
  + Creditor's argument: the “real activity” (aka foreclosure) under state law, happened before debtor filed for bankruptcy, it happened on March 22 and the rest were ministerial actions (mistake of timing)
* Holding: The default order **violates the automatic stay because the actions after the bankruptcy filing were not “ministerial”** (ex. signed without any sort of judgment made, no discretion involved, but merely carrying out) but were core to the judicial proceedings. This was a violation of §362(a)(1) because it is a continuation of a judicial act
  + Issuing a default order is pretty pro-forma, but **it is not simply a ministerial function. It involves some discretion/involvement of the court**, and therefore it is violation of the automatic stay because the decision was made after the stay was in place
  + Court rejected the creditor’s §362(d) motion to lift the stay retroactively (although it established the fact that the court does have the power to do so when appropriate)
  + “The dead tree gives no shelter” – If the automatic stay is not interpreted vigorously, it won’t provide the role it’s supposed to, ie facilitating collective proceedings
    - Driving home importance of automatic stay. If not vigorously enforced, Bankruptcy will not be effective
* Take-Away: when a judgment has been obtained against the debtor pre-petition, ministerial acts done after the stay is in place (like entry on the docket, etc) will not violate the stay. Any act that carries out a core judicial function, even if minimal, is not considered ministerial and thus will violate the stay

## Limits on the Automatic Stay

* **§108(b)**: provides for automatic extension of deadlines for property rights of the estate and the like (60 day extension of timeline to cure default)
* **§362(a)**: Only stays affirmative actions, no matter how trivial. It CANNOT stay an automatic expiration (such as an automatically expiring equity period of redemption)
  + If any action were needed, even filing with real estate office, § 362 would presumably apply
  + Note: if there was a guarantor to this transaction, the stay would presumably not reach an action against the guarantor, the stay only reaches the debtor and the guarantor is in place precisely as an alternative means of repayment should the debtor be unable to repay
* **§105**: Powers can be used to filling in the gaps to afford the debtor maximum protection, but cannot be used to conflict/change an existing provisions
  + Ex: Since §108(b) provision extended the debtor’s time with respect to the equity period of redemption already, §105 powers could not be invoked to include the running of the statutory period in the automatic stay (Johnson)
* **Equity Periods of Redemption** - Buyback periods after foreclosure where DRs can redeem the property that they defaulted on.
  + §108(b): DR can redeem property until the end of the statutory period, or 60 days after the BR order of relief, whichever is longer. As long as the period had not already run
  + §105 can’t be used to expand the period (Johnson: When a provision of the Code provides clear guidance on how to handle a situation, bankruptcy courts cannot use their broad § 105 powers to contradict or undermine the Code)
  + §108(b) might not apply in situations like options to buy real estate – if a DR had an option to buy real estate that expired on 12/1 and he filed for bankruptcy on 11/1, conceivably he has until 1/1 (60 days after filing) to purchase the real estate
    - Skeel thinks that 108(b) might not apply in this type of case since the value (and price) of an option is dependent on its length/time period. Extending the option under 108(b) would drastically change its value. 108(b) is usually construed not to apply to option contracts because the nature of those instruments is that their price is heavily tied to their length, any change in length can drastically change the character of the contract. Problem p. 204.
  + Equity periods of redemption can either expire automatically (like in Johnson) or may require the mortgagee/CR to take some affirmative step to complete the transaction – for example, some statutes require the mortgagee to mail notifications of foreclosure to the DR’s other CRs after the statutory period has run.
    - When the automatic stay is in place, the CR cannot take the additional step without violating the stay. So, even though the statutory period ran, the CR cannot actually effectuate the transfer until the stay has been lifted
      * This is relevant because the property would then be subject to the bankruptcy process (for example, the DR could keep it and pay the CR the value of its lien in a Chapter 11 reorganization)

### *Johnson v. First National Bank* (equity periods of redemption)

* Equity of redemption period - Statutory moratorium puts a certain time period in which the sale/foreclosure is uncertain. Allows the debtor to redeem property that they defaulted on
  + Here, the debtor has one year to pay up after the foreclosure sale to regain possession. Otherwise, ownership transfers
  + Note: these statutes were put in place after the Great Depression. Louisiana put in one of these provisions after Hurricane Katrina
* Facts: Debtors filed for bankruptcy 3 weeks before a 12-month statutory redemption period on their mortgage ended. At this point, had had already commenced foreclosure proceedings and purchased the property.
* Bankruptcy judge found that the debtors had substantial equity in the property that was the subject of foreclosure and tolled the statutory redemption period
* Issue: can bankruptcy court toll or suspend the running of a statutory redemption period created by state law (under broad §105 powers)?
* Holding: The debtor was not allowed to redeem property. The statutory period expired
  + The 60 day extension period (provided by §108(b)) had already run.
  + §362(a) does not stay this statutory redemption period bc this is not an affirmative act (simply a running of the time)
    - Note: would only do so if state law required affirmative action to be taken by creditor/third party in order to transfer full title to property upon expiration of statutory period (which some states do for title to actually transfer)
  + §105 (bankruptcy court’s wide discretion) does not apply here because 105 cannot be invoked when it would contradict another code provision
    - Two provisions cover this…
      * 362(a) indirectly by not including it in the activities that are stayed
      * 108(b) provides a specific extension period for various functions in the event of bankruptcy
* Note: There are generally two options in the event of an equity period of redemption
  1. Automatic running of the equity period of redemption (Johnson)
  2. Require the creditor/mortgagee to take some affirmative action in order to complete the transaction and effectuate the transfer \*Note: in this case, the creditor cannot take the additional step required without violating the stay
* Hypothetical: same situation as *Johnson*, except different timeline
  + Timeline:
    - December 1: Bankruptcy
    - January 1: foreclosure sale
    - January 1/15: Debtor wants to redeem
  + Question: does the debtor have the right to redeem?
    - YES! Because within the 60-day extension time provided by §108(b)
  + Note: 108(b) is going to give a 60-day extension (gives the debtor breathing space on whether to cure or not cure)

## Exceptions to the Automatic Stay (§362(b))

* Limits the stay to enable favored creditors to proceed against debtors unhindered by the stay
* Includes: spouses/children in domestic support scenarios; Wall street; landlords who can continue eviction proceedings obtained before filing; government regulation

### Penn Terra (govt police/regulatory exception)

* Facts: Environmental harm case. Mining company damaged landscape. Entered into a consent decree (to come into compliance with regulations) with DEP, Later filed for Ch. 7 bankruptcy. DEP came after Penn Terra, compelling Penn Terra to comply with consent decree. Ultimately fighting over 14k, which would only be done for the precedential value
* Held: DEP’s action is NOT stayed. The decree is forward-looking and seeks to prevent future harm (directly protects public health and safety). Therefore it falls under the police/regulatory power exception and is exempted from the automatic stay.
  + Repairing the land is to prevent future erosion (in addition to fixing past harm) and therefore is not a money judgment.
  + Another award like building a museum would not fall into the police & regulatory power unless it directly protects public health/safety.
* Rule: an exercise of police power that is forward looking is NOT subject to the automatic stay
  + Penn Terra makes a distinction between forward-looking and backward-looking remedies in order to define what constitutes a “money judgment”
    - Fixing past harm -> stayed
    - Fixing future harm -> NOT stayed
* Note: Nothing prevents a government agency from obtaining a money judgment, simply stays the process of enforcement when bankruptcy is filed. Yet, it is possible that an order which requires the expenditure of money is not in fact a money judgment and can still be valid while the stay is in effect
  + Definition of a “money judgment” = adjudication of liability for a sum of money (can payment satisfy request)

## Application of Stay To Non-Debtor Entities

### Co-Defendants in Lawsuits

* Rules:
  + §362(a) is applicable only to proceedings against the debtor, but §105(a) gives BK court broad authority to issue an order process … as necessary to carry out the provisions of the title
  + When a company that is defending litigation files for bankruptcy, the ongoing litigation is stayed. Courts generally refuse to use their §105 power to stay litigation against the debtor’s solvent co-Ds. See Lynch v. Johns-Mansville (asbestos litigation)
  + Litigation against non-debtors has been stayed in Chapter 11 cases to preserve D’s reorganization options
    - This exception normally occurs when there is an “unusual situations” in which the relationship of the debtor/third-party makes the debtor the “real” defendant (i.e., when a judgment against a third-party would effectively be a judgment against the debtor/the estate). A.H. Robins v. Piccinin
* *A.H. Robins Co. v. Piccinin*
  + Facts: The debtor was the subject of numerous suits for product liability. The debtor filed bankruptcy and brought a motion for a declaratory judgment that the debtor’s product liability policy was an asset of the estate and that injunctive relief restraining actions against co-defendant.
  + Holding: whole litigation has to stop bc the parries are so clearly tied. Cannot go forward on suits against third parties (doctors; directors/officers)
  + Key Arguments for Extension of the Stay:
    1. Insurance policy is structured in a way that is zero-sum\*
       - There is a fixed amount (ceiling) and anything that was paid out would reduce the amount available for creditors of Robins.
       - Skeel: this is a very strong argument for the application of the stay. This fits squarely in §362
         * Direct line into §362: §362(a)(3) applies directly because the insurance policy is for the company and the third parties. If you sue the third parties, you will be affecting the insurance policies, which will be affecting property of the estate. The actions against the third parties will so diminish the estate
    2. Indemnification Obligation – if the guarantor can turn around and sue the debtor in the event that the guarantor has to pay for debtor’s default. Robins had an obligation under state law to pay back any payouts from the doctors/directors
       - Question: does indemnification take property from the estate? §362 is really about the assets of the estate, rather the number of claims/assets per creditors
       - Skeel: indemnification argument seems dubious by itself. This is bc the claim is really the same, just the identity of the party being paid is different
    3. Managers are essential to the reorganization process and the litigation would be a distraction from the reorganization effort
       - Impact of letting the litigation go forward on the reorganization process (many of the key defendants were members of Robins and would not be able to focus on reorganization efforts)
       - Skeel: weak argument as well (esp. in light of Otero Mills)
* *In re Minoco Group of Companies, Ltd.*
  + Facts: D owned insurance policies that covered claims by D&O for indemnification of legal expenses and judgments arising from their activities. 2 months after filing Ch. 11, insurers canceled the policies.
  + Holding: a violation of the automatic stay
  + Relying on *AH Piccinin*, Court held that there was no significant distinction b/w a liability policy that insures the D against claims by consumers and one that insures the D against claims by officers and directors. Both policies protect diminution of the value of the estate.
* *Matter of Edgeworth*
  + Holding: insurance proceeds were not property of the estate b/c they were entirely payable to a P. Distinguished from Piccinin in which liability insurance proceeds would be exhausted by the claims of the many P if the proceeds were not marshaled in a BK proceeding.
* Third Parties Liable to Pay the Debtor’s Obligations
  + There are three consensual security devices that can be used to assure payment of a debt.
    1. The debtor can grant the creditor a security interest in property of the debtor.
    2. A third party can guarantee payment of the debt by either a personal guaranty or by providing collateral to secure payment of the debt
    3. The debtor can obtain a standby letter of credit from a bank for the benefit of the creditor

### Guarantors

* Rules:
  + Creditors CAN go after guarantors when the automatic stay is in effect. This is the entire point of guarantors/guaranteeing a loan! By guaranteeing a loan, we are giving the creditor a place to go if the debtor can’t fulfill his obligations (*Credit Alliance Corp. v. Williams*)
    - After a guarantor pays the creditor, the guarantor has a claim against the debtor – so allowing personal guarantors doesn’t change the playing field all that much. Now, instead of Creditor A (the bank) having a claim against the estate secured by a guarantee, Creditor B (guarantor) has an unsecured claim for the same amount against the debtor.
  + Exceptions: Courts have extended the automatic stay to guarantors in certain unique, exceptional situations.
    - If enforcement of the judgment against the guarantor would irreparably harm the bankruptcy estate the automatic stay may extend to a guarantor (*In re Otero Mills*)
    - OR
    - If enforcement of the judgment against the guarantor would have a detrimental effect on the debtor’s reorganization plan (*In the Matter of Supermercado Gamboa, Inc*)
* *Credit Alliance Corp. v. Williams*
  + Facts: CA holds a note issued by Penn Hook and guaranteed by Gary and Malcolm Williams. CA sued PH and the guarantors.
  + Holding: § 362 only applies to debtor and property of the estate. Guarantors of debtors in bankruptcy are not protected by the automatic stay. Only rarely is a proceeding stayed for a guarantor (“unusual circumstances”)
    - A guaranty does not provide an usual circumstance under Robins v. Piccinin.
* *In re Otero Mills, Inc.*
  + Holding: The bank was enjoined from obtaining judgment from the guarantor of the debtor, its principal stockholder.
  + The court reasoned that it could enjoin such action under § 105(a) because the principal stockholder provides required assets for the reorganization.
  + Argument to be made: under certain circumstances where the third-party (owner/manager) is essential to the reorganization plan, the action against the third party may be stayed
    - Either they are putting up some of the money OR they will be distracted from the reorganization effort by the litigation
  + Note: this is a very controversial case that is not absolutely followed
* *Matter of Supermercado Gamboa, Inc.*
  + The court stated that it would not follow the rationale of Otero unless there was a clear showing that the non-debtor guarantor would have detrimental impact on the debtor’s reorganization
* Note: There is a debate as the extent injunctions are permissible to maintain a debtor’s ability to formulate a reorganization plan

### Letters of Credit Lender and Insurance Contracts

* Letter of credit
  + This obligates a bank to pay the creditor if certain conditions are met. This will give rise to a claim of the bank against the debtor.
  + Does an automatic stay prevent an action to collect from such a letter? In re Page, the court on appeal answered no because although it creates indemnification claim it does not create, perfect, or enforce a lien in the property of the estate.
* Rules:
  + The automatic stay does NOT extend to letters of credit
    - If the debtor has defaulted and is in bankruptcy, the creditor can enforce the letter of credit since the letter of credit is not property of the estate and it will not divest the estate of property. (In re Page)
  + Note: Letters of credit are not subject to the automatic stay even if they are secured by property/collateral of the debtor. This is because the security interest was voluntarily provided pre-filing and thus there is no creation of a new claim (simply activation of a contingent claim). Any attempt to actually take the property of the debtor would be stayed, however
* Note: there really is no difference between a letter of credit and a guarantor.
  + Skeel: a letter of credit is effectively a form of guarantee
* Insurance Contracts
  + ARE subject to the automatic stay
  + Insurance policies are assets/are part of the estate

### Relief from Automatic Stay for Cause (362(d))

* Considerations for lifting the stay:
  + Whether the issues in the pending litigation involve only state law, so the expertise of the bankruptcy court is unnecessary
  + Whether modifying the stay will promote judicial economy and whether there would be greater interference with the bankruptcy case if the stay were not lifted bc matters would have to be litigated in bankruptcy court
  + Whether the estate can be protected properly by a requirement that creditors seek enforcement of any judgment through the bankruptcy court

### *In re Holtkamp*

* Facts: There was a pending civil action (personal injury suit) initiated in 1979 and set for trial in 1980. Five days before trial was scheduled to begin, Debtor filed for Ch. 11 bankruptcy and claimed the personal injury claim as an unsecured debt.
* Holding: lifting the stay was proper
  + Allowing the suit to proceed merely determined debtor’s liability, but did not change the plaintiff’s status in relation to other creditors
  + Allowing the civil action to go forward did not jeopardize debtor’s estate bc his insurance co assumed full financial responsibility for defending that litigation
  + Interests of judicial economy bc the court date, witnesses, etc had already been scheduled
    - Skeel: from the bankruptcy court’s point of view, allowing the litigation to proceed is preferable bc it will just result in an unsecured claim (will determine liability but automatic stay will stop any enforcement of a judgment) and this way the bankruptcy court will not have to evaluate the value of the claim. It is especially persuasive bc the case was so close to a judgment already bc litigation is so far along already before filing
* Take-Away:
  + A desire to permit an action to proceed to completion in another tribunal may provide adequate cause for a 362(d) lifting of the automatic stay
  + Other causes may include the lack of any connection with or interference with the pending bankruptcy case

## Scope of the Automatic Stay - Hypotheticals

### Hypothetical 1 - Generic Example

* Setup (Practice Problem 3 on pg. 162): Creditor has gotten a judgment lien before bankruptcy. On July 1, debtor files for bankruptcy. On July 15, creditor gets a writ of execution
* Does obtaining the writ of execution violate §362 (automatic estate)? **YES! The violation can be classified under a series of different provisions within 362(a)**
  + **§362(a)(1)** -- The commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title
    - Could potentially argue this is continuation of the judgement or that execution is the commencement
  + **§362(a)(2)** -- Enforcement of a pre-petition judgment against the debtor
  + **§362(a)(3)** -- Act to obtain possession of/exercise control of property of estate
  + **§362(a)(4)** -- Creating/perfecting/enforcing a lien against property of the estate
  + **§362(a)(5)** -- Any act to create, perfect, or enforce against any property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of a case under this title
    - Skeel - Having both (4) and (5) in the statute seems redundant. May be that (4) most naturally applies to liens that arise after bankruptcy filed; 5 focusing on property of debtor, 4 focusing on property of estate
  + **§362(a)(6)** -- Any act to collect, assess, or recover a claim against the debtor that arose before commencement of the case
  + Note: Obtaining a writ of execution is NOT a ministerial function (which would be ok –Soares)

### Hypothetical 2 - Oil and Gas Company

* Setup: A law mandates that oil and gas company (DR) clean the land up after they cause wild fires. The EPA comes after them and they enter into a consent order in which the DR will: (1) rebuild 100 homes and (2) build a mini-museum on the land to talk about conservation and environmentalism. The DR takes its time fulfilling these obligations and the EPA approaches the AG, alleging that the DR entered the consent agreement fraudulently. The AG wants to pursue a fraud claim against the DR. The DR then enters bankruptcy
* Can the AG continue to pursue the fraud claim after the DR has filed for bankruptcy?
  + Yes. This is a **criminal case and is excluded from the automatic stay under Section 362(b)(1)** – the only way a criminal action would violate the stay is if it looks like the government is actually just collecting a debt (under the guise of a criminal act)
* Can the EPA continue to pursue its claims after the bankruptcy filing?
  + Argument in favor of continuation: This is **part of the regulatory power and exempt from the automatic stay under Section 362(b)(4)**
    - State exercise of police power is excepted – governmental units are allowed to bring legal action against the DR to stop violations of regulatory laws such as fraud and environmental protection laws
    - Could potentially even argue that museum is exercise of police powers as it promotes health, safety, and welfare of the state’s populace
  + Argument against continuation: Although the fixing of the land/prevention of future erosion is probably within the EPA’s regulatory power, the museum requirement is outside the scope of the government’s regulatory powers and is actually just a money judgment
* The court ultimately held for the EPA – even though this is going to cost the company money, it does not qualify as simply enforcing a money judgment because the EPA is exercising its regulatory power. However, the court notes that acts that seem like money judgments might be exempted from the automatic stay (it does not have to be actually asking for money). This particular case was on the line
  + The **EPA is not acting like a regular CR when it is preventing future harm**
  + But if they are just trying to collect money to mend pre-petition harm the EPA looks a lot more like a CR

### Hypothetical 3 - Energy Holdings Company

* Setup: Energy holding company with subsidiaries in electricity, natural gas, and nuclear energy. For purposes of bankruptcy, treated as independent. Electric subsidiary borrows $500M from bank. Bank requires as part of loan:
  1. Electric Co must get insurance policy for top managers
  2. Loan must be guaranteed by the Holding Company
  3. Required to get a letter of credit, which will pay Bank if Electric Co fails to pay. Letter of Credit to be secured by assets of Electric Co.
     + (Letter of Credit = a promise by a 3rd party to pay a lender in the event debtor is unable to pay. Functions like a secured loan, except the one paying is not Debtor, but Letter of Credit Lender)
* Question: If Electric Co files for Bankruptcy, are each of these 3 things subject to the stay? (Electric Co is in Bankruptcy; Holding Co and Gas Estate Co are NOT)
  1. Insurance policy
     + Cannot terminate because this would be taking equity away from estate
     + If the insurance policy had a clause that said either party can terminate at any time with 30 days notice, can the insurance company terminate?
       - Courts have consistently held they can NOT. If policy is property of the estate, it is something valuable to estate. Terminating violates § 362(a)(3)
  2. Guarantee of loan by Holding Co
     + Can Bank sue Holding Co – or is that subject to stay?
     + This is ok. Not affecting property of the estate; Holding Co is a third party – Not part of the bankruptcy
     + Argument stay should apply - If Op Co and Holding Co have such a close relationship with each other, they are intertwined (i.e. Robins case). Posner opinion?
  3. Letter of Credit
     + Can Bank go after Letter of Credit lender?
       - Normal rule: An action against Letter of Credit lender is NOT stayed – they are 3rd party
         * Would not change amount of assets. Only creates a new claim
         * Policy argument: whole point of LOC is for it to be available when debtor can’t pay
       - Argument to preserve stay (weak)
         * Perfected security interest that LOC lender has on electric company assets upon failure to meet bank obligations effects the estate
     + Twist here: Security interest of LOC is in Electric Co’s assets!
       - However this does NOT change the analysis
       - The LOC Lender is secured creditor. Cannot take the assets, this will be stayed
       - Bank going after 3rd party is extraneous to estate. Entire purpose is to provide alternative means of ensuring payment upon failure to meet obligation
       - Why are we not worried that there is a new secured creditor here? Security interest was granted before the fact! LOC Lender is effectively a secured creditor from the start
     + **Basic Rule: The stay does not stop an action by the creditor, against the LOC Lender. LOC Lender is a 3rd party**
       - We are not worried about this “sudden security interest” in debtor’s assets by LOC Lender, because it is NOT sudden! It was always there, just became necessary when LOC was invoked. Action against property by LOC Lender would be stayed

### Hypothetical 4 - Bank

* Setup: Bank made an unsecured loan to debtor (500k) and the bank requires that the debtor do its banking with the Bank as a condition (unsecured loan agreement). Debtor has 100k in working capital in a savings account with the Bank. Debtor owes the bank 500k.
* Can the Bank take money from the debtor’s bank account (exercise its set-off right under state law)? NO! violation of the automatic stay
  + §362(a)(7)-- Setoff (of mutual debts)
* Can the Bank freeze the debtor’s account? Technically, YES!! (Scalia’s decision in *Strumpf*)
  + Argument that freezing the account is a shield rather than a sword. Actions that are a sword (affirmatively doing something) would be a violation of the automatic stay
  + Note: Skeel does not necessarily think this view is a good reading. Could use §362(a)(7) because freezing the account is simply a backhanded way at achieving a set-off OR §362(a)(3) because it is an attempt to exercise control over property of the estate

# The Bankruptcy Estate -- Property Of The Estate

## Key Provisions

### §541(a) -- Explicitly brings most of debtor's property into the estate\*\*

* Any property/ ownerships interests debtor has becomes part of debtor estate; court has control over it and it becomes potentially available to creditors
* **§541(a)(1)** -- “All legal and equitable interests in property as of the commencement of the case”
  + **Equitable Interests** = Something that is not in the debtor’s name but the debtor is the equitable owner. Something the debtor pays for and enjoys ownership rights of
    - Example: Daughter purchases car taking out a loan because her father couldn’t qualify for the loan. Although the car is in the daughter’s name, the father pays for it and is the only one to use it
  + **Legal Interest** = merely a legal title with no rights of ownership
    - This comes into the estate, but there is no value there for the trustee/creditors because someone else has the valuable rights in the property
    - Example: Grandson has a joint banking account with grandmother. It is solely grandmother’s money and used solely for grandmother’s benefit
  + Note: Court can compel a secured creditor to return repossessed property PROVIDED THAT the creditor’s interest in the collateral is adequately protected AND the debtor has more than a minor interest in the property
* §541(a)(2) - Community property (Doesn't concern us)
* **§541(a)(3)** – Any interest in property that the trustee recovers
  + Mechanism for trustee to use avoidance powers to bring property into estate. If the trustee uses the preference powers, that property comes into the interest of estate. Fraudulent conveyances and wiped on non-perfected interests also return to estate
* **§541(a)(5)** -- Property of the estate includes any property that the debtor had interest in at time of filing petition OR interests will acquire within 180 days of filing if that property is acquired by:
  + Bequest, devise, inheritance
  + Result of property settlement agreement with spouse or divorce decree
  + As beneficiary of life insurance policy or death benefit plan
  + Inheritances, property settlements, proceeds of life insurance settlements, etc.
  + Rationale:
    - Avoid abuse where debtor keeps an inheritance, divorce settlement, life insurance proceeds for themselves
      * Example: Debtor files for bankruptcy when their relative is about to die, but debtor has not yet received interest in the inheritance
    - Why 180 days specifically?
      * Chapter 7 case could end in less than 180 days, in which case the inheritance, life insurance, etc. would still enter into estate and be distributed among creditors retroactively
* **§541(a)(6)** – Any proceeds of the estate that arise after filing come in
  + Includes profits a company makes after filing; if DR owns equipment and sells it then the money would be labeled proceeds; rents (if DR = apartment complex)
  + **EXCEPTION: Earnings from services performed by individual debtor post-petition**
    - Point: with individuals (ch. 7), the filing of bankruptcy cuts off what is available for creditors
    - Fresh start principle:
      1. Discharge pre-bankruptcy obligations
      2. Future earnings are not available for creditors (§541(a)(6))
      3. Exemptions that creditors do not have access to (§522)
* **§541(a)(7)** – Property interests other than individual earnings acquired while the case is ongoing becomes property of the estate

### §541(b) -- What is NOT property of the estate

* Property of the estate does not include:
  + (b)(1) - Any power that the debtor may exercise solely for the benefit of an entity other than the debtor
  + (b)(5) - Retirement accounts
  + (b)(7) - Social Security and related provisions from Employer to debtor employee
  + Remember: Future earnings are not available for creditors in Ch. 7 liquidation case (§541(a)(6))

### §541(c)(1) - Property comes into the estate regardless of any restrictions on the agreement

* An interest of the debtor in property becomes property of the estate notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law that: **(A)** restricts/conditions transfer of such interest; OR **(B)** conditioned on DR's insolvency, BR commencement, or appointment of trustee and effects/gives option to effect a forfeiture/modification of DR's property interest
  + Exception: **A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title**
    - Rule: **the debtor’s interest in the property is no greater inside bankruptcy than outside of bankruptcy**
* Yet, note that **the property comes into the estate subject to those same restrictions**
  + See Club Membership Hypo below

### §542(a) – Turnover of property to the estate

* Except as provided in subsection (c - good faith transfer without notice/knowledge) or (d - automatic transfer by pre-petition life insurance contract), an entity, other than a custodian, in possession/control of property that can be sold/used/leased by trustee (§363) or exempted by DR under §552, shall deliver property (or value thereof) to trustee unless such property is of inconsequential value or benefit to the estate
  + Note: This provision has been interpreted liberally (*Whiting Pools*). In situations in which a creditor has already seized the debtor’s property but hasn’t completed the transaction (ie the debtor has a remaining equity of redemption interest in the property), the debtor has the right to get all of the seized property back

### §544, §547, and §548 - Expansion of the Estate

* §544: Trustee can void unperfected security interest
  + Frees up property; gives debtor full legal interest in property debtor had given to a creditor
  + Does not make claim go away – just no longer a property right securing the claim
* §547: Preference provision
  + Transfers made to creditor within 90 days of Bankruptcy are preferential
  + Idea here is that if one creditor getting paid right before Bankruptcy, seems suspicious
* §548: Fraudulent conveyances
  + Fraudulent conveyance: Debtor transfers property to someone, because debtor would rather they have property than the debtor’s creditors
  + If trustee can prove you were trying to defraud creditors – actual fraud
  + If transaction is for less than a reasonably equivalent value (selling something for amount not near what it is worth) – constructive fraud
  + Example: Ponzi scheme - Pretends to be operating successful business, uses money from new investors to pay the old

## Included as Property of the Estate

* Property of Estate - Pool of assets available to satisfy creditors’ claims
  + Ch. 7: Trustee liquidates property of estate and distributes proceeds
  + Ch. 11 & 13: Debtor may retain assets during reorganization (Ch. 11) or rehabilitation (Ch. 13), but debtor’s plan must give creditors as much value as they would have received under Ch. 7
* General Rule:
  + (1) Property described in §541(a);
  + (2) Certain kinds of property acquired by the debtor within 180 days after filing;
  + (3) Property the trustee brings into the estate by exercising his avoidance powers
* Property of the debtor wherever located and by whomever held
* Sometimes property of the estate is not in the possession of the debtor. 541(a) may allow trustee to recover possession
* To a limited extent, property of the estate can also include some property of the debtor transferred before the start of bankruptcy (§541(a)(3)-(7))
* Only the interests the debtor has in the property is included in the estate. **If debtor has no real interest in the property, it does not come into the estate** (as we will see in *Whiting Pools*, what constitutes a "real interest" is very broad)
* If debtor has a partial interest in something, only the partial interest comes into the estate
  + Example: if debtor has a two-week timeshare in property elsewhere. The timeshare comes into the estate, but not the whole timeshare - just the value of the two-weeks
  + Example: Lehman Brothers bankruptcy
    - Lehman had subsidiary corporations all over the world, though cash from subsidiaries would flow to NY
    - When they filed for bankruptcy, there was a ton of cash in the NY headquarters that had been routed from subsidiaries
    - The stay applied to the cash, but ultimately Lehman did not have any right to the cash and it was not part of the estate. Why?
      * Lehman only had a **managerial interest** (power to manage the cash, not to have the cash itself), as opposed to an ownership interest and **only property that debtor has an ownership interest in comes into estate**
* Remember: The bankruptcy estate is expanded by trustee preference powers, fraudulent conveyance powers, etc and reduced by debtor’s exemptions
  + Some or all of property in the estate may lose its status as property of the estate
    - Can be claimed by a debtor as exempt property §522
    - Can be abandoned or released to debtor under §554
    - Note: if debtor receives property thru §522 or §554, it is now considered property of the debtor rather than property of the estate

### Club Membership Hypothetical

* Setup: Debtor is member of club, membership worth $500k - Debtor can sell that membership, but ¾ of the other members have to approve the sale or the sale does not go through. Debtor files for Ch. 7. Trustee wants to argue that this membership is property of the estate; finds a buyer willing to purchase it for 500k. Trustee not sure ¾ of members will agree
* Does any interest come into the estate?
  + YES – If debtor has an interest in something of value, that comes in. **When it comes into the estate, it does so with exactly the conditions it has outside of Bankruptcy**
* Here: Debtor has an interest that is conditioned on the approval of the other club members. Inside Bankruptcy, as well as outside.
  + The restrictions on this interest outside of Bankruptcy does not prevent it from coming into the estate. The provision tells us it comes in, subject to those restrictions that apply outside of Bankruptcy
  + This is an application of the *Butner* principle (and codification of *Chicago Trade* case)
* §541(c)(1)(A) – Existence of restrictions (like 3/4 vote) does not prevent property from coming into the estate, but Trustee must still honor these restrictions
* Note: in a situation where ¾ of the partners of the law firm have to agree to a bonus, or it does not happen, then there is no current entitlement to a bonus. There is an argument that this property should not come into the estate at all. Distinction between this and the club membership hypo

### Law Firm Bonus Hypothetical

* Setup: Debtor works for a law firm making 160k and at the end of the year gets a 60k bonus. Start on Jan 1 and on Dec 31 of the same year, the bonus is awarded if DR continues to work there. On Dec 1, filed for Ch.7 bankruptcy. While bankruptcy is going on, gets the bonus. Is the bonus property of the estate?
* Issue: Are these earnings by DR for post-filing services and thus not subject to §541(a)(6)?
  + Reminder: §541(a)(6) – Any wage-related property earned after filing is NOT property of the estate
* Argument for it to be included in the estate:
  + Bonus is pro-rated - thus the part that is truly post-petition is severable from total amount of bonus
  + In this case 11/12 of it would be pre-petition property included as property of the estate. 1/12 wouldn’t be because it was earned after filing (if it was earned pre-petition it would be included even if it was paid after filing)
    - 11/12 of the bonus was rooted pre-petition (what matters is when you earned it, not when it was paid)
  + Note: if the bonus is framed as calculated based on the number of months you work there for the year, it would be property of the estate
* Argument for it to NOT be included in the estate:
  + Could look at the bonus earned only on Dec. 31 - you are awarded the bonus for working there on that day, not the other 364. If DR quit on the 30th, they wouldn't earn it
* What if 3/4 of the partners have to agree for the bonus to be given?
  + No contractual right to the bonus, which suggests that there is no current entitlement to the bonus at the time of filing
  + Note: Not dispositive, could still be considered part of the estate
* Main Takeaway: Court differentiates between property rooted in pre-petition past and property DR earns after filing. **Earnings have to be traced to the moment that they were earned: if before filing -> property of the estate; if after filing -> not part of property**

### Other Hypotheticals

* §541(a)(5) – Any inheritance, insurance policy that debtor gets interest in within 180 days of filing becomes property of the estate
* Hypothetical #1
  + Setup - 2 children of Duke Family are nearing age 21, at which point they will get a big inheritance. They are in financial distress and file for bankruptcy. Is the inheritance property of the estate?
    - If they turn 21 within 180 days, inheritance will become part of the estate
    - It could also be that inheritance is already part of the estate, depending on what the inheritance says:
      * If inheritance is guaranteed, then kids already have interest on it, just conditional on them turning 21, so it’s already property of the estate
      * If there’s uncertainty as to inheritance terms (ex: relative can change their will at will)…
  + If it is not guaranteed, it may not come into estate. Unresolved issue
* Hypothetical #2
  + Setup - At age 11, Kid’s parents promise to pay him 100K if he doesn’t drink or swear until he’s 21. Kid has 6 months to go and files for bankruptcy. 6 months later, he gets the 100K. What part of that $100K is property of the estate?
    - None of it is property of the estate because kid has no interest in the money until he “performs” until he’s 21 - he could technically swear or drink moments before he turns 21
    - A counter would be that a pro-rata portion of it is part of the estate. Every portion of year from age 11 to age 21 that kid goes without drinking or swearing becomes part of estate. What would be the rational for this argument?
      * §541(a)(6) because it’s earning-like property
* Hypothetical #3
  + Setup - Parents give $100K to their 11 yr old in return for promise not to drink until 21 (pre-payment). Kid files for bankruptcy at age 18. Is the 100K property of estate?
    - It becomes a 100K contingent claim that parents now have against their debtor-child in the bankruptcy process
    - If kid drinks before bankruptcy is over, he’s violated the contract and parents would have an unsecured 100K claim against their kid
    - 100K contingent claim would be discharged by bankruptcy
* Pre-packaged Bankruptcy Hypo - Revel Casino in Atlantic City is not doing well and have hired Kirkland and Ellis to advise them. Pre-packaged bankruptcy is a possibility
  + Pre-packaged bankruptcy – bankruptcy where debtor negotiate the terms of reorganization before they ever file for bankruptcy.
  + To do this, debtor must divide creditors into different classes, classes then vote
  + With pre-packaged plan, you negotiate with key creditors in advance to the point where you’re sure that they will vote in favor of your plan and when you file for bankruptcy you file a reorganization plan at the same time
  + Goal: get in and out of bankruptcy quickly; often confirmed in 30 days
  + pre-packaged bankruptcies only work if there’s a limited number of creditors and often, when the main class of creditors is bond holders (Chrysler and GM were too complicated for pre-packaged bankruptcy)
  + With a casino, pre-packaged bankruptcies work because the major class of creditors are bond holders, so if you can negotiate with major bond holder or Trustees of bond holders, then it’s easier to do a pre-packaged plans

## Butner Rule

* Basic rule with property - contours of property are defined by state law. Yet, Bankruptcy provision that is specifically on point will trump state law
  + Unless BR Code says otherwise, state law or non-BR law controls on a specific question of law
  + Makes clear that we care about Article 9 of UCC
* Whatever property rights look like outside bankruptcy is how they should like during bankruptcy. Property rights should be preserved
* Rationale: The doctrine is at the heart of the Jackson’s creditor-bargaining theory – bankruptcy should create collective proceedings, but shouldn’t otherwise affect non-bankruptcy laws
* Note: Substantive property rights are governed in large part by state law, but **procedural** rights are prescribed entirely by federal bankruptcy law

### *Butner v. US*

* Issue: Who is entitled to rents collected during the period between bankruptcy and the foreclosure sale? Is this determined by federal rule of equity or by the law of the State where the property is located?
  + Under NC law, a mortgagor is deemed owner of the land subject to the mortgage and is entitled to rents and profits, even after default, so long as he retains possession.
  + In title states, the mortgagee is automatically entitled to possession of the property and has a secured interest in the rents. In most states, the mortgagee’s right to rents is dependent upon taking actual or constructive possession by means of foreclosure, the appointment of a receiver or some similar legal proceeding.
* Holding: Substantive rights of the parties in bankruptcy are determined by otherwise applicable law (state law) unless a specific bankruptcy provision alters those rules
  + Note: Section 552(b)(2) was added after the case -- now provides that real property rents are treated as cash collateral in bankruptcy cases nationwide without regard to the idiosyncracies of state law

## Turnover

* If someone else (a third party) is in possession of the debtor’s property at the time of bankruptcy, can ask for a turnover of debtor’s assets and third party must comply

### *US v. Whiting Pools, Inc*

* Facts: Debtor owed $98K in FICA taxes and federal taxes withheld from EEs, failed to respond for requests for payment by IRS. A tax lien in that amount attached to all of Whiting’s property. Then, IRS seized Whiting’s tangible and personal property - equipment, vehicles and office supplies pursuant to levy provision of IRC. Whiting files for Ch 11. the next day (before a tax sale), claims he needs seized property to reorganize his business. Ownership had not yet transferred pending the sale
* Issue: Whether §542(a) authorized the Bankruptcy court to subject the IRS to a turnover order with respect to the seized property
  + Does this seized property come into the estate?
    - Outside Bankruptcy, Whiting Pool could have cured its taxes before IRS sold the equipment and it would have had the right to get the equipment back (right of redemption)
    - Applying Butner Doctrine (out of bankruptcy must equal in bankruptcy result): Inside bankruptcy, Debtor would have the right to require turnover of the property, conditioned on debtor paying off the lien on the property
  + Note: Not determining whether the property stays in the estate necessarily. IRS can ask for the stay to be lifted if the debtor’s interest is not substantial in this property via §362(d)(2)
* Rule (majority rule): Where a creditor has previously seized the debtor’s property but hasn’t completed the transaction, debtor (*Whiting Pool*) has the right to redeem the property so long as debtor has any interest in the property
  + Here, the **bare ownership right/right of redemption on property was enough to require turnover of the property to the estate**
  + Whiting Pools Doctrine - If debtor has any interest in property (i.e. equity in property > value of lien), §542 applies
* Dissent (minority view): The only right debtor has to the property is the right of redemption (bare ownership right). This is the only right that should be included in the estate
* Take Away: This decision shows how far the property of the estate extends
  + Expansive view of §542
    - Arguably extends past creditor's bargain theory with respect to what bankruptcy is intended to accomplish
  + Leaves open the application of this interpretation to Chapter 7 Bankruptcy
* Thought Question: Would the logic be the same in Ch. 7 as well as Ch. 11? YES!
  + It might appear that this is not as important in Chapter 7 because it is concerned with liquidation and instead of reorganization, thus the property is going to be sold anyway
  + However, there is a strong argument that the seized property would be valuable in the case of liquidation bankruptcy because it allows the property to be sold in a package that might arguably be more valuable than piecemeal sales and debtor may have more incentive to get a good price for it than creditor does (mostly treated this way by courts); turnover is mostly to facilitate reorganization, as going concern value is higher than value in liquidation
    - You would lose difference in value between what could be obtained by the trustee in liquidation and the value of the lien
  + Yet, it is possible that this logic will not be applied in an average liquidation where the value of the seized property to the creditor who already seized it is more than the foreclosure amount that would otherwise be received by that creditor

# Bankruptcy Estate Exemptions

## Overview of Exemptions

* Provisions that shrink the "pie". This involves reduction of the property of the estate (i.e. what gets kicked out of the estate)
* Rationale: Promote a fresh start for the DR -> without property, DR would have a hard time starting over
  + Historically included operational capital like farm equipment
* General rule for determining applicable exemptions: **Everyone gets their state law exemptions**. No state requires use of federal provisions, though some states allow choice between state and federal. State law exemptions vary considerably state-by-state
  + There are federal exemptions (§522(d)) and state exemptions (§522(b)) plus other federal exemptions beyond §522(d)
  + You can choose to use these federal exemptions UNLESS your state takes away your ability to choose the federal exemptions. 33 states do NOT allow the choice; 17 do allow the choice. PA is a choice state
    - This restriction on choice between state/federal provisions is limited to that enumerating applicable property and exemptions (i.e. only §522(d))
  + Why would states force you into state exemptions? There is a strong business concern (e.g. real estate) because they think federal exemptions are too generous and that their stingier state exceptions are better for business

## Key Provisions

### §522(b) State Exemptions & Domiciliary Requirement

* **§522(b)(2)** - Provides debtor with the ability to choose between the federal and state exemptions (unless their state opts out of the choice)
* **§522(b)(3)(A) - Domiciliary Requirement**: Provides which state a debtor can use for state exemptions
  + Rule: Debtor must have lived in state for 730 days (2 years) immediately before filing in order to claim that state’s exemptions
    - If debtor hasn’t lived in a single state for 2 years, look where he lived for the 180 days immediately before the 2-year period or for where debtor lived for the majority of the 180-day period
    - This keeps people in financial from moving to FL or TX for sole purpose of taking advantage of homestead exemption (However,state Homestead Exemption is only effective insofar as one can pay cash for the home. Individual does not have interest in the amount of property that is financed through mortgage)
  + This provision also states that property exempt under non-Bankruptcy Federal Law (i.e. not in subsection (d)) is also exempt

### §522(d) - Federal Exemptions

* **§522(d)(1) – Homestead Exemption** (Not to exceed $23,675 in property used as residence)
* **§522(d)(2) – Motor Vehicle Exemption** (Not to exceed $3,775 in one motor vehicle)
* **§522(d)(3) – Household Goods Exemption** (Not to exceed $600 in any particular item or $12,625 in aggregate)
* **§522(d)(4) – Jewelry Exemption** ($1,600)
* **§522(d)(5) – Wildcard** (Not to exceed $1,250 plus up to $11,850 of any unused amount in homestead exemption)
  + A debtor may use this for anything; additional homestead exemptions if the homestead exemption in (d)(1) is not completely used
  + Note: Sometimes an item is only partially exempt under a particular category but can be fully exempted with the help of the wildcard exemption
* Note: A debtor who cannot qualify for state exemptions because of the domiciliary rule (in §522(b)(3)(A)) are entitled to the federal exemptions listed in §522(d) as well
  + Skeel: Would interpret this as applying to homestead exemption only
* Note: BR Code does not allow debtors to rewrite mortgages
  + This is problematic when value of home becomes significantly less than the mortgage
  + Normal rule for re-org is that creditor has secured claim up to the value of the property and rest is unsecured

### §522(f) - Avoidance of Liens that Impair Exemptions

* Presents the ability for the debtor to avoid some liens that would otherwise impair an exemption the debtor is otherwise entitled to
* **§522(f)(1)(A): Debtor may avoid the fixing of a lien to the extent that such lien impairs an exemption to which the debtor is entitled**
  + Does not apply to consensual liens (e.g. mortgage). Can only avoid judicial liens OR non-possessory, non-purchase money security interest in certain types of property (e.g. household furnishings/goods, animals, tools of trade, health prescriptions, etc.) - definitions of these types of property are included in §522(f)(4)
* **§522(f)(2)(A): Amount of lien that impairs exemption = (all liens on the property (judicial, mortgages, security interest, personal property) + the amount of the exemption that the debtor could claim) – debtor’s interest in the property**
* Requirements:
  1. Is this type of lien avoidable?
  2. Does the lien impair an exemption? Use calculation of §522(f)(2)
     + - Steps:
     1. Add all property interests (liens) + the exemption (the debtor’s interest in property)
     2. Subtract the property value from (1) The resulting amount is the maximum amount that the debtor can avoid under §522(f)
  + Procedure - Start with the lowest level judicial lien and avoid the lowest property lien first. Then move up if there is still some of (2) left
  + §522(f)(1)(A): If you have a family law kind of lien that shows up in §523(a)(5) (restrictions on discharge), it cannot be removed under §522(f). These are domestic support obligations (e.g. alimony, child support) which explicitly says in §523 cannot be avoided. This was added after *Farrey*

### §522(n) – Exemption Cap on IRAs

* Provides an exemption cap on IRAs of $1,283,025 with rollovers not included in calculating that amount
  + Note: This is an example of a federal exemption that is also provided to debtors who elect for state exemptions because it is found in the Code outside of §522(d) federal exemptions

### §522(p) – Time Exception on Homestead Exemption

* Provides a last minute behavior limitation on state Homestead Exemption
* If debtor has not owned land/house for at least 3 years and four months (1215 days), Homestead Exemption is capped at $160,375

### §522(q) – Securities Law Exception on Homestead Exemption

* Provides a limitation on the Homestead Exemption for violations/alleged violations of securities law
* Debtor’s homestead exemption is capped at $155k if the debtor:
  + (1) Has been convicted of a felony that demonstrates abusive filing or
  + (2) Owes a debt arising from violation of securities law, or fraud related to securities
* Note: There does not necessarily need to be a judgment against the debtor because §522(q) says “debt arising from” and there is a claim arising from the debt even without a judgment. So if debtor is sued for an alleged violation, his homestead exemption is capped
  + Felony, on the other hand, requires judgement

## Avoidance of Liens that Impair Exemptions

* A debtor can only avoid a lien “to the extent” that it impairs the property. **If impairment is less than the value of the lien sought to be avoided, the remaining portion of the lien can be enforced against the property** (*Silveira*)
  + Point: Use §522(f) to free up the debtor’s exemption. When we avoid a lien, we are making the property interest disappear - CR still has a claim for the same amount, but it is simply an unsecured claim now
  + Logic behind §522(f) calculation for how much of a lien can be avoided:
    - Goal is to preserve the full state exemption he was entitled to under state law.
    - Trying to avoid enough liens (permitted by §522(f)) so that the debtor can use the full exemption allowed under state law
    - Note: On the exam, Skeel will put the liens in order of priority (top= 1st priority). When avoiding liens, start with the bottom/lowest priority lien
    - Trying to partially prioritize the exemption
* A debtor can avoid “fixing of a lien” under §522(f)
  + Rule: for a lien to be avoidable, the debtor must have an interest in the property before the lien attached (*Farrey*)

### *In re Silveira*

* Facts: Debtor owns house worth $157k with a $117k mortgage. Creditor (bank) has a $209k judicial lien on the property. Debtor claims that he is entitled to $15k exemption and can avoid the entire judicial lien pursuant to §522(f)
* Issue: To what extent can a Chapter 7 debtor, pursuant to §522(f), avoid the fixing of a judicial lien on the debtor’s property when the fair market value of the property exceeds the sum of (1) all consensual liens and (2) the amount of the exemption interest under §§ 522(d)? Should avoidance be partial or total?
* Bankruptcy Provisions:
  + Section § §522(f) -- A lien shall be considered to impair an exemption if the sum of (1) the lien in question, (2) all other liens, and (3) the amount of the exemption exceeds the value of the debtor’s property. In which case, the debtor can seek to avoid the targeted lien
  + However, the court finds that that §522(f)(1)(A) **allows the debtor to avoid only so much of the judicial lien as necessary to prevent impairment of the debtor’s exemption** within the meaning of §§522(f)(2)(A).
* Holding: Only part of the $209k judicial lien can be avoided under §522(f)
  + Under §522(f)(2)(A) – The sum of (1) the targeted judicial lien ($209k), (2) all other liens ($117k), and (3) the amount of the debtor’s exemption (15k) is equal to $341k. This exceeds the value of the debtor’s property would have in an unencumbered state ($157k)by $184k
  + Under §522(f)(1)(A), the debtor may avoid parts of the judicial lien that “impairs” the debtor’s exemption ($209-$184k = $25k). Thus bank still has $25k judicial lien
* Main Takeaway: **Just because you can avoid part of the judicial lien does not mean that you can avoid all of the lien. “To the extent that” language does NOT mean either/or**

### *Farrey v. Sanderfoot*

* Facts: Pre-divorce, husband and wife jointly own their home. When they got divorced, they reach agreement whereby husband retained the house and agreed to pay wife her half of the house’s value over a period of time (unsecured note saying as much). Wife didn’t trust her husband to make these payments and thus obtained a judicial lien as part of divorce decree securing the debt owed to her. Husband files for bankruptcy, and tries to claim the house as exempt property and avoid wife’s judicial lien under §522(f)(1).
* Issue: Can husband avoid the wife’s judicial lien under §522(f)?
* Rule: **A Debtor can only avoid a judicial lien under §522(f) if he had the property interest to which the judicial lien attaches before the lien attached to that interest**
* Holding: No, the husband can't avoid the lien. Court reads §522(f) as having temporal dimension – “fixing” interpreted to require interest in property over specific time frame
  + In order for a lien to be "fixed" to something, that something needs to already exist. A lien cannot be fixed to an interest that the debtor never had
  + Interest did not arise until after the divorce judgement at which time the the lien was simultaneously attached
    - During marriage, husband and wife jointly own 100% of the interest in the property. There is a change in ownership interest at time of divorce. Divorce decree is what created husbands property interest while simultaneously creating lien on the property, thus he never had the this property interest in a state where no judicial lien was attached
    - If the husband had owned the property alone before the settlement, the fixing of the judicial lien would occur after the debtor’s property interest was already in place and then the husband could avoid this judicial lien
* What is potential problem with this reading of §522f?
  + It does not solve all the domestic law implications (Courts don’t want husbands to be relieved of responsibilities to ex-wife)
  + Unintended Consequence of this decision: Anytime the lien arises at the same time as the property interest… this can happen if there is a judicial lien on someone (usually good for 5-10 years), and debtor acquires other property
* Lecture Commentary:
  + Even though this is an extremely technical reading of the statute, Court is probably correct here
  + There are other ways to fix this problem, such as framing this judicial lien as a consensual lien as opposed to a judicial lien
    - Could have argued that this is not a judicial lien, but essentially a mortgage, thus not what §522(f) intended to protect. This alternative approach to the case would have lead to the same result without the technical interpretation
* Note: After *Farrey*, Congress changed §522(f) to include a qualification on avoiding judicial liens. Judicial liens are avoidable except those specified in 523(a)(5) – obligations that look like alimony, maintenance, support problems
  + Congress protected alimony and support obligations by adding it to §522(f), but did not protect property settlement arrangements that are not alimony/support, thus this change would not have directly fixed issue in *Farrey*

### Additional Hypotheticals

* Hypothetical #1
  + Setup:
    - House --> market value of $100k
    - Mortgage --> $70k
    - Judicial lien --> $40k
    - Exemption sought --> $50k
      * Note: Property interests, as is, exceed the value of the property
  + Issue: How would you determine if debtor could get rid of some of the liens?
  + **Step one: Add all property interests (liens) + the exemption (the debtor’s interest in property)**
    - $70K + $40K + $50K = $160k
  + **Step two: Subtract the value of the house. This number is the maximum amount that the debtor can avoid under §522(f)**
    - $160k - $100k = $60k
    - Start with the lowest level lien (judicial lien) and then move up
    - **This does not allow you to knock of consensual liens** (i.e. the mortgage)
      * Drafters wanted to facilitate lending and other agreements that protect creditors from BR - allowing the avoidance of consensual leans would discourage this
  + Here, can remove the full $40k judicial lien. This means that the property interest is now removed, but the $40k judicial lien does not disappear. It simply becomes a $40k unsecured claim. Still owed 40k but now there is no property interest securing that amount
  + Note: assume for our purposes that §522(f) is dealing with avoiding judicial liens only
* Hypothetical #2
  + Same facts as the first except that instead of a mortgage, there is actually a second judicial lien of $70k. What would happen?
  + Could avoid the first $40k judicial lien. Still have $20k in which we could avoid from the second judicial lien. Therefore making this second judicial lien a $50k
  + **Not eliminating the liens, but simply turning them into an unsecured claim (i.e. they lose property interest)**
  + Note: this re-writes the second judicial lien. Instead of a full $70k lien, now have a $50k lien. Doesn’t remove the remaining $20k claim, it is now a $20k unsecured claim
* In-Class Hypothetical #3 (Same as #2 but with slightly different facts)
  + Assets: House - $110k
  + Liens:
    - * Judicial Lien #1 - $65k
      * Judicial Lien #2 - $40k
  + Exemptions: $50k
  + Skeel - To figure out how much debtor can avoid, add together largest exemption as well as judicial liens and subtract value of house. Purpose is to free up exemption - designed to come up with amount that would need to be gotten rid of in order to take advantage of the Homestead exemption
    - $65k + $40k + $50k - $110k = $45k

## Restrictions on State Homestead Exemptions

* Overview of Restrictions:
  1. Domiciliary Requirement - §522(b)(3)(A)
  2. Restriction Based On When Debtor Bought the Land/House - §522(p)
  3. Restriction Based On Debtor Violating/Being Sued For Violation of Securities Law - §522(q)
* Note: Remember that homestead exemptions are subject to consensual liens (exemptions are subject to any mortgage you might have on the house)
* Homestead Analysis Flow
  1. Has debtor lived in his current State for 2 years?
     + - Yes --> Go to Step 3
       - No --> Go to Step 2
  2. Did debtor live in his current state for the 180 days (or majority thereof) preceding this 2 year period?
     + - Yes --> Go to Step 3
       - No --> Use the exemption of state where D resided for majority of 180 days prior to the 2 year period
  3. Has debtor owned residence (i.e. home) for at least 3 years and 4 months?
     + - Yes --> No limitation on state Homestead Exemption imposed by federal law
       - No --> State Homestead Exemption is capped at $160,375
* Miscellaneous Homestead Exemption Information
  + Does land, without a house on it, count as a homestead?
    - In Texas, no, there has to be a home on the land!
  + If a person has more than 1 residence, could that person choose which residence to exempt?
    - Person might be restricted by §522(p) and §522(b)
    - Person might be restricted by how the state define “homestead”
    - But it seems like there might be a choice if multiple residences in same state
  + Side note: Home mortgage on a primary residence cannot be restructured in bankruptcy, debtor must repay the mortgage or lose their home. Rationale:
    - If house mortgages could be restructured, people would not be willing to lend, interest rates would go up and it would turn out to be more costly for debtors
    - There has been talk of using eminent domain on the mortgage to restructure the mortgage – cities would use eminent domain to sell interest in a new mortgage and use the profits to repay the old mortgage

### Domiciliary Requirement - §522(b)(3)(A)

* Rule: **Debtor must have lived in state for 730 days (2 years) immediately before filing in order to claim that state’s exemptions**
  + If debtor hasn’t lived in a single state for 2 years, look where he lived for the 180 days immediately before the 2-year period or for where debtor lived for the majority of the 180-day period
* Hypothetical
  + Setup: Debtor lived in State A for 30 years and moves to State B on Jan 2, 2012, where he buys a new house in State B. Files for bankruptcy on Jan 1, 2013
    - State A = $25k exemption
    - State B = $100k exemption
  + Question: Which state’s exemption are we going to use?
  + Answer: State A
    - Consider §522(b)(3)(A)
    - Because debtor has not lived in State B for 2 years, apply the exemptions from the state debtor lived in for 180 days before that. If haven’t lived in a single state for the 180 days, it is the state where you lived for the most time
    - Problem: State A exemption only applies to property in State A
    - Solution: The end §522(b)(3) includes a stand alone sentence which provides federal exemption (found in §522(d) -- 22k) in the event that the state exemption rules/domiciliary rule would make debtor ineligible for any exemption
      * Skeel would interpret this as applying to homestead exemption only - **We interpret §523(b)(3) as homestead specific**
      * This would not preclude debtor from claiming other non-homestead exemptions provided by state law

### Restriction Based On When Debtor Bought the Land/House - §522(p)

* Rule: If debtor has not owned land/house for at least 3 years and four months, homestead exemption is capped at ~ $160k
* Hypothetical
  + Setup: Debtor moves to TX (state of unlimited homestead exemption)
    - 1/1/02: Debtor moves to TX
    - 1/1/09: Debtor buys land ($1M)
    - 1/1-6/1/11: Debtor builds a 2M house (total value of the house = $3M)
    - 1/1/13: Debtor files for bankruptcy
  + How much can the debtor exempt?
    - Look at §522(p) cap on homestead exemption
      * If debtor has not owned land/house for at least 3 years and four months, it is capped at ~ $160k.
    - Total: $1M (land bought before 3 yr 4 mo mark) + $160k
      * Note: $1M in land will be completely exempt because it was before the 3 + year and the home renovations are subject to the cap

### Restriction Based On Debtor Violating/Being Sued For Violation of Securities Law - §522(q)

* Rule: Debtor’s homestead exemption is capped at ~160k if debtor (1) has been convicted of a felony that demonstrates abusive filing or (2) owes a debt arising from violation of securities law, or fraud related to securities
* Hypothetical
  + Setup: PG&E violates securities law and case is still pending (litigation filed). CEO purchases house in state with unlimited Homestead exemption for $5 million in cash. Files for BR. Notwithstanding domicility exceptions, how much could CEO claim as exemption?
    - Note: Rich people buy homes with cash partially because mortgages are immune from Homestead exemption
  + Look at §522(q)(1) – Violations of the securities law
    - Skeel: Essentially says if you have been sued by regulators in connection with allegations of fraud, your exemptions are limited to 155k as well (§522(q))
      * Don't actually need a judgement in civil cases. However, felony cases of fraud require conviction
  + Answer: This debtor would be limited to $160k TOTAL under §522(q)

# Limits On The Discharge

* Discharge - Releases debtor from liability for certain debts and prohibits creditors from attempting to recover these discharged debts (e.g. through lawsuits, demand letter, etc.)
  + Once the process of Bankruptcy ends, earlier claims are eliminated so a creditor who fails to file a claim and realizes it only after discharge is out of luck
* Transition From Exemptions to Limits:
  + It turns out that sometimes absolute exemptions are abused and lead to the bankruptcy court imposing some limits on the debtor’s discharge; curbing the fresh start
  + General rule: The bankruptcy court allows for some strategic behavior (feeding the exemptions), but as the saying goes “when a pig becomes a hog, it gets slaughtered”. If the exemption is unlimited and the debtor takes advantage of it, he risks losing his whole discharge (e.g. case with unlimited insurance exception, rather than farmer case)

## Key Provisions

### §727(a) - Denials of Discharge

* Complete denial of discharge (all discharge is denied). States that debtor should be granted discharge unless one of the conditions in the subsections is met
* **§727(a)(1) - The debtor is not an individual**
  + Note: Only an individual is provided a discharge; not a corporation/other entity that can be dissolved after liquidation
* **§727(a)(2) - Actual fraud occurs with property of estate** - Transferred/concealed/removed/destroyed property within one year of filing with the intent to hinder, delay, or defraud creditors or trustee
  + Note: Some pre-bankruptcy planning is allowed (consistent with the idea of a “fresh start”), so must be careful when seeking to invoke this provision that the conduct was truly meant to defraud
* **§727(a)(3) - Fraudulent or failure to provide financial records**. Debtor intentionally concealed, destroyed, or failed to keep records from which debtor’s financial condition could be ascertained
* **§727(a)(4)(A)/(B) - False oaths and claims**. Failure to disclose transfer or makes false statements or knowingly provided false claims
* **§727(a)(5) - Failure to explain satisfactorily any losses of assets**
* **§727(a)(6) - Failure to co-operate**. Refusal to obey lawful court order or respond to material question (including invoking 5th after immunity has been given)
* **§727(a)(8) - Chapter 7 Time Limitation**. Denies discharge to debtor who has previously received a discharge under Chapter 7 within 8 years of this case
* **§727(a)(9) - Chapter 13 Time Limitation**. Denies discharge to debtor who has previously received a discharge under Chapter 13 within 6 years of this case
  + Exception: If debtor paid all unsecured claims or 70% of such claims were paid and debtor made good faith, best effort

### §523(a) – Non-Dischargeable Debts

* Lists of debts that cannot be discharged or included in the bankruptcy process. Unlike §727(a) which takes away a debtor’s whole discharge, **§523(a) only denies the discharge with respect to the particular obligation**
* **§523(a)(2) – Fraudulently incurred debts**
  + §523(a)(2)(A) – Debts obtained by “**false pretenses, a false misrepresentation, or actual fraud**” are non-dischargeable
    - **Justifiable reliance** is required, thus must consider any red flags/anything that a credit card company, for example, should have been aware of
  + §523(a)(2)(B) — **False statements**. Must be materially false (related to financial condition), intended to deceive, and on which creditor reasonably relied
    - Note: In the credit card context, this would involve a false statement on an application about your credit situation
      * Credit cards rarely use this; difficult to establish because credit card companies don’t reasonably rely on that job info, salary, etc. (in fact even potentially encourage people to embellish on these sections)
  + §523(a)(2)(C) – **Luxury goods carve-out + cash advance**
    - Luxury Goods: Consumer debts to a single creditor used for purchasing luxury goods within 90 days of filing that exceed $650 creates a presumption of fraud (excludes goods/services reasonably necessary for support/maintenance of debtor)
    - Cash Advance: Cash advances totaling more than $925 within 70 days of filing are presumed non-dischargeable
  + Note: All of §523(a)(2) debts are also non-dischargeable in a Chapter 13 case
* **§523(a)(4) – Fraud or defalcation** - Includes embezzlement and larceny when acting in fiduciary capacity
* **§523(a)(5) – Domestic support obligations** - Alimony, child support, etc
* **§523(a)(6) – Willful & malicious injury** - Caused by debtor to another person or their property
* **§523(a)(8) – Educational loans** - Only if it would not create undue hardship. Very narrow/strict interpretation of undue hardship which makes this difficult to prove
* **§523(a)(9) – DUI debt** - Arising out of harm done while operating under influence
* **§523(a)(15) – Other debts incurred in divorce** - Separate from (5), this is related to property settlements

### §1328 – Deals with discharge in a Chapter 13 situation

* §1328(a) - Super Discharge. Also provides a list of non-dischargeable debts in a Ch. 13 case (incorporates some of the §523(a) non-dischargeable debts, but not all of them)
  + §1328(a)(2) - Main limitations on the super discharge
    - List of exceptions in §523(a) that are non-dischargeable in Ch. 13
      * §523(a)(2) – Fraudulently incurred debts
      * §523(a)(4) – Fraud or defalcation
      * §523(a)(5) – Domestic support obligations
      * §523(a)(8) – Educational loans
      * §523(a)(9) – DUI debt
  + Note: Does not include discharge willful or malicious injury
  + §1328(a)(3) - Restitution, criminal fine imposed on debtor for conviction of a crime
  + §1328(a)(4) - Restitution, damages awarded in a civil action against the debtor as a result of willful or malicious injury caused by debtor that resulted in personal injury
    - Note: this is only half of the §523(a)(6) – Willful or malicious injury to person/property non-dischargeable debt. Therefore, injury to property will be dischargeable in Chapter 13 cases
* §1328(b) – Hardship discharge in non-completed Ch. 13 plan
  + Applies in a situation where the debtor fails to complete a Ch. 13 plan, but tried really hard to comply. Hardship discharge (non-completed Ch. 13 plan)
  + Get a discharge for everything except your §523(a) non-dischargeable debts
* §1328(h)(2) – Cannot get discharge until after court can determine whether debtor will be found guilty of a felony
  + Essentially stops everything if it looks like debtor might be found guilty of a felony

## Comparing Discharge in Different Chapters

* Chapter 7 Discharge:
  + Only allow a discharge for an individual. Corporation/other entities do NOT get a discharge if liquidating
  + §727(b) – Discharge frees debtor from all debts arising before bankruptcy
* Chapter 11 Discharge:
  + A corporation that is reorganizing DOES get a discharge
  + Carve-out for non-individuals in the context of liquidation, do NOT get a discharge.
* Chapter 13:
  + Uncertain. Majority of debtors are individuals, but it is possible for a business to file for Chapter 13
* Chapter 7 v. Chapter 13 Discharges:
  + There are some debts that are non-dischargeable in Chapter 7 (under §523) that are dischargeable in Chapter 13 cases
    - Example: willful or malicious injury to property (e.g. trashing hotel room)
    - Note: This is because the legislature wanted to incentivize Chapter 13 filings
  + What are the advantages for an individual to file Ch. 7 rather than Ch. 13?
    - Get discharge immediately
    - Quick/straightforward especially if individual does not have any property

## Complete Denial of Discharge - Actual Fraud §727(a)(2)

* What factors would Court consider in deciding whether debtor’s pre-bankruptcy planning behavior should lead to §727(a)(2) discharge to be disallowed?
  + (1) Intentional misconduct - Whether debtor incurred debt as part of his plan to buy the $1M life insurance?
    - If yes -> no discharge allowed
    - If not -> discharge allowed
  + (2) How much debt does debtor have and whether debtor is putting all of its assets into exemption plans like life insurance plan?
    - If debtor puts all assets into exemption -> no discharge allowed
    - If debtor puts only some assets into exemption -> discharge allowed
  + (3) Did debtor sell assets to raise money and if so, did debtor sell property at fair market value or was there something off about the sales?
    - If debtor did not sell assets -> discharge allowed
    - If debtor sold asset at market value -> discharge allowed
    - If debtor sold assets at lower than market value or there’s something else off -> no discharge allowed
  + (4) If debtor sold property to raise funds for exemption, did debtor actually sell it, or did it sell to family/fake-sell?
    - If real sale -> discharge allowed
    - If fake sale -> no discharge allowed
  + (5) How big is the exemption?
    - If the exemption is unlimited or more than debtor will actually need for a fresh start -> no discharge allowed
    - If exemption is limited to what debtor will need for a fresh start -> discharge allowed

### Insurance Policy Hypothetical (Not Discussed in Class)

* Setup: PA allows debtor to exempt up to $500k of any whole life insurance policy. Debtor, whose only main asset is Matisse painting, sells Matisse to her sister for $500k; buys $500k worth of PA life insurance, and then files for Ch. 7
* Trustee's response in this situation depends on question of how much Matisse is worth
  + If worth $500k (i.e. has nothing other than the policy) -> Cannot use fraudulent conveyance argument
    - However, can object to the discharge through § 727(a)(2). Effect of the sale was to leave nothing for creditors, because what is left is exempt property. Argument that this was a design to hinder a creditor within one year of filing and should lead court to deny discharge to debtor
    - Debtor response: This was consistent with fresh start; Debtor can engage in pre-BR planning and that taking advantage of exemption on the eve of Bankruptcy is not by itself sufficient to justify denying the discharge)
  + If worth $2M:
    - Trustee would undo the transaction as a fraudulent conveyance. Estate entitled to the painting
      * Requirements for constructed fraudulent conveyance: debtor did not receive reasonably equivalent consideration, and debtor was insolvent
      * If family member acted in good faith, would probably be protected for the $500k she paid, but painting would come back into the estate
      * Trustee can also object to the discharge
  + The trustee’s two options: 1) go after it as a fraudulent conveyance; 2) object to the discharge

## Non-Dischargeable Debts - Domestic Support Obligation (§523(a)(5))

* §523(a)(5) – A domestic support obligation is not dischargeable
* Domestic support obligation: §101(14A)
  + “Debts owing to a spouse, former spouse or child of the debtor or governmental unit that is in the nature of alimony, maintenance, or support and that is established by separation agreement, divorce decree, or property settlement agreement, a court order, or a determination made under non-bankruptcy law by a governmental unit”
* 6 Factors to Determine Whether Spousal Debt is DSO and thus non-dischargeable:
  1. Debt’s label
  2. If spouse/child has strong need for support
  3. If obligation terminates on death or remarriage of the receiving spouse
  4. If term is for a fixed time (factor AGAINST)
  5. If obligation subject to modification by the court
  6. If tax law treats the payments as alimony
* §523(a)(15) – Other debts a spouse/child incurred during divorce/separation (separate from (a)(5))
  + Note: While both (a)(5) and (a)(15) are both non-dischargeable debts in a chapter 7 case, only (a)(5) is non-dischargeable in chapter 13 case. This means that (a)(15) is dischargeable in a chapter 13 case, which is why classification of settlement arrangements under the two categories is so important.

### *In Re Werthen*

* Background Information: Granted that support payments (alimony) and divorce property settlements are non-dischargeable under both (5) and (15) respectively, why does it matter which it is categorized as?
  + Non-BR Reason: There is a tax difference. Alimony is taxed as income whereas property settlements are not. In the family law context, there is thus an incentive to classify settlements as a property settlements (avoid taxes on this arrangement)
  + BR Reasons:
    - At the time of *Werthen*, §523(a)(15) were dischargeable
    - §523(a)(5) obligations are non-dischargeable under both chapter 7 and 13 whereas §523(a)(15) is only non-dischargeable in Chapter 7
      * §1327(a)(2) "super discharge" was written to incentivize debtors to use Chapter 13 instead of 7
    - In Chapter 7, the §523(a)(5) obligations gets distribution priority at the end of BR
* Facts: Husband and wife divorce. Wife gets settlement judge separated into “child support” and “property division.” Part of the property division is composed of bonus payments and equity payments. Alimony was relatively low, so likely was the case that the alimony was incorporated into bonus payments in the settlement for tax purposes. However, if not an §523(a)(5), this would be dischargeable at this point in history
* Issue: Are the bonus payments/equity payments court listed as “property division” non-dischargeable?
* Rule: **An award designated as “property division” under a state divorce decree may be treated as an award of alimony or support under the Bankruptcy Code where there is evidence that the award was intended to serve as support**
* Holding: The obligation falls under §523(a)(5) and is thus non-dischargeable. Even though labeled as “property division,” the intent behind these payments was to insure adequate support for the wife and children so it should qualify as domestic support obligation

### Domestic Support Obligations vs. Property Settlement Hypotheticals

* Hypothetical #1: §523(a)(5) Support Obligations
  + Suppose we are in Chapter 7 and characterize a $100,000 as support obligation
  + Support obligation gets priority over unsecured claims (under §507) so creditor/ex-spouse would get a bigger payout and any amount that’s not paid back would still be non-dischargeable and could be collected through judicial lien
  + Takeaway: Both §523(a)(5) and §523(a)(15) are non-dischargeable in Chapter 7, but §523(a)(5) gets priority while §523(a)(15) does not under §507
  + Irony: Debtor-Spouse will actually prefer obligation to be labeled as support obligations, bc debtor will have to pay out that obligation to ex-spouse regardless (since it’s non-dischargeable), so spouse will rather pay out more to ex-spouse as part of bankruptcy and have less left over as non-dischargeable once bankruptcy ends
* Hypothetical #2: §523(a)(15) Property Settlement Obligations
  + Setup: Suppose we are in Chapter 7 and characterize a $100,000 as property obligation. After all secured creditors are paid, there’s $20K left
  + What would effect be of that overall?
    - Property obligation is an unsecured claim, so creditor gets a pro-rata of what’s left
    - So if there’s $1,000,000 of total unsecured claims, creditor/ex-spouse will get ($100,000/$1,000,000)\*$20,000 = $2,000 OR (ex-spouse/creditor’s share/total unsecured claims) money left for unsecured creditors
    - Creditor/ex-spouse would be left with a claim for $98,000, which is not dischargeable, so creditor/ex-spouse can continue to try to collect using judicial lien. How does one collect?
    - From new property (paycheck, etc.) that debtor acquires after bankruptcy BUT NOT from property/interest that have been labeled as exemptions in bankruptcy!

## Non-Dischargeable Debts - Willful & Malicious Injury (§523(a)(6))

* §523(a)(6) – A debt for “willful and malicious injury by the debtor to another entity” is non-dischargeable
* Two Categories of “Willful & Malicious Injury”
  + (1) Personal Injuries
    - Examples: Intentional torts; setting fire to a house; bar fight
    - Requires actual intent to cause harm
    - Traditionally medical malpractice cases do NOT qualify unless there is actual malice
      * *Kawaauhau v. Geiger* - Plaintiff sought medical care of debtor. DR made wrong diagnosis that led to P’s food being amputated. P sued DR and obtained 300k judgment in medical malpractice case. Dr then filed for bankruptcy. Court held that this was NOT willful or malicious injury under §523(a)(6) and thus was dischargeable in Chapter 7 bankruptcy
  + (2) Conversion of Property
    - Note: Non-dischargeable so long as the debtor did not truly believe actions were lawful
* Hypothetical: Rockstar trashing hotel room and discharge under Chapters 7 and 13
  + Setup - Rockstar trashes hotel room doing $250k worth of damage to the property. He subsequently filed for bankruptcy
  + Chapter 7?:
    - The obligation is not dischargeable here. Debtor willfully/intentionally caused injury to the property thus it comes within §523(a)(6) exception
  + Chapter 13?:
    - This obligation is discharged at the end of BR. Willful/malicious injury to property is not an exception to discharge in Chapter 13

## Non-Dischargeable Debts — Fraudulently Incurred Debts (§523(a)(2))

* Reminder: A debtor who has obtained debts fraudulently (concealing assets, hiding info) may also be denied a discharge completely under §727(a)(2)
* §523(a)(2)(A)) - Debts obtained by “false pretenses, a false misrepresentation, or actual fraud” are non-dischargeable
  + Fraud = contracting debt intending not to pay
  + **Creditor can establish non-dischargeability by showing: the debtor knowingly made false representations for the purpose of deceiving and the creditor reasonably relied on such representations and sustained loss as a result**
  + Intent to defraud credit card company can be inferred by: Intervals/frequency/number/amount of charges, financial/employment status at time of charges, spending habits, etc.
* §523(a)(2)(B) – False statements
  + In the credit card context, false statements would be intentional mistakes on an application form
  + This is not a heavily used provision as it would be difficult to establish the requisite reliance because it is pretty common knowledge that no one uses these forms. Credit card companies will do just about anything to sign people up for new cards
* §523(a)(2)(C) – Presumption for luxury goods and cash advances
  + Debts to a single CR for luxury goods/services incurred on/within 90 days of BR aggregating more than $675 is presumed non-dischargeable
  + Cash advances aggregating more than $950 obtained on or within 70 days of filing for bankruptcy are presumed non-dischargeable

### Am Ex Travel v. Hashemi – Credit card fraud

* Facts: DR went on a six-week vacation to Europe and charged $60k on his credit card (more than a year of income). When he got home, he immediately filed for bankruptcy
* Issue: Although credit card debts are generally dischargeable, AmEx argues this should be non-dischargeable under §523(a)(2)(A). Does court agree?
* Holding: These debts are non-dischargeable
* Reasoning: Meets all of the common-law elements for fraud
  1. Fraudulent intent (charges exceeded yearly income, already in large amount of debt)
  2. False representations
  3. Justifiable reliance (no red flags that should’ve alerted credit card company of potential for problems)
     + Note: There were no red flags or other obvious reasons AmEx should question debtor and thus they were found to have “justifiably relied”
* Different from reasonable reliance
  + Justification is subjective to the abilities of the particular plaintiff and the circumstances of the particular case, rather than a community standard of reasonableness that applies to all cases
  + However, credit card companies assumed to have the capacity to recognize red flags and have compelling interest in performing an sufficient inquiry into DR's financial situation

### In Re Ellinsworth – Contrast to AmEx on issue of justifiable reliance in context of credit card fraud

* Facts: Credit card co offered debtor a pre-approved card based on a credit score they received. Debtor actually owed 65k on various other cards at the time. Credit Card co made no effort to get a full sense of debtor’s financial situation
* Holding: DR’s credit card debt is dischargeable
* Reasoning Even if debtor made false representations, credit card company **did not justifiably rely because it made no effort to make an adequate inquiry into debtor’s financial situation** when giving her the pre-paid card

## Non-Dischargeable Debts Educational Loans (§523(a)(8))

* Educational loans are non-dischargeable except in cases of “undue hardship”
* Student loans are really hard to get rid of. Why?
  + Because students have a lot of liability/very few tangible assets except for earning capacity. Fear is that if students could discharge loans, they would strategically file for bankruptcy
* **Brunner Test for “Undue Hardship”**:
  1. Debtor cannot maintain, based on current income and expenses, a “minimal” standard of living for herself and her dependents if forced to repay loans
  2. Additional circumstances exist that show this state of affairs is likely to persist for a significant portion of time
     + - Circuit split regarding whether meaning. Some courts believe additional circumstances require serious illness; disability; lack of useable job skills; large number of dependents (4th Cir). Others do not (9th Cir)
  3. Debtor has made good faith efforts to repay loans

### Student Loan and Credit Card Debt Hypothetical

* Setup: Third year law student with a big job in NY firm to begin in September
  + July 1: $30k cash advance from credit card company; paid student loans (30k)
    - Why? Credit card debt easier to discharge than student loans
  + Late July: Takes bar exam
  + August 1-15: Trip to Asia. $25k worth of credit card debt
  + August 20: Buys patented Trump (gold-plated) furniture on credit for his apartment ($30k Trump store)
  + August 25: Law firm rescinds his offer
  + August 26: Completely broke, gets arrested for shoplifting
  + September 1: Files for bankruptcy
* Three Main Groups of Creditors:
  + (1) Government (for student loans)
    - Debtor now owes $70k (paid down $30k with cash advance)
  + (2) Credit Card Companies
    - Debtor owes $55k
  + (3) Trump Store
    - Debtor owes $30k
* Question: Are any of these debts dischargeable?
* Student Loan Obligations? No:
  + §523(a)(8) - Students loans are generally non-dischargeable unless the situation meets the undue hardship exception
  + Here, debtor probably does not satisfy the undue hardship exception. A good degree from a great law school will make it hard for the court to sympathize, as debtor still has large earnings potential. However, possible that the criminal conviction will make it difficult for debtor to obtain a job now/get admitted to the Bar
  + While there is argument that debtor satisfies all components of *Brunner* test, government could counter that there was no good faith effort to pay back loans since this was pre-BR planning intended to transfer debt to type that is dischargeable
* Credit Card Debt? No:
  + Cash advance within 70 days is presumed to be non-dischargeable (§523(a)(2)(C))
  + Company will also argue that fraud is present (possibility to use the basic §523(a)(2)(A) because the cash advance suggests there was no intention to pay back since credit was used to pay off student loans, which not dischargeable, whereas loans from credit cards may be
    - Most courts take view under view that there is nothing that raises a red flag, it is justifiable reliance; debtor could argue that $40K cash advance is a red flag that credit card company should not have justifiably relied on (under *Hashemi* majority view)
    - Student may counter by arguing that he racked up credit card debt with expectation that he would soon be making ~$160,000 which would enable him to easily pay this back
  + Luxury goods exception (§523(a)(2)(C)(i)) might also apply
    - Would require analysis of purchases on vacation to determine if required aggregate amount is exceeded
* Trump Store? No:
  + Luxury goods exception (§523(a)(2)(C)(i)) would apply and make this debt non-dischargeable

# Claims

## Key Provisions

### §101 - Definitions

* §101(10) – **Definition of Creditor**
  + An entity holding a claim that arose before filing petition in a voluntary case OR before the order of relief in an involuntary case
  + Skeel: to be a creditor in a bankruptcy case, you have to have a claim that arose before the order of relief. Definition of creditor is where we get the distinction between pre and post bankruptcy. Technically, the person owed money for post-petition activity is NOT a creditor, but rather the holder of an administrative expense (e.g. BR counsel)
* §101(5) – **Definition of Claim**
  + Broad interpretation - Can be contingent
    - Purpose of broad definition is because framers of BR code wanted to ensure all possible issues against DR are brought into BR so they could be addressed through the collective process and allow DR to leave without overhanging/encumbering issues. This is consistent with both fresh start and creditor's bargain theories
    - There are certain situation where having a claim would be undesirable for CR, such as when DR is re-organizing and CR would be able to get full dollar value for their claim if they waited until after BR to bring a suit
  + Any right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, legal, equitable, secured or unsecured
  + Includes right to equitable remedy for breach of performance if breach would give rise to a right to payment (see equitable remedy section below)

### §501 – Gate Keeping Provision (“A creditor may file a claim”)

* Enables creditor's to submit proof of a claim - controls who gets a piece of the pie and how big
  + If creditor doesn't file proof of claim in timely manner, trustee or debtor may file such a claim (§501(c))
  + §501(d) outlines what is needed in order to have a valid claim

### §524(g) – Future Asbestos Claims (Mansville trusts)

* Enjoins future claimants from pursuing the assets of a debtor who has already been through bankruptcy, so long as the debtor forms a trust pursuant to its plan of reorganization that assumes the liabilities of the debtor for these personal injury/wrongful death/property damage actions resulting from the manufacture of asbestos

### §502 — Determining The Value Of A Claim

* **§502(b)** – Determines who has claim, who doesn't, and to what extent
  + Court is charged with determining the amount of an unsecured claim
    - Fixed amount claims: Bankruptcy court does not have to do anything unless the value of the claim is contested
      * However, §502(a) allows interested parties to object to claim
    - Otherwise, court must conduct a summary hearing to determine the validity and amount of the claim
      * Allows the court to fix the amount of the claim as of the date of filing the petition
  + **§502(b)(2)** - Matured/accrued interest IS included in the value of the claim (un-matured interest NOT)
    - Claim for principal + accrued interest up unitl filing date but NOT unaccrued interest
  + **§502(b)(6)** - Restriction on real estate leases
    - The claim is limited to the greater of (1) 1 year of rent OR (2) 15% of the remaining rent on the lease, not to exceed three years of the remaining term
* **§502(c) – Pending cases**
  + Bankruptcy court can estimate (i.e. put a tentative amount on) the amount of contingent/unliquidated claims where liquidating or fixing them would unduly delay the BR case
    - Courts typically do this when BR judge does not have authority to decide the claim
    - Example: Court can only estimate personal injury claims (cannot fix them)
  + Also estimates any right to payment arising from a right to an equitable remedy for breach of performance.
* With a contractual obligation, the claim is generally for the amount of the contract (although there is no statutory support for this)

### §506 – Secured Claims

* **§506(a) – Scope of a secured claim**
  + Secured creditor has a claim up to the value of the collateral
  + Undersecured creditor (claim > collateral) will have a secured claim in the amount of the collateral’s value + unsecured claim for the rest (bifurcates undersecured creditor’s claim)
  + Value to be determined by court in light of purpose
    - **Rash analysis** – Foreclosure v. replacement value **depends on what debtor intends to do with property**
  + **§506(a)(2)** – Waives Rash in Chapter 7, 13 involving individuals when dealing with personal property (non-real estate)
    - Value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing
      * Personal Property = anything except real estate if the debtor is an **individual**
      * Note: Does not matter what the debtor intends to use the property for
    - If consumer good (goods a debtor would use for personal household needs), replacement value is defined in a very specific way (“price a retain merchant would charge for property of that kind considering the age and condition of the property at the time value is determined”)
    - Note: This is because individuals are allowed to redeem consumer goods if debtor can cough up the value of the property in cash in full (722). §506(a)(2) defines what §722 value means
* **§506(b) – Interest To Oversecured Creditors** (up to amount of value of collateral)
  + To the extent that an allowed secured claim is secured by property the value of which...is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges
  + Note: applied to voluntary and involuntary over-collateralized creditors. Thus, IRS (secured creditor via a statutory lien) can also obtain interest
  + Under-collateralized creditors CANNOT receive interest (or payment for delay of enforcement of states rights) (Timbers)
* **§506(d) – Avoiding Liens**
  + Natural reading of §506(d)
    - To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless…
    - Such claim was disallowed only under §502(b)(5) - domestic support claim, or §502(e) - certain claims for reimbursement/contribution OR
    - Such claim is not an allowed secured claim due only to the failure of an entity to file a proof of such claim under §501
    - Under non-Dewsnup approach, traditionally, §506(d) was interpreted to permit debtors to “strip down” secured claims to the value of collateral (assuming a claim was over-secured) in certain situations and void the unsecured portion.
  + Dewsnup Reading – Only if the claim is not allowed (illegitimate), then it is void. Does **not** void a lien in excess of the amount at which the court valued the secured claim
    - Ex: If Bank’s loan was fraudulent -> Bank would have no claim
    - Supreme Court read (§506(d)) in a tortured way. Why? Because they interpreted the history to suggest that a lien rides through bankruptcy (bankruptcy discharges debtor’s personal liability but not the in rem liability)
    - Note: this does not get applied in Ch. 11 or 13, just used in Ch. 7. Would cause major problems in application in 11 or 13 and negatively impact the reorganization efforts

## Claims in General (Unsecured Creditors)

* Types of Claims
  1. Secured
  2. Priority – unsecured claims that are given priority over others (ex: DSOs)
  3. Unsecured – creditors get a pro-rata share of the estate

### Filing of Claims

* Chapter 7:
  + Claim has to be filed within 90 days of the date set for the date set for the first meeting of creditors
    - Meeting of creditors: meeting of creditors that the court is not allowed to come to, creditors are able to ask questions to the debtor. It is not a violation of the automatic stay for the creditors to yell at the debtor
* Chapter 11:
  + No absolute rule on relevant date (bar date)
  + Bar date is whatever the date the court sets
  + Exception: if the debtor lists you and the amount you are owed, you are ok and do not need to file a claim.
  + Basically lose the claim if you fail to file by the bar date (unless there is excusable neglect)
    - Excusable Neglect: it might be excusable that a creditor does not file a claim if he never received notice

### Who Has A Valid Claim

* Rule: Need conduct + relationship prior to BR in order to have a claim
  + Relationship defined as when the creditor comes in contact with the DR in whatever gave interaction rise to the claim
  + Note: We do not want the definition of claim to be too limited because we want to pull as many claims into bankruptcy as we can. A pure conduct claim, however, would open the floodgates. Piper adds relationship to conduct requirement, meeting somewhere in the middle
    - Example: Nuclear power plant explodes and energy company files for BR. However, people don't experience effects of radiation exposure until several years later. If pre-filing conduct is all that is needed, victims claim would have been discharged
  + Note: If don't have a claim under the rule, possible to bring it post-BR since it isn't discharged
* **Piper Test:**
  + **(1) Pre-Petition Conduct of Debtor**
    - Conduct has to be before bankruptcy filing or confirmation
    - Conduct: injury, design, manufacture, sold, etc
  + **(2) Relationship must be established before confirmation**
* Note: whether a creditor wants to have a claim depends on the chapter debtor has filed under. If it is a chapter 7 case, creditor want to have a claim because otherwise you do not get anything. If it is a chapter 11 (reorganization) case, creditor might not want a claim, but instead want everyone else to have a claim and you not to have a claim. This is because then you could potentially get 100-cents on the dollar from the post-reorganization debtor post-bankruptcy. The debtor, however, wants everything to be considered a claim so that it can be discharged in bankruptcy

### *In re Piper Aircraft*

* Test: Pre-petition conduct + relationship pre-confirmation
* Facts: Piper has faulty aircrafts and has been defendant in several law suits for damages arising out of these defects. It iles for Chapter 11 bankruptcy. Appointed legal representative fields proof of claim on behalf of future claimants for $100MM
* Issue: Do future claimants (those presently unknown individuals who may be injured in the future) hold claims against debtor within the meaning of §101(5)?
* Holding: No. Conduct + Relationship both needed
  + Here, there is no pre-petition exposure to specific defective products; no pre-confirmation relationship between debtor/future claimants.
  + Since there was no way of determining who these future parties would be, these future claimants did NOT have a claim in Piper’s bankruptcy case and thus could not be discharged
* Rule: In order for a claim to fit within §101(5), **the events that caused the injury must occur pre-petition and must create some type of relationship between the claimant and the debtor’s product. This relationship must be with an identifiable claimant or group of claimants and the basis of the claim must be the debtor’s pre-petition conduct in designing, manufacturing, and selling the allegedly defective or dangerous product**
* Question: What if Piper filed for bankruptcy after one accident knowing that there are thousands of bad planes?
  + Under Chapter 7 – Piper would get a windfall (because of liquidation)
  + Under Chapter 11 – Piper would not get off free because future victims don't have dischargeable claims and would be able to sue after bankruptcy (because of reorganization)
  + Piper was a bit of a hybrid since they filed for Chapter 11, yet opted for the liquidation plan so it resembled Chapter 7
    - Successor Liability - After sale is clear of liability, a claimant cn nonetheless argue that the buyer is responsible for the claim because it's a continuation of the same business
* Posner Note case (*Fogel*):
  + Concrete manufacturer sold defective concrete to Denver airport. Manufacturer files for Chapter 11 after it had been sued by 8 different purchasers. Airport did not file claim before the deadline. Pipes exploded and airport wants to bring suit.
  + Issue: Did they have a claim that was discharged at the time of confirmation?
  + Under Piper test, they had a claim, but they missed their chance. Conduct would be defined really broadly (i.e. when the concrete was installed, not when the injury ocurred)
  + The *Fogel* Court: finds no claim not because of a precise rule surrounding conduct and relationship, but due to the circumstances of the tort in that case
  + Posner: thinks it is crazy to call this a claim
    - Posner advocates a reasonableness test (cost/efficacy of providing notice)
      * **Reasonableness test**: Bearing in mind cost and efficacy of providing notice perhaps long before any tort claim arose. If it would be unrealistic to take account of these kinds of claims, it is not really a claim
      * Is it reasonable to expect the creditor to know it had a claim by the time of the bar date or confirmation (whichever is earlier)? In *Fogel*, Posner concluded it would not be reasonable to expect this
    - "It may not be possible to say anything more precise than that if it is reasonable to do so, bearing in mind the cost and efficacy of notice to potential future claimants and the feasibility of estimating the value of their claims before any harm giving rise to a tort claim has occurred, the bankruptcy court can bring those claimants into the bankruptcy proceeding and make provision for them in the final decree."
  + It would be unfair to say that all possible future-claimants have claims that are discharged in bankruptcy (because those claimants would be deprived recovery) = not fair. This is an adjustment of *Piper* test
  + Skeel: Easier way to get to Posner’s result = due process argument (no notice/no reason for the creditor to know of the filing).
    - To deal with this fact, you tend to get national notice to cut this argument off

### Hypothetical Based on *Piper*

* Debtor is a manufacturer of planes
* Timeline:
  + 12/1: 2 pilots buy planes
  + 1/1: Debtor files for bankruptcy (Ch. 11)
  + 2/1: Pilot #1 and customer crash
  + 3/1: Chapter 11 plan is confirmed
  + 4/1: Pilot #2 and customer #2 crash
* Question: Which of these individuals have claims in bankruptcy case?
  + Rule: Need pre-petition conduct AND pre-confirmation relationship in order to have a claim
  + Pilot #1: Yes - has a claim
    - There is pre-petition conduct (pre-petition manufacturing of the plan)
    - There is a pre-petition relationship (pre-petition buying the plane on 12/1, connecting pilot to manufacturer)
  + Customer #1: Yes - has a claim
    - There is pre-petition conduct (pre-petition manufacturing of the plan)
    - There is a pre-petition relationship (buying the ticket to go on the plane, connecting pilot to manufacturer)
  + Pilot #2: Yes - has a claim, but it is discharged
    - There is pre-petition conduct (manufacture, sale, etc)
    - There is a pre-confirmation relationship (buying the plane on 12/1)
    - There is a potential due process issue here if Pilot #2 did not have notice
      * Would violate DPC if potential claimant did not have notice of the BR proceedings and and the proceedings discharged his claim
        + What counts as notice? Direct notice, for one. Newspaper publication of notice is usually enough to give potential claimants notice as well
        + Even if Pilot #2 had been given notice, should we have expected him to make his claim? This would depend partially on the expectation of injury. Why would he make a claim if he never expected to be injured?
  + Customer #2: No - does not have a claim
    - There is pre-petition conduct
    - The relationship was post-petition (UNLESS he bought the ticket before 3/1, his connection to the debtor/manufacturer occurred after the 3/1 confirmation date)
* Adjusted Hypo: If pilots don’t buy plane
  + Pilot #1 still has relationship because flew plane before Ch. 11 confirmation

### Mass Future Claims in Bankruptcy - §524(g) (Asbestos Cases)

* Johns-Manville - Early case where company had huge tort exposure. Even people who were exposed to asbestos before BR might not experience effects for several decades (due process issue)
  + Holding: Asbestos claims were technically pre-petition claims because the asbestos causing the injuries was manufactured pre-petition even though some of the individuals who later suffered from diseases did not have any symptoms at the time of bankruptcy. However, court did not decide who had claims
  + Instead, it set up a channeling trust, put aside most of the value of the company (50-60% of the stock of the re-organized company). Put in place a channeling injunction that said that no matter when the harm arises, you can only exercise the claim against the trust, not against the re-organized company. Ensured due process through a future claimant’s representative
  + Constitutionality of this trust was initially questioned, so Manville went to congress who then enacted §524(g)
* §524(g) – Future asbestos claims
  + Enjoins future claimants from pursuing the assets of a debtor who has already been through bankruptcy, so long as the debtor forms a trust pursuant to its plan of reorganization that assumes the liabilities of the debtor for these personal injury/wrongful death/property damage actions resulting from the manufacture of asbestos
  + Requirements:
    - **§524(g) only applies to asbestos-cases**
    - Trust has to:
      * (1) Own a majority of the stock in the re-organized company;
      * (2) Claimants who do exist have to approve the proposed plan by 75% (higher than average—idea being that many people will not actually be part of the vote);
      * (3) There has to be a representative of the future victims (future claimants’ representative)
  + If you put together a trust that looks like the Manville trust, it has been treated as legitimate. Trust has been used in a number of cases/even non-asbestos cases although there has been no decision on the Constitutionality of it
    - Assumed these trusts are ok, that they satisfy due process although it has never been actually decided

### Equitable Rights - When are equitable rights considered claims within the meaning of §101(5)

* **General Rule**: Equitable rights are claims within the meaning of §101(5) when breach of performance triggers an equitable remedy AND an alternative right to payment (i.e. choice between equitable and monetary damages)
  + Specific performance generally treated as a claim because there may be an alternative right to payment
  + Covenants-not-to-compete are questionable depending on how they are structured/whether the court adopts the Udell or Ward approach
* **Specific Performance**:
  + If the creditor could insist on specific performance outside of bankruptcy, there can be an argument for no claim (e.g. Real estate sales - Often the theory is that land is so unique that monetary damages are insufficient to remedy the breach)
* **Covenants Not To Compete**:
  + Courts are hesitant to allow injunctions enforcing non-complete covenants to be stayed in bankruptcy even though the underlying breach of K gives rise to money damages
* **Udell Approach** (majority, pro-creditor view) – Depends on whose choice it is:
  + **If creditor's choice -> No claim** (i.e. if debtor can't force creditor to tke money damages outside of BR, then there is no claim)
  + **If debtor's choice -> Claim** (i.e. if debtor can force creditor to take money damages, then there is claim. Debtor would always chose monetary damages since unsecured claim is less burdensome than post-BR enforceable injunction)
  + **If no choice -> No claim**
  + Udell court looks to see whose choice it is to determine whether the covenant can be considered a claim
    - If the creditor gets the choice of which to take (monetary damages/injunction), it is not a claim if the creditor doesn’t want monetary damages
      * In other words, if the creditor could get a court to force the debtor to comply with injunction, then no claim
    - If the debtor could force the creditor to take monetary damages outside of bankruptcy (in other words, if the creditor could NOT insist on the injunction), then it is a claim
      * Example: 3rd Circuit case involving a Continental/United merger. As part of the collective bargaining agreement, pilots of Continental had a provision that if there was any merger, their seniority rights would be honored. During the merger, they realized that it would be impossible to honor seniority rights. Question was whether seniority rights could be converted into damages? Looked to state law for guiding principle. Under PA state law, court would award damages for a refusal to honor this principle, so this would be a claim
      * Note: this shows that there is an option for the debtor to force the creditor to take monetary damages
    - Pro-creditor: This is in line with the Butner principle (attempts to mirror non-bankruptcy law). The state law of covenants-not-to-compete already wrestles with issues of fresh start, so it is not that this law ignores the debtor’s needs
    - Skeel: Endorses this approach
* **Ward Approach** (minority, pro-debtor view) – If there is A choice, almost always considered a claim
  + If anyone (debtor/creditor) has a choice of monetary damages outside of bankruptcy, it is a claim (almost always a claim)
  + When does debtor have the option?
    - Statute allowing option of turning injunction into monetary damages
    - Common law rule allowing option of turning injunction into monetary damages
  + If there is an alternative to equitable relief, then there is a claim that can be discharged
    - Possibility of money damages is sufficient to constitute a claim. The only exception is if it is too speculative
  + Only time there would NOT be a claim is when there is no choice to get monetary damages
  + Pro-debtor: this is in line with a strong fresh-start policy

### Non-Compete Covenant Hypothetical

* Setup - Debtor is a mid-level employee at Target. As part of his employment contract, there is a covenant not to compete – debtor is not permitted to work at another retail store within 25 miles of a Target store for 5 years if he is fired or leaves voluntarily. If debtor breaches covenant, Target can get an injunction to prevent debtor from working at other retailer and for every month of violation, debtor has to pay $25k/month. Debtor quits Target, goes to work at Walmart. Target finds out after debtor has been violating it for two months and goes after debtor. Gets an injunction and then the debtor files for bankruptcy.
* Issue - Debtor wants to get rid of the injunction in bankruptcy. Can he?
* Debtor’s Arguments:
  + Consistent with Fresh start policy view of bankruptcy - Target is ubiquitous. Seems impossible for him to get a job
  + Is this enforceable covenant-not-to-compete under state law? Assume it is enforceable
    - This is somewhat debatable even in a state that enforces these covenants. States typically have common-law restrictions (“reasonableness”—duration, geographical regions, etc.) Too wide and too long here
    - CA does not enforce covenants-not-to-compete; really helpful for an emerging industry if people can move around a lot (in this case, end of story)
  + Argument that this is equitable relief that gives right to payment so it is a claim in bankruptcy under §101(5) that can be discharged
    - Yet, this looks like *Udell* covenant, where the injunction is NOT a claim because the creditor is entitled to BOTH money and the injunction under the covenant (one is not a substitute for the other)
* Target’s Arguments:
  + They can get remedy AND the injunction too because they can’t get the injunction immediately and so the remedy would provide for this lost time and attorney fees
* Assume the contract is enforceable:
  + *Udell*: Who has the choice outside Bankruptcy?
    - **If the creditor gets the choice to choose between money damages or injunction (the debtor cannot force the creditor to take money damages outside of bankruptcy) --> No claim**
    - **If the debtor could choose outside of Bankruptcy - to force creditor to take money damages --> There is a claim**
  + Under *Ward*, if there is a possibility of money damages, it is a claim
    - Only not a claim if the creditor would not be entitled to monetary damages (if damages too speculative - unlikely to happen)
  + On the other hand, Posner in *Apex*: Nobody has a right to money judgement, so the non-debtor's only choice is to get injunction for SP of the remedy. Therefore, it is not a claim; it is only equitable relief
  + Skeel: Dollar sign and injunction doesn’t necessarily make this a claim. Dollar sign would be a claim if it was serving as a replacement for the injunction
* Note: This is essentially the same issue as Penn Terra (does this violate the stay?)
  + Only if it is a claim - otherwise injunction won't be discharged
* Recap
  + 99% of the time, creditors do have claims. The 1% of times there isn’t a claim is in cases like:
    - Piper – when creditors have not been hurt yet, so their potential future claims are not valid claims in bankruptcy
    - Udell/Ward – if outside of bankruptcy, obligations would give rise to specific performance
* Other remarks:
  + Widely held view: the non-enforcement of covenants not to compete is one reason Silicon Valley took off
  + Seniority Respecting Provision in a Contract:
  + Continental merges with United; United refused to honor the continental airlines pilots’ seniority rights
  + The question: whether the K could be rejected, and if it was, whether the seniority rights could be converted into damages
    - 3rd circuit did a Udell-like decision: asked, under PA law – could the debtor refuse to accept the seniority rights and the non-debtor get money damages?
    - Looked at state law, under that state law the non-debtor would NOT be able to insist on SP. So the court awarded damages.

### Environmental Claims

* *United States v. Apex Oil*
  + Facts: debtor oil company has an injunction against it requiring it to clean up contaminated sites. Company will have to hire an independent contractor to do the work (cost 150M)
  + Issue: does the government have a claim that is dischargeable in bankruptcy because of the injunction?
  + Holding: NO. The cost incurred by debtor carrying out an equitable decree is NOT a “right to payment” making an injunction a disposable claim under §101(5)
  + Note: a claim is dischargeable only when the holder of the equitable claim (here, the injunction) could obtain monetary damages instead of the injunction/in the event that the injunction cannot be obtained otherwise (here applies a Ward analysis but says there is no claim)
  + Posner’s approach: Does NOT take a side on the Udell/Ward. Simply says government's injunction would NOT be a claim because only equitable relief is available. There is no monetary damages option. Non-debtor’s only choice is to obtain an injunction calling for specific performance
  + Kovacs case is a problem here
    - Kovacs allows something that looks like solely injunctive relief to be a claim
* Question: How does this issue (is this a claim?) fit with Penn Terra issue (is this a violation of the stay?)
  + Same legal issue – is this part of the bankruptcy process?
    - If this is a claim, it will also be subject to the automatic stay
    - If this is NOT a claim, it will NOT be subject to the automatic stay/NOT going to be discharged in bankruptcy
  + Is the government acting like an ordinary creditor or is it doing something else?
    - If fixing pre-existing harm…govt looks like an ordinary creditor
    - If fixing future problems….govt does NOT look like an ordinary creditor (doesn’t look like the sort of thing we are going to deal with in bankruptcy and so it does not seem to be a claim that would be dischargeable in bankruptcy)

### Hypotheticals Determining The Amount of An Unsecured Claim - §502(b)

* Hypothetical 1:
  + Setup - Bank makes a loan to debtor in the amount of 1M. Ten-year loan, 100k/year, 5% interest rate. After one year, DR pays nothing and files for bankruptcy. What is the value of the claim?
  + Claim = 1M (principal) + 50k (matured interest)
    - Debtor still owes the whole thing. Effectively bankruptcy accelerates the loan + interest that has accrued at the time of bankruptcy
  + Rule: **A claim is in the amount of the entire principal + interest that has come due already**
    - §502(b) makes it clear that un-matured interest is not part of the creditor’s claim
  + Question: how are Banks getting around this rule?
    - Make-whole payment requirement – Lending contracts often have penalty provision - if you default, you must pay it. Looks like un-matured interest (interest remaining on the loan)
* Hypothetical 2:
  + Contract in which manufacturer sells machine (equipment) to the debtor. Unsecured agreement. Sale on credit situation. Sales contract arrangement is $100k payment each year for 7 years. After one year (before making first 100k payment), the debtor files for bankruptcy.
  + What is the amount of the claim? Note that here the manufacturer has NO interest to the equipment
  + 700k (full purchase price)
  + Skeel: Arguably this is not a fully accurate value
    - Implied loan here because ownership transfers
    - If you were to be precise here, you would have to look at which portion of this price is the purchase price for the equipment and which portion is interest. Then determine how much of the interest has accrued.
  + Note: this is an unsecured creditor!!
  + Skeel: with a contractual obligation, the claim is generally for the amount of the contract (although there is no statutory support for this)
* Hypothetical 3:
  + Setup - Debtor gets accused of an anti-trust violation. Claim is filed before bankruptcy. It is a claim for $10M and there is a 3% likelihood that the plaintiff will win against the debtor
  + Question - What is the value of the claim?
  + Option One: most logical way to do it is to do something like….expected value approach
    - Look at the likelihood of success, look at whether the damages requested are reasonable
    - Expected value approach /probability analysis
    - 0.03 x 10M = 300k
  + Other possibilities…
    - Option Two: say it is zero. Low probability suit will result in no claim against debtor (this is the approach taken by the actual case)
    - Option Three: lift the stay and allow the plaintiff to pursue litigation/make the court ultimately determine the value of the claim if plaintiff does win
  + Point: under §502, court has a lot of discretion because it has a lot of power to value the claims

## Secured Creditor Claims

* Secured Creditors:
  + Those who have liens on certain property (real or personal) of the debtor; top priority in bankruptcy
  + Secured creditors have a voluntary lien on property when they have an Article 9 security interest
  + §506(a)(1) - Secured party has a **secured claim to the extent of the value of its collateral**
    - If value of the collateral is less than the claim, difference becomes an unsecured claim
  + Undersecured Creditor:
    - Creditor whose claim is bigger than the value of the collateral (claim > collateral)
    - In bankruptcy, all proceeds of sale go to secured creditor who will then have an unsecured claim for the remaining amount
    - Other Options:
      * Trustee can abandon the property (§544(a))
      * Lift the stay under §362(d) to save expenses of sale (collateral deteriorating in value or debtor has no equity in property and it is not vital to reorganization)
  + Oversecured Creditor:
    - Creditor whose collateral is worth more than the amount due on their loan to debtor [claim < collateral]
    - In bankruptcy, trustee will sell collateral, pay secured creditor, and distribute rest to other creditors
    - Note: Oversecured creditors are entitled to interest and fees
* Remedies for secured creditors OUTSIDE bankruptcy:
  + If borrower does not pay loan on time, secured creditor has the right to repossess its collateral, sell collateral to pay down the loan, and pursue the debtor for deficiency judgment (part of the loan that was not paid off from sale)
  + Note: for deficiency judgment, creditor is an unsecured creditor
* Process for secured creditor INSIDE bankruptcy:
  + Primary role of Trustee in Chapter 7
    1. Disposing of property where there are secured claims
    2. Liquidating the rest and distributing it based on priorities
  + Make sure security interest is perfected (otherwise the trustee can avoid secured claim -> make it unsecured claim)
  + File a proof of claim
  + Note: secured creditors cannot simply repossess/foreclose on collateral because they are subject to the automatic stay (§362(a)(4))
    - Yet, secured creditors can ask for the stay to be lifted, however

### How to Value a Secured Creditor’s - Claim §506(a)

* "Cram down" - In re-org, debtor can elect to keep the property over CR's objections and makes payments over the life of the plan equal to the value of the collateral at time of filing
* §506(a) – “Value should be determined in light of the purpose of valuation and of the proposed disposition/use of such property”
  + Foreclosure Value (how much you would get through foreclosure) v. Replacement Value (how much it would cost to purchase comparable collateral) depends on the situation
* **Rash Test – look to see what the debtor intends to use the property for**:
  + **If debtor liquidates -> foreclosure value**
  + **If debtor using it for business purposes -> replacement value** (determining this value left to the BR courts, though it should not reflect items/features not retained in the property but are reflected in the retail price)
  + **If debtor reorganizes but doesn’t use tractor for business purposes -> foreclosure value or amount debtor sells tractor for**
* Pre-Rash Views
  + Easterbrook Valuation (*Hotchkins*) – should always use the foreclosure value
    - Logic: this is the only value the creditor would get outside of bankruptcy
    - Note: this view ignores the language in the statute (court is supposed to look at the proposed purpose of the property)
  + Posner Valuation: split the difference between the two values
    - Foreclosure value and replacement value
    - Ex: private sale (30k); replacement value used (40k) -> 35k
    - Why? Outside of bankruptcy, there would be a negotiation (the debtor would be willing to pay anything less than 40k –replacement value; the Bank would take anything more than 30k –value bank would get if it underwent a foreclosure sale… thus, it would be somewhere between 30 and 40)
* *Rash* Case:
  + Facts: Ch. 13 case (though also applies to 7 and 11). Debtor exercises its “cram down” power under §1325(a)(5), permitting him to keep property over objection of creditor. Creditor retains a lien securing the claim to the value of the collateral
  + Issue: How should the collateral be valued?
  + Holding: Under §506(a), the property retained via exercise of cram down power should be valued at replacement value because that is cost debtor would incur to obtain comparable collateral
  + Proposed disposition or uses is important to the valuation question
  + Appropriate to use replacement value (higher value) because creditor is exposed to higher risks. Under cram down, replacement value standard would deprive CR of immediate possession of the collateral while also exposing him to risk of another default while the collateral continues to deteriorate
    - High probability CR receives less in a failed re-org than in prompt foreclosure
  + Rash test reflects reality, don't use foreclosure value if there is no sale
  + Note: §506(a)(2) – Changes Rash applicability when debtor is an individual in Chapter 9 or 13. Still applied when debtor is a corporation and in Ch. 11 cases
* Post-Rash
  + Congress added § 506(a)(2): If a debtor is an individual in Ch. 7 or 13, and creditor has security interest in personal property -> valuation is replacement value
    - Courts used to let Debtors pay foreclosure value. Now personal property in Ch. 7 and 13 must be replacement value.
    - §722 redemption provision: Debtor files for Ch. 7 – Wants to keep things like microwave. If debtor pays trustee value of microwave, can keep it (unlike cram down, CR is paid in full at time of redemption)
* Skeel: Rash applies in Ch. 7, 11, and 13: Every context except the § 506(a)(2) context
* Valuation Hypothetical - Determining Payout of Unsecured Claims:
  + Setup - Small business debtor files for Ch. 11 bankruptcy
    - Assets: (Total = 75k)
      * Tractor -> 50k
      * Other -> 25k
    - Liabilities: (Total = 150k)
      * Bank -> 60k (Secured claim in tractor)
      * Unsecured creditor -> 90k
  + Question: What is the secured creditor’s claim?
    - Outside bankruptcy: $50k (tractor value) along with a $10k deficiency claim (unless CR voluntarily waives it)
      * First come, first serve. Can bring suit for the $10k and get judgement, meaning they are paid in full. However, if too late bringing suit, may get nothing (Creditor's Bargain attempts to avoid this result of rushing in order to get paid)
    - In bankruptcy: Secured claim for $50k, unsecured claim in the amount of $10k (§506(a) – two claims for undersecured creditors)
    - What is the pay out for Bank’s 10k unsecured claim?
      * Pro-rata calculation - in the pool of unsecured claims, there is no ranking system:
        + (10k)/(10+90k) (25k) = 2.5k
        + Determine what fraction of total unsecured claims each CR's claim represents and payout remaining assets on that basis

(amount of CR's claim / amount of all unsecured claims) \* amount of debtor’s remaining assets

* + - * + Note: This is different than outside of bankruptcy which is a first come/first serve payout and is thought to be a better outcome, as claims are dealt with in orderly fashion through collective process
  + Question: If the value of the tractor is unknown. Which is the correct value of the tractor?
    - Options:
      * Private sale -> $30k (foreclosure value)
      * Debtor buys a tractor like this used -> 40k (used replacement value)
      * Debtor buys a tractor like this new -> 50k (new replacement value)
    - Rash approach: Depends on what the debtor is going to do with the property…
      * If in Ch. 11 (debtor is going to keep the property/using the cramdown or stripdown power) -> replacement value
      * If debtor is abandoning or selling -> foreclosure value (foreclosure value minus cost)
    - §506(a)(2) – If dealing with an individual in a Ch 7 or 13 case (personal property), use the replacement value at the time of the filing
    - What might make the replacement value (new or used) lower?
      * If tractor was used intensely, if debtor’s tractor no longer under warranty (but new ones are)
* Additional Rash Test Hypothetical:
  + Debtor is a corporation
  + Foreclosure value of tractor: 50K
  + Debtor buys used tractor: 75K
  + Cost of new tractor: 80K
  + Debtor files for Chapter 7. What is value?
    - Since debtor is liquidating, tractor will not be used for the business -> foreclosure value, or 50K
  + If debtor files for Chapter 11 or 13. What is value?
    - If in reorganization, debtor uses tractor for his business -> replacement value standard, so 75K
    - if in reorganization, debtor will not use tractor for his business -> foreclosure value, or whatever debtor receives for tractor in the sale of it

### Avoiding Liens - §506(d) + *Dewsnup*

* Plain meaning of §506(d):
  + To the extent that a lien secures a claim against the debtor that is not an allowed claim, such lien is void, unless:
    - Such claim was disallowed only under §502(b)(5) – domestic support claim or §502(e) – certain claims for reimbursement or contribution OR
    - Such claim is not an allowed secured claim due only to the failure of an entity to file a proof of such claim under §501
  + Traditionally, §506(d) was interpreted to permit debtors to “strip down” secured claims to the value of collateral (assuming a claim was over-secured) in certain situations
    - Plain reading suggests this as well: Lien on property would strip down to the value of the secured claim at the time of BR. The lien would survive BR, but the portion converted to an unsecured claim during BR is voided
* *Dewsnup* reading of §506(d):
  + SCOTUS reads it as if the word "secured" had been omitted. Could only void claim if disallowed as fraudulent, for example, and thus there is no strip-down of secured claims (either the whole claim is voided or the entire amount survives BR)
  + §506(d) does not void a lien in excess of amount of secured claim. Instead, under Dewsnup, a lien passes through bankruptcy. Now, after *Caulkett*, even a totally under-water claim (like the second lender in hypothetical below) passes through bankruptcy and can’t be stripped off under Dewsnup
    - Skeel: bad court decision and just about everyone in the BR world agrees
    - Note: “Lien passes through bankruptcy” means that the lienholder’s property interest does not disappear until voluntary dismissal or sale of collateral. Once property is sold (consensual sale or foreclosure proceeding), most liens disappear. Exception being environmental obligations which “run with the land” (meaning if D sold land to third party, third party would be responsible for satisfying the obligation) and tax liens
    - After a statutory sale process (foreclosure, Art. 9 sale), the lien of the creditor who initiated the sale and all subordinate to that lien will be extinguished. The higher priority liens will NOT be extinguished. Neither will the liens held by creditors not involved in the sale. This includes tax liens (highest priority), unless the tax lien holder is the one initiating or consenting to the sale.
    - The debtor selling property outside of bankruptcy will not extinguish liens
    - §363 - provision authorizing sale of property inside bankruptcy. Generally extinguishes liens, however *Dewsnup* was a weird case because it involved abandonment of the property in Chapter 7, but value of the property was not known since no trustee sale
  + The effect of this reading is that bankruptcy case discharges the debtor’s personal liability, but does NOT discharge the in rem liability
  + Additionally, under this reading, the bankruptcy court’s assignment of a secured claim value is not binding and (unlike in non-Dewsnup approach)
* Dewsnup view only applies in Ch. 7 case (not 11 or 13)
  + Why? It would negatively impact debtor’s ability to successfully reorganize and there are provisions in Ch. 11 and 13 that clearly imply debtor being able to reorganize over-collateralized lenders
  + It would also conflict with fresh start principles: purpose of re-org is to enable debtor to rebuild vialble business and we don't want bank to be able to come after th DR for the property later on
    - Without *Dewsnup* reading: Bank has 80K secured and 20 K unsecured -> Bank will get 80K secured with let’s say 20 cents/dollar on unsecured claim, for a total of 85K
    - With *Dewsnup* reading: Bank has 80K secured and 20 K unsecured -> Bank will get 80K secured with let’s say 20 cents/dollar on unsecured claim, for a total of 85K. Plus Bank still has security interest in the equipment (or for the remaining 15K) bc discharge does not include in rem obligations
* Although not limited to such occasion, Dewsnup is most applicable when the property is abandoned by trustee in a Ch. 7 case
  + Big downside of home equity loans is that if you borrowed money and give a second liens on your house, it’s not dischargeable; to get around this, people would file for Ch. 7 and ask court to strip 2nd liens and immediately file for Ch. 13 and would do a rehabilitation plan that would pay off the 1st mortgage in full (dissonance in circuits as to whether this was doable)
* Hypothetical based on *Dewsnup*:
  + Setup - Debtor is a small business in chapter 7
    - Assets: tractor -> court valued at 60K
    - Liabilities:
      * Bank -> 100k (security interest in tractor)—under-secured creditor
      * Second lender -> 25k (security interest in tractor) – Totally under water lienholder
      * Unsecured creditors -> 50k
    - Trustee abandons tractor allowing the bank to foreclose on it (costs less for trustee, bank better positioned to do so, estate won't benefit from it since all proceeds likely will go to bank)
      * Sales price outside of BR: 75k (15k more than court valued property)
  + Question: who gets the extra 15k?
  + *Dewsnup*: Bank gets the 15k because the court’s valuation of the secured claim is not binding, thus lien is not altered (only if entire claim is disallowed would it have any affect)
    - Under Dewsnup, the only way that the debtor would get any value is if the sale price of the tractor were greater than the entire 1st lien (over 100k) and greater than any other liens on the property (more than the additional 25k)
    - Since the estate gave up interest in the property by abandoning it, unsecured creditors will not get anything in ANY scenario
  + *Non-Dewsnup*: Would give the remaining value to the debtor
    - Under this approach, once the court values the claim, it is fixed at that amount and we do not go back and change it
    - Secondary lenders lien gets voided during strip-down and releasing property mean estate has no interest in it. Thus it is the DR that gets the $15k
  + What if the actual sale of the tractor miraculously was for 120k. Who would get this amount?
    - Bank would get the full 40k unsecured claim. Then second lender would get the remaining amount (second lender’s 25k becomes 20k secured claim and 5K unsecured claim)
    - Under Dewsnup, debtor would only get the additional money if the property was sold for more than the amount owed by all of the secured creditors
      * If there was anything leftover from the sale for the unsecured creditor, that goes to the debtor instead of the unsecured creditor under Dewsnup (because of trustee’s abandonment, property has been abandoned back to the debtor); if no abandonment, overages go to the unsecured creditor via the estate
    - Note: There is a logical argument that in this case, the Bank would be an over-collateralized creditor and thus entitled to interest. Yet, under §506(b) would only be able to get interest up to the value of the collateral (here, value is 120, so only able to get 20k in interest). The effect of giving the Bank this interest would be to take money that would’ve been given to the second lender
  + What if: property valued at 60k actually sold for 50k?
    - The Bank gets 50k when it should’ve gotten 60k
    - in the non-Dewsnup word, once we void the unsecured claim (under §506(d)), it is permanent (tough luck Bank). No readjustment because the separation of the claim into secured and unsecured portions (bifurcation) is permanent
    - Unfortunately, we do not live in this world due to the SCOTUS decision in *Dewsnup*
* Summary of Dewsnup Standard: Secured creditor gets proceeds of sale (up to original secured claim), because BR discharges personal liability but not in rem liability
  + The money that debtor owes to Bank is a personal liability to debtor. However, Debtor also has the in rem obligation, aka the property part of the obligation, in this case, the tractor.  lien rides through bankruptcy, assuming property is not sold during bankruptcy case
    - rides through Bankruptcy meaning that it survives through Bankruptcy until property is sold. Once sold, proceeds distributed to whoever has property interest in it
  + SCOTUS’s Rationale:
    - §506a removes security interest to the extent that secured creditor is under-collateralized (so creditor is only secured to extent of value of collateral)
    - However, §506d removes security interest to the extent it’s not an allowed claim under §502 (this can happen if security interest was gotten through fraudulent behavior for instance) or to extent that entity did not file proof of claim. In all other circumstances, lien rides through bankruptcy
* Sold outside of BR for less than estimated value:
  + If property sells for more than court’s value: Secured creditor gets paid MORE than it should, bc it gets paid $80K secured claim + pro rata part of $20K unsecured claim in bankruptcy PLUS it would get the $15K after bankruptcy!
  + On the flip side, if property sells for less than court’s value: Secured creditor gets paid less than it should, bc it gets what it sold the tractor for (secured claim) + pro rata part of $20K (but that unsecured claim should have been worth more, since truck sale did not cover the full secured claim amount)
  + Therefore, it evens out
* Sold during BR for less than amount of original secured claims -> No Dewsnup Problem
  + If property is sold during the bankruptcy proceeding, the in rem obligation becomes cash and secured creditor gets the cash and there’s no more Dewsnup-type issue!
* Sold during BR for more than amount of original secured claims -> No Dewsnup problem
  + If tractor was sold for more than 100K during bankruptcy, Bank would get up to 100K (its original secured claim) and the rest will go to unsecured creditors (if there was no one else with lien on the tractor)
  + If secured creditor is owed $100k, property worth $120k, and we are inside BR -> secured creditor gets interest on that claim – §506(b): to the extent that you are over-collateralized, you get interest

### Post Filing Interest on Secured Claims - §506(b)

* Over-secured creditors are entitled to interest up until the value of the collateral
  + Interest to be calculated using the contract rate generally (if voluntary)
  + Interest is capped at the “equity cushion” (collateral value – claim amount)
    - In other words, if collateral is worth 110k and Bank owed 100k. Bank can only get up to 10k in interest
  + Concerns post-petition claims (§502(b)(2) worried about pre-petition)
* Also includes reasonable fees, costs, charges
* Undersecured creditors do not get interest (or anything that might resemble interest)
  + Do not get compensated for delay in states’ rights because of bankruptcy and automatic stay application (*Timbers*)
* *Ron Pair*: (Comma case) an over-secured creditor is entitled to interest regardless of whether the lien is consensual/voluntary
  + SCOTUS read §506(b) to allow for interest in both voluntary and involuntary over-collateralized cases (including the IRS)
  + However, only entitled to fees if it says so in the written agreement
* *Timbers*:
  + Facts: Bank (under-secured creditor) was asking for interest starting 6 months after bankruptcy petition was filed.
  + Tom Jackson’s creditors bargain theory: outside of bankruptcy, debtor would not have been able to stop foreclosure proceedings, which would’ve taken approximately 6 months for Bank to complete. After 6 months, theoretically, Bank would’ve reinvested and been receiving interest, so Bank is entitled to interest inside bankruptcy. Statutory hook for this argument in §362(d)(1) – creditors entitled to “adequate protection”
  + Holding: denied any interest because under-secured creditors are not allowed interest. (506(b) clearly spells out that only over-secured creditors are entitled to it)
  + Note: everyone agrees that “adequate protection” means that a creditor should be compensated if the value of the collateral securing its loan depreciates over the course of bankruptcy. This argument unsuccessfully tried to stretch “adequate protection” to include consideration for lost opportunity costs.
    - This is because compensation for delay would be seen as interest and §362(d)(1) only guarantees “adequate protection” (i.e. that the value of secured collateral will not go down/drop during the bankruptcy case)
    - BUT, an under-secured creditor can still get rents (so long as creditors have an appropriate security interest in rents under §552(b))
      * Ex: if creditor has 110k claim and collateral is worth 95k, but creditor has security interest in rents (2k/month)…creditor gets 2k every month from rents until 95k reaches full 110k
  + Creditors do get interest on the value of property the debtor keeps in a reorganization (Ch.11) starting from the date of confirmation
* Class Hypothetical Setup
  + Individual debtor files chapter 7. Has a house valued at 100k. Claims involved are:
    - Bank -> 125k
    - Secondary Lender -> 80k
    - Unsecured -> 50k
  + Trustee abandons house to the bank who has a security interest in it. House sells for $110k ($10k over)
    - Note - Bank is undercollateralized and unsecured creditors, meaning there is nothing that would be left over for unsecured creditors. Thus there is no benefit in trustee further pursuing. Could be that bank is simply in better position to sell the house
* Question: Who gets the $10k in surplus value?
* Dewsnup Court
  + Bank would get this. Grounded in idea that security interest rides throughout bankruptcy. This means if property is still there after bankruptcy (e.g. doesn't get sold), that property interest is still there and thus bank (lienholder) entitles it the entirety of the proceeds
    - Lien dissolves at the time of sale, but if never sold lien still exists
    - Bankruptcy does not discharge *in rem* liability (i.e. liability of the property)
* Alternative Interpretation
  + Lien doesn't "slide" through bankruptcy. Value of home is permanently fixed at $100k at time of valuation and at that time, the extent to which lienholder is undercollateralized converts to an unsecured claim. Fact that property sells above this value doesn't matter because lien on everything in excess of $100k has been voided (i.e. lien is stripped down)
    - Seems like a more natural reading of §506

# Executory Contracts

## Key Provisions

### §365(a)—Trustee (debtor-in-possession) has the power to assume or reject executory contract

* Allows trustee to assume or reject any executory contracts or unexpired leases of debtor
* Must be assumed or rejected in entirety
* Must obtain court’s approval to assume or reject

### §365(b)—Assuming the contract when there is a default

* If the debtor wants to assume (keep) the contract and there has been a breach, the debtor must cure the breach before assuming the contract
* Debtor must provide adequate assurances that he will keep the contract and is capable of fulfilling its terms (or that the third party assigned can perform)
* Note: Exception in §365(b)(2) excuses estate from curing non-monetary breaches that are impossible to cure at the time so long as DR provides adequate assurances and otherwise compensates for loss

### §365(c) + (f) – Limits on right to assume or assign contracts (conflict)

* §365(c) – DR cannot assume/assign contracts whenever “applicable law” would bar assignment (limits on when you can assume a contract)
  + Skeel: Seems to say you cannot assume if you cannot assign under applicable law
* §365(f) – anti-assignment laws cannot prevent an assignment
  + Skeel: Seems to say that debtor can assign contracts even if applicable law says otherwise
* Note: There appears to be a conflict between the two provisions. (f) appears to be expansive, while (c) appears to be very limiting

### §365(d) – Timing provided for assumption/rejection in Ch. 11 (also applies to Ch. 9, 13)

* In Ch. 11 case, debtor’s decision to assume or reject may be made “at any time before confirmation of a plan”
  + This gives trustee considerable time to consider what to do/what is best for the estate
* 120 day limit for non-residential real property leases if plan is not confirmed sooner than that
  + Retail bankruptcies: Often would like to have a little over a year to decide. Typically, retailer uses the holiday season as one last attempt to turn it around. File in January. Would like to go through another holiday season to decide which stores to close. Typically important for commercial real estate leases. Commercial leasors were not happy, persuaded Congress to enact 210 day time limit (7 months)
* Note: Can still enforce contract before trustee has officially assumed/rejected the executory contract (see below!)

### §365(e)—Anti-ipso facto provision

* Ipso Facto Clause: Clause in a K that says in the event one party files for bankruptcy or becomes insolvent, the K terminates automatically
* (e) invalidates all provisions that terminate or allow termination on bankruptcy or insolvency, meaning that once a debtor files for bankruptcy, the non-debtor party must honor an executory contract or unexpired lease to which the debtor is a party
* Ex: As long as Kmart continues to perform the K post-petition, Kmart’s bankruptcy filing is no excuse for Martha Stewart not to perform
* Exception: §365(e)(2)
* Note: §541(c) also says so

### §365(g) – Effect of rejection of executory contract

* Rejection of an executory contract is treated as a pre-petition claim (covering pre-petition breach)
  + Non-debtor will receive ratable share of assets of the estate that is available to general creditors (treated with unsecured creditor status)
* Note: If a DR assumes a K and THEN rejects it, the non-debtor has a post-petition obligation and is entitled to administrative expense status
  + Why? This is because the time of the breach is when the K was ultimately rejected rather than deemed a pre-petition breach in the ordinary case of a simple rejection

### §365(h)/(i)—Special protection for real estate contracts/leases

* Give the buyer special protection to limit the effect of rejection. Allows buyer to specifically enforce property contracts (to keep property) even if the DR breaches/rejects the contract

### §365(n)—Special protection for intellectual property contracts

* Special case of intellectual property (definition provided in §101(35A))
* Allows licensees (those who pay for license) to retain rights in intellectual property conveyed to them before licensor’s bankruptcy
* Note: Overrules *Lubrizol*, instead saying that debtor cannot walk away from conveyance of property interest (license) that has already occurred

## Overview of Executory Contracts

* §365 gives the debtor extraordinary powers that would not otherwise be available outside of bankruptcy and so there is a huge amount at stake (similar to 362)
  + Note: 365 power is a reason to use bankruptcy (there is no available power like this under state law, so settlements outside of bankruptcy do not have this)
* Executory Contracts falls in the middle of estate and claims (2.5)
  + Cross between property of the estate and claims
  + If the debtor assumes K -> executory contract is property of the estate (asset of the estate). §365 allows debtor to keep contract even if it has breached it
  + If the debtor rejects K -> executory contract becomes a pre-petition claim (unsecured creditor status) that the non-debtor has against the estate

## What Qualifies as an Executory Contract

* Definition: “A contract under which the obligations of both the bankrupt and the counterparty to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.”
* Translation: A contract on which neither party has fully performed its obligation and thus some performance is still due on either side. Skeel says a contract is executory if failure to perform the rest of the contract would amount to a material breach
* Application: As long as there is an ongoing obligation and some time left on the contract term, a court is likely to determine that the contract is executory even if the obligations left on either side appear somewhat minimal. Although some courts reject the idea that performance due by the debtor can be payment, for our purposes even if the debtor only has to make payments it will still be an executory contract
* Note: Classification as executory contract is important because if a contract is NOT executory, the non-debtor party is simply an unsecured creditor

### Is An Entertainer’s Contract An Executory Contract Such That It Can Be Rejected

* Two big cases in the 80s
  + Tia Carerre - General Hospital—had ABC contract, but got a more lucrative offer that she wanted to take. Wanted to reject contract after filing for bankruptcy
    - Holding: Court did not allow her to reject contract
    - Justification: Idea being that a recording contract is excluded from bankruptcy (§541(a)(6) — Future earnings) because it is actually post-petition earnings, so cannot be rejected. Logic being that if it is excluded from the estate, it cannot be dealt with in bankruptcy at all
  + JT Taylor (lead singer of Kool & the Gang) wanted to reject his recording contract after filing for bankruptcy
    - Holding: Court allow rejection of the contract
* Kurupt case with Death Row Records –
  + Bankruptcy court says look to state law to see if this type of contract would be specifically enforceable. Relevant state was CA
  + CA law says this issue turns on whether the recording artist is a celebrity at the time of entering into the contract
    - If celebrity -> Cannot reject
    - If NOT celebrity -> Can reject
  + Why? If you are a celebrity, debtor is irreplaceable and contract can be specifically enforced. If you are not a celebrity, you are a dime a dozen and monetary damages can be adequate
  + Court determined Kurupt was NOT a celebrity at the time he entered into the contract. So, he was able to reject the contract
  + Skeel: This is somewhat backwards logic because the economic model of the music/recording industry takes a huge risk with no-name artists and gets a major payout on the one-in-a-million case where the artist is a success

### Is A Security Interest Ever An Executory Contract

* **No!**
  + Security interests are not executory and cannot ever be rejected under §365
  + Note: Security interest stays even if it is tied to a lease that can be rejection (treated as two different contractual obligations)
* Leasing Services Corp. v. First Tennessee Bank (p. 224)
  + Manufacturer has a lease with debtor for equipment where the debtor is supposed to pay over 20 years. There is a security interest. There are still obligations on both sides, so it is executory (debtor –payment; creditor – servicing the equipment for example)
  + Debtor argues this is executory and he has the option to assume/reject (§365(a)). Argues that when debtor rejects this contract, he is also rejecting the security interest
  + BLL: Debtor cannot reject security interest that is involved in an executory contract situation
  + Argument: It is as if there are two separate contracts here. One for the lease; one for the security interest. Idea being that you do not want to be able to reject a perfected security interest

### Special Protections in §365(h)/(i)/(n)

* *Lubrizol Enterprises Inc. v. Richmond Metal Finishers*
  + Debtor in ch. 11 = RMF
  + Facts: Debtor has a licensing agreement with Lubrizol granting L the non-exclusive licensing of its metal coating process technology (basically its only asset). Agreement requires debtor tell L if it licenses to anyone else and give L the best deal. L has to keep the technology secret in return
  + Debtor wants to reject the contract after filing for bankruptcy
  + Issue: Whether debtor should be able to reject as executory a technology licensing agreement with L?
  + K was executory bc of continuing core obligations of notice and forbearance in licensing
    - Note: Contingent duties make a K executory until the time has expired during which an event triggering a contingent duty may occur
  + Rejection would be advantageous to debtor since the technology was debtor’s main asset and the agreement with L would hinder its ability to license and use technology in future
  + Holding: Court lets debtor reject contract
  + L now has an unsecured claim for $20k against debtor (and will most likely only get 10 cents on the dollar for it) under §365(g)
    - Skeel: Allowing debtor to reject this contract means that Lubrizol would get a claim for material breach/do contract damages calculation and L would have a claim for that amount. The problem with this is that it would be a pre-petition claim that would be paid off in bankruptcy dollars
  + Note: §365(n) overrules Lubrizol. §365(n) affords leasers of intellectual property special protections in bankruptcy
    - Congress was sympathetic to licensees in IP context because intellectual property rights are different. More similar to real property rights (which are also afforded special protections found in §365(h)/(i))
    - Skeel: Distinction between real property rights (real estate, property) and other rights. If the debtor breaches the real property contract, non-debtor is entitled to specific performance. CANNOT do that with other kinds of assets. Argument for specific performance in real estate is that land/real estate is individual/unique and special/cannot be replicated and cannot put a price on it adequately. IP licenses, like real estate, cannot be replicated/monetary damages will not be adequate. IP license is like a partial real estate ownership right. Other argument is that the licensee is typically the big guy with a lot of lobbying power

## Basics of Assumption or Rejection

* If a contract is assumed -> it converts the obligations of debtor into obligation of the bankruptcy estate
  + If there is a subsequent failure to perform after assumption, this results in an administrative expense (higher priority)
* If a contract is rejected (formal declaration not to assume contract) -> non-debtor is released from his obligation to debtor
  + Non-debtor now has claims under §365(g) and §502(g) – status as an unsecured claim
* Generally the court will defer to a trustee’s decision to assume/reject a contract so long as there is no evidence of bad faith/abuse of discretion, yet court may engage in balancing of equities
  + Court may refuse to go along with trustee’s decision if
    - The contract is NOT “burdensome” to the debtor/estate
    - The cost of rejection to non-debtor is disproportionate to the benefit received by the estate

## Assumption & Assignment

* Definitions:
  + Assumption: Performance of agreement by and to the bankruptcy estate
  + Assignment: Performance by and to a third party. Involves the release of bankruptcy estate from further liability on the contract
    - Must assume contract first, then can assign it
  + Note: Difference has to do with WHO is performing the agreement
* There are limits on the trustee’s ability to assume and/or assign a contract
  + Limits based on “applicable state law”
  + Other Limits on Assumption (§365(b))
    - If the debtor wants to assume (keep) the contract and there has been a breach, the debtor must cure the breach before assuming the contract
    - Debtor must provide adequate assurances that he will keep the contract and is capable of fulfilling its terms

### Two Approaches to Understanding §365(c)

1. Hypothetical Test (Catapult)
   * Plain language of §365(c)(1)
   * If a contract/lease could NOT be assigned outside of bankruptcy, it cannot be assumed OR assigned inside bankruptcy
   * Skeel: What the provision actually says
2. Actual Test (Majority approach)
   * Looks at what debtor is actually trying to do
   * Assumption is allowed IF it is the debtor/debtor-in-possession who will perform
   * Assumption is NOT allowed if it is the trustee or a third party who will perform the obligation
   * Note: Most concerned with personal services contracts (didn’t want third party/trustee to perform the contract)
   * Skeel: Even if the contract is un-assignable, it can be assumed so long as the debtor/debtor-in-possession is the one performing
   * Skeel: What the provision SHOULD say

* Note: This circuit split has been going on for years. West Electronics case (Government contract case. Federal law makes government contracts un-assignable) that Skeel’s judge wrote when he was clerking. Trying to figure out how 365(c) and (f) fit together
  + (c) – If you cannot assign a contract outside of bankruptcy, you cannot assume it inside of bankruptcy
    - People do not like the hypothetical test because all the debtor is trying to do is keep a contract in place. The hypothetical test seems at odds with this goal

### Three Approaches to Understanding Conflict Btw §365(c) & §365(f)

* Note: §365(c) seems to say cannot assume or assign a contract inside bankruptcy that cannot assign outside bankruptcy. §365(f) seems to say that can assign even if applicable law would say otherwise
* **(1) Pioneer Approach**
  + If there is an explicit anti-assignment law outside of bankruptcy -> §365(c) controls
    - Result = Rights cannot be assigned
  + If the restriction on assignment is contracted for (if applicable state law does not take a stance on anti-assignment issue, but otherwise would enforce the K with an anti-assignment provision) -> §365(f) controls
    - Result = Overrides the contractual provision
    - Skeel: Assignment can be allowed when applicable (state) law prohibits assignment simply because the contract does not allow assignment. (aka the state law does not take a stance on assignment, but enforces anti-assignment contract clauses)
* **(2) Catapult Approach**
  + If anti-assignment law /particularized/ identity is material (from the perspective of the law in question) -> §365(c) controls
    - Result = cannot be assigned
  + If general anti-assignment law -> §365(f) controls
    - Result = can be assigned regardless of applicable state law
  + Catapult would have applied 365c in Pioneer b/c was particularized to car dealerships
* **(3) Bussels Approach**
  + Reads §365(f) as overriding restrictions in all instances except when assignment is absolutely banned
  + Would say that law in Catapult is absolute

|  |  |  |
| --- | --- | --- |
| **Approach** | **When §365(c) applies**  (*when assignment is not allowed because of applicable anti-assignment state law*) | **When §365(f) applies**  (*when assignment is allowed despite applicable anti-assignment state law; overridden by §365(f)*) |
| **Pioneer**  (*least likely to allow assignment under §365(f)*) | Ban assignment when State law bans assignment.  **Non-BR state law explicitly limits/prohibits** | Assignment will be allowed even when state law would enforce anti-assignment contract provision (without taking a side on the assignment issue)(state contracts law overridden by §365f).  **Non-BR state law defers to contract**.  *Example: Common law is that a contractual provision barring assignment will be enforceable OR State law says “we will enforce anti-assignment contracts if they are included in your contracts”* |
| **Catapult** | Not assignable when there is an explicit anti-assignment law.  Debtor is necessary person (when the DR’s identity is necessary to the K, like Kurupt in recording contract).  **Particularized** (type of party/contract).  *Examples: Federal patent law; Pioneer law seems to be particularized because it applies just to car manufacturers* | Can be assignable if applicable state law is **general** anti-assignment law.  Debtor is NOT necessary person to the contract.  Non-Particularized.  *Example: could override law if CA had a general “we do not allow assignment of contracts”* |
| **Bussel** (*Debtor friendly. Most likely to allow assignment under §365(f)*)  **Bussel** (Cont.) | Ban assignment when applicable state law is **absolute** (state law completely prohibits assignment, no exceptions).  *Note: designed to allow assignment in almost all instances, except personal services contracts (e.g. if Kurupt tried to sell recording contract to third party). Skeel thinks that an anti-assignment law that says “cannot assign unless the CR consents” would still be absolute* | Can be assignable if applicable state law is **non-absolute** (including state law that has a qualification)  *Example: “cant assign, unless…”; rule in Pioneer which allows manufacturers to veto assignment except also provides that veto cannot be unreasonably withheld* |

### *In Re Catapult Entertainment Inc*

* Perlman -> (leases patent rights) Catapult/debtor -> MPCAT that is a subsidiary of Mpath (reverse triangular merger) (merged MPCAT into Catapult)
  + If Catapult had merged into MPCAT, would have had to assign patent rights, instead of assuming (these types of contracts would have been unassignable unless non-debtor agrees)
* At the end of the day, Mpath will own all stock of Catapult
  + Why structure the transaction in this way? So that Catapult can make it seem like they are reorganizing (rather than being sold). If they did this as a sale, cannot assign patent rights. But if this is a reorganization, Catapult can assume this contract (does not need to assign it) because Catapult is theoretically not going anywhere/can still be seen as the one who is performing on the obligation. Logic being that under the actual test, this would be fine. Didn’t end up working because the court adopted the hypothetical test instead
    - Actual test: If anti-assignment law outside of bankruptcy exists, you can’t assign it, but you can probably assume (if you are the debtor or debtor in possession, but not the trustee or transferee)
* Trustee cannot because Skeel can’t assume Kurupt’s contract
* Issue: Whether a Ch. 11 debtor-in-possession may assume nonexclusive patent licenses over a licensor’s objection under §365(c)(1)?
* Holding: Debtor not able to assume the contract
* Court adopts Hypothetical Test (sticking to plain language of §365(c )(1)) to determine whether assumption is possible
  + A debtor/debtor-in-possession may not assume an executory contract over the non-debtor’s objection if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession has no intention of assigning the contract in question to any such third party
  + Here, the “applicable law” is federal patent law, which says that non-exclusive patent licenses are personal and assignable only with the consent of the licensor

### *In re Pioneer Ford Sales*

* Facts: Dealership wants to sell his Ford franchise to a Toyota dealor, but Ford objects. Debtor wants to assign franchise K over Ford’s objection. RI law (applicable state law) provides car manufacturers with a veto on sales of franchises, except “consent shall not be unreasonably withheld”/veto should not be abused. RI provides this ability even if K prohibits assignment
* Issue: Can debtor assign K over objections?
* Holding: K was non-assignable. Toyota dealership had little working capital and thus the veto was reasonable
* Pioneer Approach to Assignment:
  + If there is an explicit anti-assignment law outside of bankruptcy (here, RI law for manufacturers) -> §365(c) controls. Rights cannot be assumed OR assigned
  + If the restriction on assignment is contracted for -> §365(f) controls. Overrides the contractual provision

### Hypothetical - State Restriction on Assignment

* Setup: PA state law says “assignment is not allowed, without the consent of the debtor”
* How would this play out under the three different approaches?
  + Under Pioneer, this law would NOT be overridden (§365(c) would apply) because in this instance the state has taken an anti-assignment stance
  + Under Catapult, this law would be overridden under §365(f) because it is a general anti-assignment law that is not particular/tied to the debtor’s indemnity being important
  + Under Bussel, this law would most likely be absolute/not assignable

## Skeel’s Four Test To Determine Whether DR Can Assume A Contract

1. Which approach to the anti-assignment law (conflict btwn (c) and (f)) are we using?
   * Pioneer
   * Catapult
   * Bussel
2. Can the debtor assign the contract?
   * If can be assigned -> **can be assumed**
   * If cannot be assigned -> question 3
3. Can the debtor nevertheless assume the contract even if the contract can’t be assigned?
   * Hypothetical Test
   * Actual Test
4. Apply the appropriate test from question 3
   * Hypothetical Test -> CANNOT assume contract
     + Note: Interprets (c) to say that if you cannot assign contract outside of bankruptcy, you cannot assume contract inside bankruptcy
   * Actual Test -> CAN assume it in bankruptcy if debtor or debtor-in-possession is the one assuming it (NOT trustee or third party)
5. Is the assumption proper? Can the debtor fulfill the obligations for assuming K?

## Damages & Enforcement Before Assumption/Rejection

* Rule: Until the debtor has assumed, a contract is non-enforceable against the estate. Yet, debtor can enforce K against non-debtor before assumption. If debtor enforces, this does NOT mean the contract has been assumed
* Essentially, creditor must perform K between filing of bankruptcy and confirmation of plan. The expenses incurred during this time are treated as a post-petition obligation (administrative expense status)
* Scenarios
  + Debtor enforces K in the period between filing and confirmation, and decides to assume executory contract
    - Creditor has administrative expense claims for both
  + Debtor enforces K in the period between filing and confirmation, and decides to reject executory contract
    - Creditor has an administrative claim for the expenses of enforcement between filing and confirmation (post-petition obligation)
    - Creditor has unsecured claims for damages from executory contract (pre-petition claims)
  + Debtor enforces K in the period between filing and confirmation, decides to assume executory contract but ultimately changes its mind and rejects
    - Here, both pre-petition and post-petition obligations are treated as administrative expenses

### *Matter of Whitcomb & Keller Mortgage Co*

* Debtor = W&K
* Facts: Creditor (D&L) had a data processing lease with debtor in which creditor provided computer services to debtor. When debtor filed for bankruptcy, creditor tried to terminate the contract. Debtor sought injunction forcing creditor to provide computer services between filing of bankruptcy petition and confirmation of their Ch. 11 plan. Debtor took a long time to decide whether to assume/reject the executory K. Lower court allowed injunction, required creditor to continue providing in the interim
* Holding: Affirmed providing debtor with injunction requiring creditor to continue performance of K in the interim
  + Debtor did NOT assume the executory contract, but rather was entitled to an did reject the contract eventually
  + Creditor’s pre-petition claim is an unsecured claim
  + Creditor was adequately protected (debtor paid post-petition obligations in full)
* Note: Somewhat controversial case bc this requires the dramatic step of requiring the non-debtor to continue performing

### Expenses Hypothetical

* 10k owned to CR at the time of bankruptcy filing
* 20k owned to CR incurred post filing, but before deciding to assume the contract
* Question: What is the status of the 30k owned to the CR?
  + 20k is an administrative expense. Technically to get administrative expense status you have to satisfy §503
  + 10k is administrative expense here
    - Logic: §365(g) – when the breach is treated as having occurred. Here, at the time of actual rejection (post-petition)
    - Note: If the debtor just rejects the contract, the 10k would be an unsecured claim
  + Rule: Everything post petition gets administrative expense status (needs to be paid in full in cash before confirmation)

# Trustee’s Avoidance Powers – Preferences

* Context: Part of property of the estate section
  + Expands the estate by bringing transferred property back into the estate to be distributed among creditors equally and according to the priority scheme
  + Since an insolvent debtor cannot pay all unsecured creditors in full, transfer of debtor’s property to pay or secure obligations of some creditors gives them preference
* Voidable Preferences
  + Governed by §547
  + Avoid/reverse transfers that are made "on the eve of bankruptcy" (defined as within 90 days of bankruptcy, extended to 1 year if the transferee is an insider)
  + Allows trustee to avoid transfers from the debtor’s ESTATE only
  + Justification for preference law
    1. Equality of creditors (similarly situated creditors should be treated equally)
    2. Discourages a race to the courthouse (important to bankruptcy’s collective process)
       - Like the automatic stay, which is THE most important provision for ensuring collective process

## Key Provisions

### §507 - Priorities

* Order of Priority
  1. Secured creditors - §507(b)
  2. Administrative expenses of the trustee
  3. Domestic support obligations owed at time of BR
  4. Unsecured priority creditors
  5. Unsecured without priority creditors (pro-rata distribution)
  6. Exceptions found in §726

### §550 - Liability Of Transferee Of Avoided Transfer

* Tells trustee what he can get and who he can get it from (works with §547)
* §550(a)(1) – the trustee can recover, for the benefit of the estate, a transfer from:
  + (1) The initial transferee of such a transfer (whomever received the preferential transfer) OR
  + (2) The entity for whose benefit the transfer was made
* §550(b) - The trustee may not recover under section (a)(2) of this section from
  + (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
  + (2) any immediate or mediate good faith transferee of such transferee
* §550(c) — If the transfer is made for the benefit of a CR who at the time of the transfer was an insider and the transfer was made outside the 90 day period, the trustee can ONLY recover from the insider

### §547 – Preferences

* §547(b) – Requirements for a voidable preference
  + Trustee can avoid transfers from the DR’s estate only
  + Preference Test (see further explanation below!)
  + Pre-Requirement: There must be a transfer made (usually the payment of money, but really any giving of value)...
    1. To/for the benefit of the creditor
    2. For an antecedent debt
    3. The debtor must be insolvent at the time of the transfer
       - Worried about eve of bankruptcy transfers to an insolvent debtor
    4. The transfer must have occurred within 90 days of filing
       - Note: This extends to one year of filing for an "insider"
    5. Must satisfy the "more than" test
       - Must give creditor more than he would receive in a chapter 7 liquidation, if the transfer had not occurred, or it had been paid subject to the BR process
       - This is almost always satisfied when the creditor is under-collateralized. However, not satisfied when creditor is fully secured or when debtor is solvent during the bankruptcy case
  + Note: Unlike the old Bankruptcy Act (which required creditors whose preference was avoided to have received notice of its advantage over other creditors), now there is no such reasonable-cause-to-believe requirement
* §547(e) - Time of transfer for a security interest
  + A security interest that is perfected within 30 days (filed within 30 days), then the date of creation is the relevant date for determining when the security interest "transferred" for purposes of determining if it is a preferential transfer
  + If fail to file within 30 days of creation, the date of perfection is when the security interest is deemed to have "transferred"
  + Immediately before the date of filing the petition if not perfected at the commencement of the case
  + Note: Can file before security interest agreement. However, there is no transfer until the agreement or until the debtor has obtained rights in the collateral. Always remember all components of VAR must be satisfied
    - Value: Creditor either made a loan or committed to make a loan
    - Agreement: Parties must have signed an agreement (normally a security agreement)
    - Rights: Debtor must have rights in the collateral. Cannot have rights in property you do not own yet
  + Skeel: If you file within 30 days, important date is date of creation (of the interest; usually when transfer takes place). Otherwise important date is date of perfection
* §547(f) – Presumption of debtor’s insolvency
  + For the purposes of the section, debtor is presumed to have been insolvent during 90 days immediately preceding the date of filing
  + Creditor (receiving transfer) has burden of proof to rebut this presumption
  + Note: No presumption of insolvency when dealing with an insider preference, so trustee must prove insolvency
* §547(c) — Safe harbors: Conditions where trustee cannot avoid transfer
  + §547(c)(1) -- Contemporaneous exchange safe harbor
    - Only available when parties both intended for the value to transfer at the same time and for the transfer was in fact a substantially contemporaneous exchange
  + §547(c)(2) -- Ordinary course of business safe harbor
    - When debtor (1) incurs obligation in the ordinary course of business and (2) payments are made either (a) in the ordinary course of business or (b) according to ordinary business terms
      * Ordinary business terms must be common to both parties
    - This safe harbor applies even when involving payments on a long-term debt
  + §547(c)(3) -- PMSI protection safe harbor
    - Transfer that creates a security interest in property acquired by the debtor to the extent that it secures property given at or after signing of an agreement by CR which enabled DR to obtain such property (PMSI)
    - As long as perfection is done within 30 days of DR obtaining the collateral that secures the loan, it is NOT a preferential transfer
  + §547(c)(4)-- Future Advances safe harbor (payment, then extension of credit)
    - Provides protection when CR receives payments from DR within the window, but then extends new unsecured credit to DR afterwards
      * Protection only covers the amount to which the CR is exposed
    - §547(c)(4)(a) - Takes away this safe harbor when CR’s future extension of credit is secured
    - §547(c)(4)(b) - Takes away this safe harbor when CR’s future extension of credit could be protected by another safe harbor provision
  + §547(c)(5) -- Two Point Net Improvement Test (inventory and accounts receivable)
    - Protects to the extent that transfer creates perfected security interest in inventory or receivables unless:
    - To the extent that CR is less under-collateralized at BR than it was at the time of the transfer and this prejudices other creditors (However, does not apply, for example, if oil is the collateral and there is a change in oil prices)
    - **Pre-Step**: Determine whether we are dealing with collateral that involves inventory or accounts receivable
    - **Step 1**: Determine how under-collateralized CR is 90 days before bankruptcy OR at the time of the loan if made after 90 days (aka closer to bankruptcy filing than 90 days)
      * Note: If **90 days** before bankruptcy, the CR was fully secured. Then there is NO preference.
    - **Step 2**: Determine how under-collateralized CR is at the time of Bankruptcy
    - **Step 3**: If the value in (2) is LESS than the value in (1) -> the CR is less under-collateralized at the time of BR (i.e. in a better position) and there IS a preference
    - Step 4: Determine the value of the preference by subtracting (1) – (2)
  + §547(c)(7) -- Domestic Support Obligations safe harbor
    - Safe harbor to the extent that it was bona fide payment of debt for domestic support obligation. Spouses, children, and government units providing assistance do not have to give back alimony/child support payments received within preference period
  + §547(c)(8) + (9) -- Small amounts safe harbor
    - §547(c)(8) – Payments made on debts that are "primarily consumer debts" less than $600 cannot be recovered as preferential transfers
    - §547(c)(9) – Payments made on debts that are "not primarily consumer debts" less than $6,425 cannot be recovered as preferential transfers

## Voidable Preference Test - §547(b)

* Pre-requirement: That there was a transfer made from the debtor’s estate
  + **Transfer - §101(54)**
    - Broad definition, basically anything involving transfer of value, which includes….
      * Transfer of money, transfer of a security interest, transfer of lien\*\*
      * Creation of a lien
      * Retention of title as a security interest
      * Foreclosure of debtor’s equity of redemption
      * Each mode of dispensing/parting with property OR an interest in property
      * Note: Also includes lien on property and judicial liens
    - Note: It is important to figure out WHEN the transfer actually occurred (can be difficult if dealing with a security interest—refer to §547(e))
* (1) The transfer must be made to /for the benefit of the creditor
  + Skeel: Seems like a trivial requirement, but is actually really more important, especially when dealing with three-party transactions (see below HYPO with preferential transfer to Bank from DR for the benefit of insider/guarantor of bank loan!)
* (2) The transfer must be made for an antecedent debt
  + Debt must have occurred before payment (i.e. there must be some gap between the debt and the payment/transfer). Theoretically any gap is enough but be reasonable
  + Note: Antecedent requirement NOT met when there is a contemporaneous transaction (where the debtor pays and gets something at the same time) or payment in advance
  + Skeel: "Mechanical" time frame requirement (unlike contemporaneous exchange safe harbor)
  + Hypothetical:
    - Epstein & Staples
    - If E pays first, then S delivers goods month later, S files for bankruptcy. The delivery of the supplies was on behalf of an antecedent debt. Would figure out the value of the supplies, which would be the value of the transfer and then E would have an unsecured claim for that value assuming there was no security interest
    - If E pays first, then S delivers goods month later, E files for bankruptcy. The payment was NOT on account of an antecedent debt (payment in advance)
* (3) The debtor must be insolvent at the time of transfer
  + Insolvent: The value of debts/liabilities > the value of assets
  + §547(f) creates a presumption of insolvency during the 90 days pre-filing. DR could rebut the presumption and show assets > liabilities at the time of the transfer
  + Note: If trying to go after DR for a transfer to an insider (within one year), there is NO presumption and the trustee will have to prove DR insolvency beyond the 90 days
* (4) Transfer occurred within 90 days of filing OR 1 year of filing if made to an insider
  + "Insider" (§101(31)) – broadly defined, includes affiliates, officers, directors, persons in control
* (5) Satisfies "more than" test
  + Determines whether CR would be better off getting transfer than Ch. 7 liquidation
  + Exceptions (when fails "more than" test):
    1. If CR is fully secured – fails more than test because he will get 100% of his claim paid in bankruptcy anyway
    2. If DR is solvent – DR will be able to pay all unsecured claims in full anyway. Here, we are talking about insolvency at the time of filing/during the bankruptcy case, not necessarily at the time of the transfer.
  + Skeel: An under-secured creditor will always satisfy the more than test
  + Note: More than test only looks at what the CR would recover from the DR’s estate in bankruptcy (does NOT consider any third party payments, like the possibility of turning to a guarantor/letter of credit lender in the event of bankruptcy filing) (in re Powerine Oil Co)

### In re Powerine Oil Co

* Facts: Koch sells oil to DR (Powerine). There is a LOC from bank that lists Koch as beneficiary. DR pays for oil and then soon after files for bankruptcy
* Trustee tries to reclaim the payment as a preferential transfer
* Holding: Yes preferential transfer. Must be returned
* Meets "more than test" which only looks at what CR would receive from DR’s estate (does not consider third party payments)
* Note: Argument that Koch is actually worse off not better off from this payment because otherwise could turn to the Bank for payment in full in the event DR defaults and files for bankruptcy
* Note: Unlike the old Bankruptcy Act (which required creditors whose preference was avoided to have received notice of its advantage over other creditors), now there is no such reasonable-cause-to-believe requirement

### What Counts As A Preferential Transfer

* Is the attaching of a security interest a preferential transfer?
  + Prima facie voidable preference IF other §547(b) elements are satisfied because attaching of a security interest is a transfer of property of debtor on account of antecedent loan debt
* Are Letters of Credit preferential transfers?
  + **No**. The security interest does not secure an antecedent debt
  + The transfer of property is contemporaneous exchange for new value (the value being the bank’s issuance of the letter of credit)
  + Note: This analysis depends on when letter of credit was originally sought

### Preferential Transfer Hypotheticals

* Hypothetical 1:
  + Setup:
    - 1/1: Bank loan (100k). Security interest in property (worth 125k).
    - 3/1: 10k payment (now Bank owed 90k)
    - 7/1: 50k payment (now Bank owed 40k)
    - 8/1: Bankruptcy (Bank owed 40k still, after the 60k payments leading up to the filing)
  + Can trustee avoid the 7/1 50k payment? **No**
    - Over-collateralized creditor. More than test fails although the other requirements are satisfied for a preferential transfer. Fully secured creditor would get the same thing either way (inside and outside bankruptcy).
  + Modification: Assume that the collateral is worth $75k (less than Bank’s 100k claim) in which case Bank is an under-secured creditor.
  + Can the trustee avoid the 7/1 50k payment? **Yes**
    - At the time of the 7/1 transfer, the Bank was an under-collateralized creditor at the time of the transfer (had a 90k claim and a 75k security interest in collateral)
    - Skeel: If you are an under-collateralized creditor, the more than test will always be met
  + Can trustee avoid the 3/1 payment? *No*
    - This payment was made outside of the 90 day (reverse) window. Would not be a preferential transfer unless it is to an insider.
    - Note: If the 3/1 payment (outside of the 90 days) was large enough to make the Bank a fully secured or even over-collateralized creditor, then the 7/1 transfer would no longer be a preferential transfer and so would not have to give it back to the estate
* Hypothetical 2:
  + Setup
    - 1/1: Loan, security interest
    - 1/15: Files (perfects security interest)
    - 2/15: Dr files for bankruptcy
  + Is this a preferential transfer?
    - Is there a transfer (exchange of value)? Yes. CR provides loan; DR provides security interest
    - When did the "transfer" of security interest occur? Did it cover an antecedent debt?
      * Possibilities: (1) date of creation (1/1); (2) date of perfection (1/15)
      * If date of creation, this would NOT be a preferential transfer because the security interest DR provided would not be covering an antecedent debt (would instead be contemporaneous exchange of value)
      * If date of perfection, this would be a preferential transfer because it would be securing an antecedent debt
      * Answer: The creation date (1/1). This is because perfection was completed within 30 days of the agreement.
      * Rule: §547(e) – if you perfect security interest within 30 days, the time of creation is the relevant date to determine when the security interest "transferred." If you fail to perfect security interest within 30 days, the time of perfection is the relevant date for determining the time of "transfer." Must remember that you can file before the transaction (before 1/1), but the creation date would still be the relevant date because that would also be the perfection date

## Safe Harbors

### Contemporaneous Exchange Safe Harbor - §547(c)(1)

* Rule: When an exchange is essentially contemporaneous (occurring at the same time or with only a short gap), transfer will NOT be treated as a preference
* Question: What happens if there is a delay between payment and obtaining a security interest/perfecting a security interest?
  + Potential that creditor who gave value at the time security interest was created (contemporaneously), but did not perfect until later would be seen as having a lien for an antecedent debt. If this were the case, contemporaneous exchange exception would NOT apply
  + Note: Creditor who fails to perfect within 30 days are unlikely to be able to turn to §547(c)(1) exception
* Note: **Only get the contemporaneous exchange safe harbor if the parties intended for the value to transfer at the same time**
  + Example:
  + If the parties intended to have a security interest backing up a loan on the date they entered into the agreement  could be a contemporaneous exchange
  + If the parties did NOT intend for there to be a security interest when they entered into agreement, but then later the CR decided it wanted or needed a security interest  contemporaneous exchange safe harbor does not necessarily cover it
* Example 1: Skeel goes to Staples to get supplies. Goes to register and forgot his wallet. Kept goods but ran out to his car to get wallet and then pays. This is simultaneous transfer most likely
* Example 2: Skeel goes to the store and asks can he pay them back tomorrow. Paying them back tomorrow would still most likely be seen as contemporaneous exchange transaction
* Hypothetical based on the following:
  + 1/1: 100k loan (when the CR gives value –V)
  + 1/3: Parties sign a security agreement (grant security interest in equipment) (when the parties enter into agreement –A)
  + 1/15: Files (perfecting security interest)
  + 2/1: File for bankruptcy
  + Is this a preferential transfer under §547(b)? Does §547(c)(1)—contemporaneous exchange safe harbor cover this?
    - Was there a transfer? Yes. Exchange of value = security interest.
    - When did security interest transfer? 1/3. Since the security interest was perfected within 30 days of the agreement, the date of the "transfer" of the security interest is the creation date, here 1/3.
    - Was it securing an antecedent debt? Yes. This is because the loan was made on 1/1 and the agreement in which the DR agreed to give a security interest was 1/3.
    - Do any safe harbors save this seemingly preferential transfer? §547(c)(1) – contemporaneous exchange
      * Could argue that 2 days is thinkable for a contemporaneous exchange. The fact that it was just 2 days weighs in favor of it being a contemporaneous exchange, but if there is other evidence (sudden financial trouble for example), this might tip against it being a contemporaneous exchange
      * Note: Only get the contemporaneous exchange safe harbor if the parties intended for the value to transfer at the same time.
      * If the parties on 1/1 intended to have a security interest backing up this loan  could be a contemporaneous exchange
      * If the parties did not intend for there to be a security interest on 1/1, but then later (on 1/3) the CR decided it wanted or needed a security interest  contemporaneous exchange safe harbor does not necessarily cover it

### Ordinary Course of Business Payments Safe Harbor - §547(c)(2)

* Rule: a Trustee may not avoid a transfer to the extent that such transfer was in payment of a debt incurred by DR in the ordinary course of business or financial affairs of DR and transferee
* Requirements:
  1. The obligation was incurred in the ordinary course of business
  2. The payment/transfers were made in ordinary course of business OR made according to ordinary business terms
     + "Ordinary Business Terms"= must meet business standards common to all parties (must be ordinary from both the perspective of the CR and DR)
* Examples: Credit card payments; electric bills; long term loans are o.c.o.b. (as per *Wolas*)
* Skeel: Safe harbor most commonly invoked
* *Union Bank v. Wolas* – Ordinary course of business
  + Facts: Debtor borrowed 7M from Bank. Filed for bankruptcy. During 90 days before filing, DR made two interest payments (100k total) + loan commitment payment/fee (2,500)
  + Issue: Can payments on long-term debt qualify under §547(c)(2)—ordinary course of business exception?
  + Holding: Payments on long-term debt, as well as payments on short-term debt, may qualify for the ordinary course of business exception
  + Meaning of "ordinary course of business" left open
* *In re National Gas Distributors* – Ordinary business terms
  + Facts: Dr paid revolving line of credit and working capital loan to CR prior to filing for Ch11. DR made payments to free up collateral property pre-filing.
  + Trustee contends obligation was incurred in ordinary course of business. BUT payment NOT made according to "ordinary business terms"
  + Rule: "Ordinary business terms" defense must consider standards of BOTH debtor and creditor
    - Here, DR and CR were in different industries. CR= commercial lender; DR= distributor of natural gas
  + Holding: Transaction was ordinary from CR’s perspective (banking standards), but not from DR’s perspective.
  + Since DR looked to be engaging in pre-bankruptcy planning and thus trustee can avoid and recover these payments
* Problem (p. 293): Restructuring of a loan. Debtor borrowed 400k from Bank on an unsecured basis. It had an interest payable monthly and had a maturity date of 90 days. DR suffered bad financial reversal during previous 90 days. Bank renegotiated the loan. DR paid monthly interest of about 11,500 and repaid 450,000 of the principal after which point the Bank renewed the loan for its unpaid principal amount of 500k but interest rate increased substantially.
* Are the 450k payment made when the loan was re-negotiated (3 months before filing) and 11,500 interest payment retrievable as preferences?
  + Looks like a preferential transfer. Meet the §547(b) requirements.
  + Only safe harbor argument is §547(c)(2) –ordinary course of business. Creditor will say it is ordinary course of business payment, argue this is what happens in these types of situations, say it is an ordinary event in the life of the loan. Response from the trustee is that it is not normal action (like Wolas).
  + Skeel: Bank will likely lose on 450k payments because it seems like an extraordinary transaction. Better chance that the interest payments fall into (c)(1)—it was incurred during ordinary course of business and could argue either ordinary business terms or ordinary terms course of business between the debtor/creditor

### PMSI Safe Harbor §547(c)(3)

* As long as perfection is within 30 days of the DR obtaining the collateral, it is NOT a preferential transfer so long as it is clear that the loan was intended for the DR to be able to purchase the collateral that secures the loan
* Hypothetical #1:
  + Setup
    - 3/1: Loan and security agreement to give CR security interest in equipment
    - 3/15: Dr buys equipment
    - 4/30: Cr files (perfects)
    - 5/1: Bankruptcy
  + Bank must file within 30 days of DR obtaining collateral to be protected (did not here)
* Hypothetical #2:
  + Setup
    - 1/1: 100k loan, security agreement purports to give CR security interest in equipment (value is exchanged/promise made + agreement is entered into)
    - 2/1: Dr buys equipment (creation—this is when the DR first had rights)
    - 2/15: Cr files (perfection)
    - 3/1: Dr files for bankruptcy
  + Can trustee make out an argument for preferential transfer under §547(b)?
  + Was there a transfer (exchange of value)? Yes. Security interest
  + When did transfer of value happen? 2/1. This is the date of transfer because the perfection date is within 30 days (on 2/15)
    - Note: Dr does NOT have rights in this collateral until DR buys the property (equipment) on 2/1 despite the agreement previously.
  + Was this transfer to secure an antecedent debt? Yes. The creation date (2/1) is the date that the "transfer" occurred, which seems to be securing an antecedent debt (incurred on 1/1). Looks like a preference.
  + Does §547(c)(3) – safe harbor created for PMSIs apply? Yes
    - PMSI: When the loan is being used for the DR to obtain the collateral that secures the loan.
    - Note: Pms Is in consumer goods perfect automatically. NOT business PMSIs (like equipment here)
    - Question: How do you know when a loan is a PMSI if it doesn’t say in the security agreement? Have to show that this loan was intended for the DR to obtain this collateral. Need connection between the loan and the acquisition of the collateral. No bright line rule!!!
  + Note: If the DR never bought the goods, then the CR would simply be an unsecured creditor

### Future Advances ("Subsequent Advance") Safe Harbor - §547(c)(4)

* Rule: When CR extends more credit after DR makes a payment, the earlier payment will be protected to the extent of the extended credit amount
  + Ex: Cr extends $90 credit after DR makes a $100 payment. Only $10 is preferential, the $90 is deemed to fall under the subsequent advance safe harbor
  + Delivery of new supplies/new credit extension is NOT a preferential transfer (to the extent of the new supplies/credit extended)
* Note: Does NOT apply if DR’s payment is secured (only if unsecured/otherwise exposed) OR if any other safe harbors apply
* Purpose being to encourage CRs to continue dealing with troubled debtors
* Skeel: Cannot apply (c)(4) if the CR’s future advance is otherwise secured or protected/un-avoidable by another safe harbor (aka the CR would be paid regardless). Only use (c)(4) if the CR’s advance is exposed.
* Hypothetical #1:
  + Setup:
    - Day 1: Cr ships $100 worth of supplies
    - Day 15: Dr pays $100
    - Day 30: Cr ships $125 worth of supplies
    - Day 45: Dr pays $125
    - Day 60: Cr ships $150 worth of supplies
    - Day 80: Dr pays $150
    - Day 90: Dr files for bankruptcy
  + Are any of these payments voidable preferences?
  + Trustee will argue that all of these payments are voidable under §547(b)—want to retrieve all payments (on Day 15; Day 45; Day 80) because they are all payments on account of an antecedent debt
  + Note: If other safe harbors were available, what would you argue? §547(c)(2) – ordinary course of business. These obligations were incurred in the ordinary course of business and payments were all made in the ordinary course of business/according to ordinary business terms
  + Does §547(c)(4) – Future advances/subsequent advances safe harbor apply?
    - CR will argue that after the CR received payment he provided new value.
    - Look at Day 15 payment, afterwards CR did extend new value (125 worth of goods)
    - Look at Day 45 payment, afterwards CR did extend new value (150 shipment)
    - Look at Day 80 payment, no more credit extended. SO, this is the only payment that could be voidable as a preferential transfer
  + Note: Protections is ONLY to the extent of the future advance
    - Ex: If the Day15 payment is $100 and the Day30 shipment was worth $70, the protection would only be $70. This would mean that there is a voidable preference of $30.
    - Note: a Future extension of credit later on could cover a previous preferential transfer in this series of events.
    - Ex: If there is a $30 preference on Day30, and on Day45 DR pays $125 and on Day60 CR extends $150. CR’s 150 extension of credit would cover the full 125 payment (Day45) and have $25 extra to cover the previous $30 preference, in which case there is only a $5 preference left.
* Hypothetical #2:
  + Setup:
    - Day 1: Cr ships $100 worth of supplies
    - Day 15: Dr pays $100
    - Day 30: Cr ships $125 worth of supplies
    - Day 45: Dr pays $125
    - Day 60: Cr ships $150 worth of supplies
    - Day 80: Dr pays $150 (made in the ordinary course of business, (c)(1) safe harbor applies)
    - Day 90: Dr files for bankruptcy
    - Assume that Day 80 $150 payment is made in the ordinary course of business, then the Day60 credit does not count as a future advance for purposes of the safe harbor.
  + Now what?
    - Day 15 (100) payment is OK because of CR extending more credit on Day30 (125). The credit is more than the payment, so the DR’s Day15 payment is not preferential.
    - Day 45 (125) payment seems ok, BUT it isn’t because the Day60 extension of credit no longer makes the CR exposed because the Day80 payment is protected. This means that the $125 is a voidable preference and NOT covered by the (c)(4) future advances safe harbor.
  + Result: Cannot use the future advances safe harbor to protect the DR’s Day45 ($125) payment
    - Why? Because the CR is no longer deemed to be exposed for the Day60 extension of credit. The CR would be paid for regardless of the future advances protection
  + Rule: If one of the payments is protected because of a different safe harbor, then the "advance" connected to it can no longer count as a future advance. This is because the future advance sage harbor is intended to be used only to protect creditors who are exposed (not those that are secured or will be paid for some other reason regardless)
* Hypothetical #3:
  + Setup:
    - Day 1: Cr ships $100 worth of supplies
    - Day 15: Dr pays $100
    - Day 30: Cr ships $125 worth of supplies
    - Day 45: Dr pays $125
    - Day 60: Cr ships $150 worth of supplies (secured by collateral worth $100)  under-collateralized
    - Day 80: Dr pays $150
  + What would happen here?
    - Day15 (100) payment is still saved by the future advances safe harbor
    - Day45 (125) payment is made and then a $150 extension of credit is provided. BUT, now the CR is partially secured (100 in collateral) and is only exposed by $50. The $50 is protected by (c)(4), but the remaining $75 is a preferential transfer (125-50 = 75)
    - Day80 (150) payment is a preferential transfer because there is no extension of credit afterwards
  + Result: Preferential transfer of $225 (75+ 150 = 225). This means that the CR would have to give $225 back to the estate. BUT the claim would be partially collateralized by $100

### Two-Point Net Improvement Test (§547(c)(5))

* Rule: **When the collateral is inventory or accounts receivable, there wont be a preference as long as the CR is not better off in BR than it was in the preference period (i.e. not a preference unless CR is less under-collateralized in BR than they were 90 days before BR)**
* Designed for inventory, accounts receivable loans (not equipment) that is constantly turned over
  + Example: Laser printers or other supplies at Staples. When current inventory is sold, Staples will buy a new one replacing the original one and the creditor’s security interest will transfer to the new replacement collateral. Old security interest in laser printer that was sold will transfer to the new printer that is attained. The transfer of the security interest looks like a preferential transfer, but not treated as such because of this safe harbor
* Assumes there is an after-acquired property clause in their contract
* Test: Compare how under-collateralized the CR was at two points: (1) 90 days before filing (OR time the loan was made if made after 90 days); (2) time of filing.
  + If the CR is less under-collateralized at the time of BR (i.e. in better shape), then the extent of the improvement is treated as a preference. The preference will be the difference in under-collateralization (i.e. improvement in position)
  + Note: If involving an insider, use the one year before bankruptcy time period instead of the 90 days
* Steps to Apply (c)(5):
  + Pre-Step: Determine whether we are dealing with collateral that involves inventory or accounts receivable
  + (1) Determine how under-collateralized CR is 90 days before bankruptcy OR at the time of the loan if made after 90 days (aka closer to bankruptcy filing than 90 days)
  + Note: If 90 days before bankruptcy, the CR was fully secured. Then there is NO preference.
  + (2) Determine how under-collateralized CR is at the time of Bankruptcy
  + (3) If the value in (2) is LESS than the value in (1) -> the CR is less under-collateralized at the time of BR (i.e. in a better position) and there IS a preference
  + (4) Determine the value of the preference by subtracting (1) – (2).
* Note: Only a preference to the extent that it PREJUDICES other creditors (ex: Oil is the collateral and there is a change in oil prices)
* Hypothetical:
  + 90 days before bankruptcy:
    - Debtor owes $100k
    - Collateral = $60k (inventory)
  + At time of bankruptcy:
    - Debtor owes $90k
    - Collateral = $70k (inventory was sold, new inventory is worth more)
  + DR did two things: (1) made a $10k payment to CR (reducing the $100k loan to $90k); (2) got new inventory worth $10k more than the previous collateral
  + Rule: If you get new collateral within 90 day period, (c)(5) can apply so the transfer of security interest to the new collateral is not treated as a preferential transfer even though technically under §547(e)(3), there is no "transfer" until the DR has rights in the collateral
  + What does the trustee want to do? Argue that the 10k payment and entire security interest can be retrieved as a preferential transfer
  + If this was not an inventory loan (but an equipment loan), could it be saved?
    - No!
* Application of (c)(5) Safe Harbor
  + (1) Look to how under-collateralized the DR was 90 days before bankruptcy.
    - DR owed 100k, CR secured by 60k worth of inventory. CR is under-secured by $40k.
  + (2) Look at how under-collateralized the DR is at the time of bankruptcy filing.
    - DR owed 90k, CR secured by 70k worth of inventory. CR is under-secured by $20k.
  + (3) Since (2) is less than (1), we know that the CR is less under-collateralized at the time of bankruptcy (meaning CR is better off at time of bankruptcy). Thus, there was a preferential transfer
  + (4) To determine the amount of the preferential transfer subtract (1) –(2) = 40-20= 20k.
  + Result: Remove the difference between the DR’s under-collateralized status. SO, there is only a $20k preference that trustee can avoid
    - Note: Can ignore payments within this 90-day period. Just focus on the relationship between the value of the collateral and the loan
  + Modification 1: What if at 90 days the collateral was worth 120k (making CR over-secured)?
    - Result: There would be no preference.
    - Rule: There is only a preference if the CR is under-collateralized at point one and less under-collateralized at point two
  + Modification 2: What if the inventory was not sold, but simply went up in value?
    - Result: There would be no preferences because there was NO transfer that occurred in the 90 days before bankruptcy
  + Modification 3: What if the inventory is sold and new inventory is purchased. But for some reason, the value changes because of a change in price of the commodity generally?
    - Result: Some courts accept that there isn't really a preference because there is no prejudice to other CRs (Skeel isn’t persuaded by this argument)

### Third Party Transactions/Insider Preferences (§550(c))

* §550(a)(1) – Trustee can go after either the initial transferee or a person for whose benefit the transfer was made (often an insider in the case of a CEO guaranteeing a loan)
* §550(c) - Trustee’s power is limited to going after the insider if the transfer has occurred outsider the 90 day window. Trustee can still recover a transfer after 90 days by going after the insider.
* "Insider" (§101(31)): Broadly defined, includes officers, directors, persons in control and family of DR.
  + If the trustee can show that a CR is actually "in control" of the DR then he may be able to take advantage of the one-year insider recovery period.
* Hypothetical:
  + Setup: Bank makes a $250k loan to the DR. President of the DR corporation has to make a personal guarantee on the loan.
    - 120 days before bankruptcy:
      * DR makes a payment of $50k
    - 80 days before bankruptcy:
      * DR makes a payment of $30k
  + Who does the trustee want to go after to retrieve the payments? Either the bank or the president of the DR’s corporation because both are CRs
    - President is a CR of DR because as a guarantor he holds a contingent claim (would have a right of indemnification against the DR in the event he had to pay)
  + Are both of these payments preferential transfers under 547(b)?
    - Day 80 payment is clearly
    - Day 120 payment is as well
      * Note: Guarantor is an insider, which means that the window for preferential transfers is extended beyond 90 days to cover the payment at 120 days.
      * This payment can also be seen as "for the benefit" of a CR (§547(b)(1)). When the trustee made this payment, it was arguably for the benefit of the president
  + Who can the trustee recover the preferential transfers from?
    - Day 80 payment from either the Bank or the president (§550(a)(1))
    - Day 120 payment ONLY from the president (§550(c))—unless of course the Bank can be considered an insider of the DR
      * How can a bank be an insider of DR?
      * If owe equity in the corporation (rare)
      * If Bank has direct authority or indirect authority (control over the DR) – has someone who is an officer/director/board member of the corporation
      * Example: Worldcom in financial trouble needed to borrow money from group of lenders. Condition was that they needed to put in a restructuring officer. If DR selected one of 3 names lenders provided, they would lend them the money. Strategic way for bank to get control over DR

# Trustee’s Powers – Fraudulent Conveyances

## Key Provisions

### Uniform Fraudulent Transfer Act (state law version that can be invoked in bankruptcy through §544(b)(1))

* Basically the same as federal version found in §548 - "A transfer is fraudulent (whether the creditor's claim arose before or after the transfer was made) if the debtor made the transfer with actual intent to hinder, delay, or defraud any creditor"
  + §4(a)(1) – Actual fraud
  + §4(a)(2) + §5(a) – Constructive fraud
    - Show property sold for a price that was not reasonably equivalent to the value
    - AND debtor was engaged in a business or a transaction for which the remaining assets of DR were unreasonably small - (§4(a))(2)
    - OR the debtor was insolvent at that time or as a result of the transaction (§5(a))
  + §4(b) Badges of Fraud - “in determining actual intent...consideration may be given, among other factors, to whether:
    - (1) Transfer to an insider
    - (2) Debtor retained possession or control of the property transferred
    - (3) The transfer concealed
    - (4) Debtor sued or threatened with suit before the transfer was made
    - (5) Transfer of substantially all the debtor's assets
    - (6) Debtor absconded
    - (7) Debtor removed or concealed assets;
    - (8) Value of consideration received by the debtor was not reasonably equivalent to the value of the asset transferred
    - (9) Debtor insolvent or rendered insolvent
    - (10) The transfer occurred shortly before or shortly after a substantial debt was incurred
    - (11) Debtor transferred essential assets to creditor who transferred assets to an inside
* Two Key Differences:
  + UFTA has a longer statute of limitation (4 years), compared to the 2 years allowed in §548
  + UFTA §8 provides for a complete defense (good faith buyer of fraudulently transferred good does not have to give back the property) for a case that deals with actual fraud, whereas §548(c) and §550(b) offer a partial defense

### §544(b)(1) – Trustee In Bankruptcy Has Derivative Rights of CRs Under State Law (including UFTA)

* §544(b) Trustee has right to invoke any non-BR law that any existing creditor can invoke outside of BR
  + Gives the trustee the potential to take advantage of longer state law statute of limitations for fraudulent conveyances
* Only applicable if there is a creditor who would have this right under applicable law
* Using § 544(b) and pulling in UFTA allows trustee not just to do what creditor could have outside Bankruptcy, but allows trustee to completely wipe out the transaction
* If anyone could have avoided a small part outside Bankruptcy, can avoid ENTIRE transaction inside Bankruptcy
  + Where this matters: leveraged buyout transactions; restructuring of business (Caesar’s restructuring left creditors of operating company much more vulnerable than they were before); payments to executives right before firm files for Bankruptcy (AIG in 2008)

### §548 – Fraudulent Conveyances

* Trustee can avoid transfers made within 2 years where DR acted with
  + (1) **actual** intent to hinder, delay, defraud creditors OR
  + (2) Engaged in a transfer that wasn’t for a reasonably equivalent value while insolvent – **constructive** fraud
    - Instead of insolvency, can also be satisfied if would leave DR's business with unreasonably small amount of capital or intended to to incur debts beyond ability to pay
  + Note: Trustee must prove insolvency or one of the others (no presumption like in voidable preferences section)
* §548(a)(1) – Actual Fraud
  + Trustee must show that the transfer was made with actual intent to hinder, delay, or defraud an entity to which DR became indebted to
  + “Badges of Fraud” (Indicators of Intent to Defraud)
    1. Insider relationship between parties
    2. Retention of possession, benefit, or use of property
    3. Lack or inadequacy of consideration for property transfer
    4. Financial condition of DR before and after the transaction
    5. Series of transactions/course of conduct
    6. General chronology of events
    7. An attempt by DR to keep the transfer a secret
  + Classic example: D deeds interest in residence to her mom for no consideration after causing a car accident. D continues to live in the residence
* §548(a)(2) – Constructive Fraud
  + Trustee must show:
    - (1) DR received less than reasonable equivalent value in exchange for the transfer of obligation
    - (2) DR was insolvent at the time of the transfer OR became insolvent because of the transfer (no presumption)
      * Several different tests for insolvency: Insolvency (assets are less than liabilities)/small capital/equitable insolvency
  + Note: special case for Religious or Charitable Donations
    - Religious or charitable donations are allowed so long as…
      * (1) Contribution does not exceed 15% of debtor’s gross annual income in the year the transfer was made OR
      * (2) If it is greater than 15%, the contribution is consistent with past practices
    - But payment of a “pledge” within 90 days may be avoided as a preference
* §548(c) – Defenses available to recipients of fraudulent conveyances for good faith purchaser
  + A transferee that takes for value and in good faith may retain any interest transferred to the extent that such transferee gave value to DR in exchange for such transfer
  + Applicable for constructive and actual fraud
  + Provides a partial defense up to the value given.
  + Note: There is a complete defense for actual fraud under UFTA (DR/trustee cannot get anything back)

### §550 - Liability Of Transferee Of Avoided Transfer

* §550((a) – Who trustee can recover fraudulent transfers from…
  + Trustee can either recover fraudulent transfers from (1) initial transferee or (2) immediate/mediate transferee
  + Note: trustee’s powers to recover fraudulent transfers also applies to a debtor-in-possession in a chapter 11 case (§1107(a)) OR maybe even a creditor’s committee (although there is no statutory authorization for the committee)
* §550(b) – Defense for good faith purchaser. Limitation on who trustee can recover fraudulent transfers from…
  + The trustee may not recover from (1) a transferee that takes for value in good faith and without knowledge of the voidability of the transfer avoided or (2) any immediate or mediate good faith transferee of such transferee
  + Note: A transferee who acquired the property from the DR in good faith but for a value that was not reasonably equivalent is partially protected. Trustee can recover the property or a money judgment, but the trasnferee/purchaser is entitled to offset against that recovery the value that had been given to the DR for the property
    - Ex: Good faith purchaser who bought the painting for 250k (when the painting was worth 500k) would have to give painting or 500k back, but would have a lien for 250k
    - Skeel says a good faith purchaser who bought painting for 2M when it was worth 500k would have a lien for 2M
  + §550(b)(2)-- Subsequent good faith purchasers (bought not from DR but from transferee who bought from DR) is completely protected regardless of whether they paid a reasonable price

## Overview of Fraudulent Conveyance Law

* Definition: transfers where DR acted with intent to hinder, delay, or defraud CRs (actual fraud) OR engaged in a transfer of property that wasn’t for a reasonably equivalent value when insolvent (constructive fraud)
* Governed by the UFTA and §548
* Note: trustee can choose to invoke UFTA (state law version) in bankruptcy case through §544(b)(1) so long as there IS a CR that would have the right to avoid any part of this transaction under applicable law. Trustee can then wipe out the entire transaction
  + Expands the state law power, which would be limited outside of bankruptcy to only the portion of the transaction that affects the individual CR who has the right
  + Ex: leveraged buy-out transaction – trustee could wipe out a $2M transaction based on a CR who has $2k stake in the transaction
  + Ex: Caesars restructuring before filing for bankruptcy – many of these restructuring arrangements
  + Ex: payments to executives just before bankruptcy (even those that are part of the employment contract) –AIG

## What Counts as a Fraudulent Conveyance

* Religious or Charitable Donations? Not necessarily
  + Religious or charitable donations are allowed so long as…
    - (1) Contribution does not exceed 15% of debtor’s gross annual income in the year the transfer was made OR
    - (2) If it is greater than 15%, the contribution is consistent with past practices
  + But payment of a “pledge” within 90 days may be avoided as a preference
* Excessive Compensation for Insider Employees? Yes
  + Can be avoided if…
    - (1) Employee’s services were not of reasonably equivalent value for the transfers/obligations AND
    - (2) Transfers were not made in “ordinary course of business”
  + Note: do NOT require a showing of insolvency for this to constitute a fraudulent conveyance
* Non-collusive foreclosure sales? NO! (BFP v. Resolution Trust)
  + Rule: Trustee cannot avoid foreclosure sale as constructive fraud regardless of the sales price as long as all state foreclosure procedures are followed
  + Note: BFP holding only covered mortgage foreclosure sales, but its rationale seems to reach forced sales, like forced public auctions of personal property as well.
* Ponzi schemes? Presumption of actual fraud
  + Definition of Ponzi scheme:
    - No real business to invest in, fake profits are reported and paid to early investors, inducing more investment from both new and old investors until the scheme collapses
    - Question becomes the extent to which those who received distributions pre-bankruptcy can be forced to give them back to the bankruptcy trustee. Issue arises with innocent victim/good faith recipients
  + Rule: All distributions to investors in such debtors are made with actual intent to hinder, delay, and defraud other creditors

## Fraudulent Conveyance Hypotheticals

### Hypothetical #1

* Setup: Skeel owns a painting worth 500k. Skeel does not want CR to have it because they do not appreciate it. Goes to Vegas with the painting and casino will make him a loan on the spot in the back. Skeel gets 500k worth of chips. Plays and loses it all. Files for bankruptcy.
* Question: Is this a fraudulent conveyance?
* UFTA 4(a)(1) or §548(a)(1) argument for actual fraud
  + Skeel could counter by saying that he didn’t act intentionally with the purpose of stiffing the CRs, really thought he would win. Was not planning to not pay the CRs
* Argument for constructive fraud
  + This would apply if Skeel didn’t get reasonably equivalent value for it. Argument would be that the House has the odds in its favor in all games on the floor, which means that 500k worth of chips are actually worth less than the present value of the painting
    - House does not have the odds in its favor for games like poker, blackjack
  + Argument that it was reasonably equivalent value bc theoretically Skeel could just take the chips and cash out for the $500k value in full without playing at all. Also could argue that 80-90% of the value is reasonably equivalent. Skeel thinks this would be reasonably equivalent value
* Suppose this really was a fraudulent conveyance (constructive fraud), would the casino have a defense?
  + §548(c) — Good Faith Purchaser Defense
    - Constructive fraud doesn’t necessarily get fully protected if acting in good faith – gets a lien on the value of what purchaser transferred
    - Casino would either (1) have a lien for the value of the painting or (2) keep the art but have to give the difference in value presuming it went up
  + Note: UFTA gives a complete defense to a buyer that is acting in good faith (difference between UFTA and §548)

### Hypothetical #2

* Facts: DR is in financial trouble, gives property to good faith buyer for 80k bc he is willing to pay right away. Good faith buyer then sold this property to good faith purchaser for 120k. DR files for bankruptcy and trustee wants to avoid this sale as a fraudulent conveyance
* Question: Can trustee avoid this sale as a fraudulent conveyance?
* Under BFP could argue this was a distressed sale (like a foreclosure sale). The low price is not indicative of fraud based on the circumstances. But note that BFP is about foreclosure sales and this is not a true forced sale
* If we determine that 80k is indicative of constructive fraud. What would happen?
  + If the buyer acted in good faith, then the buyer would have a lien of 80k and would have to give back the difference in value between the price he paid (80k) and the true/appropriate value of the property
    - Note: if the court valued the property at 120k, the buyer would have to give back 40k. Would have an 80k lien. (lien for purchase price, give back difference in value and purchase price OR painting itself)
* Could trustee go after good faith purchaser (who got property from the good faith buyer who bought it from DR)?
  + **No**, good faith purchaser is fully protected under §550(b)(2)

### Hypothetical #3

* Prior to BR, DR has an extravagant dinner for $10k. Can this be seen as a fraudulent conveyance?
  + If trustee can show that the DR had intent to defraud, restaurant would have to return 10k and would then have a claim against the DR for 10k
  + However, §548(c) would provide the restaurant with a defense so long as it acted in good faith

# Trustee's Strong Arm Powers

## Key Provisions

### §544 – Trustee’s “Strong Arm” Powers

* Empowers trustee to avoid unperfected property interests, thereby turning CR claims into unsecured claims
  + The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable [under the conditions listed under this subsection]
* Essentially treats trustee as having a lien on every piece of property that the DR has starting at the moment of the filing
* Note: This power prevails even if the trustee has knowledge of other creditors (support provided by introduction language in (a) saying “without regard to any knowledge of the trustee or of any creditors”). Does NOT prevail if trustee has notice or if applicable state law deems constructive notice sufficient for perfection
* **§544(a)(1) + (a)(2) – Personal property lien “strong arm” powers**
  + Trustee assumes the status of a creditor that is a judicial lien holder (whether or not such exists), which has priority over unperfected claims
    - Note: Trustees trying to capture the differences in state law regarding when a judicial lien takes effect (properly perfect lien)
    - Bottom line = trustee can eliminate any property interest that is not properly perfected
  + Beware of retroactive effect to perfection
    - When applicable non-bankruptcy law provides retroactive effect to perfection, perfection after bankruptcy defeats rights of trustee under §544(a)(1)
* **§544(a)(3) – Real Property Strong Arm Power**
  + Trustee has status of a bona fide purchaser of real estate/real property (minus fixtures) that has perfected such transfer prior to commencement
  + Puts holder of an unrecorded mortgage in the same position as a holder of an unperfected UCC security interest
  + Note: there is a difference here based on the differences in real estate (needed to make the trustee more powerful, although it has the same effect as (a)(1)/(2))

### §541(d) - Property of Estate

* **What to do with Property Held by DR as Nominee or Trustee**
  + §541(d) – Estate provision that says that property the DR holds only legal title to comes into the estate under §541(a)(1) and (a)(2), but is limited to just the legal title. NOT equitable/beneficial interest
    - Skeel: By its very terms, §541(d) does NOT apply to property the trustee recovers using the strong arm powers (incl 544(a)(3)), which is brought into the estate under §541(a)(3). §541(d) is limited to property that comes into the estate through 541(a)(1) and 541(a)(2)
  + Compared with §544(a)(3). §544(a)(3) is the strong arm provision that allows for the trustee to avoid unrecorded property interests (i.e. can avoid equitable interest of those who failed to record their interest in the property)
    - Note: Technically, this property is brought into the estate under §550, which is the provision that empowers the trustee to actually recover the property identified under 544(a)(3)
  + Some courts held that 541(d) and 544(a)(3) do NOT conflict, meaning that unrecorded interests in real property can be avoided by the trustee using 544(a)(3) (*Belisle v. Plunkett*)

## When Can Strong Arm Powers (§544) Be Invoked

* Strong arm powers are extremely important. These powers are meant to discourage secret liens. Applicable in circumstances where there was a failure to perfect (either because of a failure to file financing statement or failure to provide notice in real estate context). These powers do not eliminate the claim, but make a property interest into an unsecured claim
* When the trustee has “notice”? NO
  + Rule: Notice is NOT the same as knowledge. Notice is sufficient for perfection, which disallows trustee’s avoidance power under §544. Trustee having knowledge is ok/can still avoid
  + Note: beware of instances in which applicable state law provides for constructive notice as sufficient for perfection (example= PA)
  + *McCannon v Marston*
    - Facts: McCannon bought condo from DR (hotel) and lived there, never having properly perfected the sale.
    - Trustee tries to avoid M’s interest in condo under §544(a)(3)
    - Under PA law, interest is automatically perfected if actual or constructive notice is giving. Living in property qualifies as constructive notice
    - Holding: DR’s trustee CANNOT avoid M’s interest under §544(a)(3)
    - Rule: notice is not the same as knowledge. Under applicable state law, constructive notice is enough for perfection, which means that §544 does not apply
* When DR holds property as a nominee or trustee? Courts are split
  + Some jurisdictions hold that what it says on the deed is actual ownership (in which case legal title would convey actual ownership) and under §544(a)(3) the trustee as a bona fide purchaser has priority over unrecorded interest of others

### Hypothetical: Diocese As Legal Title Holder

* Setup: Church bankruptcy cases. Many churches filed for bankruptcy. Property is technically owned by the Church corporation because that is what is listed on the deed (legal title). Church corporation files for bankruptcy. Nominally the church is the owner of the property, but there is an argument that the property is truly owned by the parish/parishioners. Tension between legal ownership (diocese) and beneficial ownership (parish/parishioners).
* Question: Who owns the property?
  + Note: This question is important because if the diocese (DR) owns the property, it is part of the estate, whereas if the parish/parishioners own the property, it is not part of the estate
* Parishioners argue that it is their property. Could point to 541(d) and say that even if the property is part of DR’s estate, it is limited to the legal interest (not beneficial interest)
* Trustee will argue that even if the parish/parishioners are have a beneficial interest in the property, §544(a)(3) grants the trustee the status of a bona fide purchaser of real property, which has the power to obtain this property free and clear of the unrecorded beneficial interests of the parishioners. Since the parish/parishioners’ name is not on the deed, their interests are unrecorded/unperfected
* Plunkett: A constructive trust/beneficial interest of the parish/parishioners could be overridden by §544(a)(3) because as the legal title owner, the Diocese would have been able to sell the property free and clear of any interests to third parties

# Consumer Bankruptcies - Chapter 7 & Chapter 13

## Key Provisions - Chapter 7

### 109(b) - Basic Eligibility for Chapter 7 Filing

* Person (defined in §101(41) includes individuals, partnerships, or corporations) OR a corporation (defined in §101(9)).
  + Excluded: Commercial banks, Insurance companies, Railroads

### §101(8) - Definition of consumer debts (imp. bc determines whether DR subject to means test)

* Debts incurred by an individual primarily for personal, family, or household purposes
  + Note: to be distinguished form an individual with business debts or partnerships/corporations with debts

### §707(b) - Means Test for Chapter 7

* Exempts all DRs whose (current monthly income x 12) is at or below the median family income from being rejected from Chapter 7 on the basis of the means test
  + §101(10A) - Current Monthly Income (CMI)
    - Average monthly income for the 6 months pre-bankruptcy
    - Includes income from all sources (NOT social security benefits)
    - Note: If dealing with a joint case, it includes spouse’s income as well
  + Note: CMI can be easily manipulated so that it is below the state median by waiting a few months to file after a lay off for instance (see HYPO below with two identical employees filing at different points)
* Even though DR cannot be kicked out of Ch. 7 because of the means test, DR can still be screened under it
* §707(b)(7) - DRs whose **current monthly income is below the state median are eligible for Ch. 7** and do not have to be subject to the means test
* Once you have determined that DR’s current monthly income is above the state median, look to see if DR fails part two of the means test. If DR fails means test, DR is kicked out of Ch. 7 (presumption of abusive filing that can only be rebutted in special circumstances under §707(b)(2)(B)
* **Application of Means Test**:
  + Pre-Step: determine whether the DR’s current monthly income x 12 (annual income) is above the state median provided by the IRS
  + Step One: Determine which category DR falls into based on the amount of unsecured debt he owes. The category will provide the amount DR must be able to pay in order to fail the means test
    - Unsecured less than 29,900 -> fail if over $7,475
    - Unsecured btw 29,900- 49,900 -> fail if over 25% of debt owed
    - Unsecured over 49,900 -> fail if over $12,475
  + Step Two: Determine whether the DR can pay the amount identified in step one.
    - Look at excess/disposable monthly income [CMI - deductions/allowances based on living expenses] x 60 [usual term of plan]
    - Note: if this number is greater than the number in step one, then the DR fails the means test and is kicked out of Ch. 7 because of a presumption of abuse
* **§707(b)(3)** - Allows court to throw out a case that is filed in bad faith or as an abuse of the system regardless of the means test or CMI below median
  + Includes abusive pre-bankruptcy planning; living so extravagantly; purchases made in anticipation of filing; etc.
  + Note: motion can only be made by US trustee or judge, NOT creditors
  + Limitation on Ct’s ability to dismiss: charitable contributions cannot be used as the basis to show bad faith filing
* **§707(b)(2)(B)** - DR can rebut the presumption of abuse created by failing the means test under “special circumstances”
  + “Special Circumstances” - limited to situations, like serious medical condition, call or order to active duty in the Armed Forces
  + Note: can use these limited circumstances to the extent they justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative

## Key Provisions - Chapter 13

### §109(e) - Eligibility for a Ch. 13 case

* DR must be a “natural person”/individual with regular income
* DR must have **non-contingent and liquidated** debts less than:
  + $394,725 in unsecured
  + $1,184,200 in secured
* DR must also satisfy other requirements:
  + §109(h) - DR must meet credit counseling requirements
  + §1325(a)(7) - DR must have filed petition in good faith

### §1325 Confirmation of Plan

* **§1325(a)(3) - Good Faith Requirement for Filing**
  + The plan has been proposed in good faith and not by any means forbidden by law
  + Skeel: Good faith provision has extra teeth when DR wants to use the super discharge
* **§1325(a)(4) - Best Interest of Creditors Test**
  + Value of property to be distributed among unsecured CRs is just as much as they would under a Ch. 7 liquidation
* **§1325(b)(1) - Disposable income test**
  + If any creditor objects, DR must show that plan provides for all disposable income to be dedicated towards repayment of unsecured CRs
  + In the event that CR objects, Court would have to figure out DR’s disposable income, which raises issues about how to evaluate standards of living
* **§1325(a)(5) - Modifying secured claims in Ch. 13 (stripdown)**
  + Allows DR to modify some agreements and security interest in chapter 13

### §1322 - Contents of Plan

* **§1322(b)(2)**
  + Limits ability to modify mortgages secured only by a security interest in real property that is the DR’s principal residence

### §1328 - Discharge in a Chapter 13 situation

* **§1328(a)** - Super Discharge (see discharge section)
* **§1328(b)** - Hardship discharge in non-completed Ch. 13 plan
  + Applies in a situation where the debtor fails to complete a Ch. 13 plan, but tried really hard to comply. Hardship discharge (non-completed Ch. 13 plan)
  + Get a discharge for everything except your §523(a) non-dischargeable debts.

## The Means Test for Chapter 7 Filing (Did not discuss in detail during class)

* §707(b) establishes means test
  + Main form to file for Ch. 7 case.
  + Point: Tries to weed out those who are able to pay back most of their debts
  + If DR fails means test, he is kicked out of chapter 7 bankruptcy because there is a presumption of abuse
    - Skeel: Requirement can be justified in principle, but not a test that can be defended in practice. Widespread view of hostility toward it in the community. Main effect is to make it a little more expensive to file for Ch7 case (price to get a bankruptcy lawyer went up)
* Who is subject to the means test?
  + Only individuals with mostly consumer debts (§101(8))
  + NOT…individuals with business debts; partnerships; corporations
  + NOT…individuals who fall below the state median income

## Choosing Between Chapter 7 and Chapter 13

### Hypothtetical: Choosing between Chapter 7 & Chapter 13

* Setup: Debtor makes $35k/year
  + Assets:
    - Beach house worth $100k
  + Debts:
    - Bank -> 75k
    - Credit Card -> 50k
    - Neighbor Lawsuit Pending -> 1M (based on DR’s intentional destruction to property)
  + Plan:
    - Bank: Cure and reinstate loan
    - Credit card: pay $15k
    - Neighbor: pay $15k
* Should DR file in Chapter 7 or 13?
  + The answer is almost certainly Chapter 13
    - Lawsuit will be dischargeable under Chapter 13 if plan is completed ((a)(6) is excluded from non-dischargeable debts in Ch13 when applied to property, but non-dischargeable in Chapter 7 (§523(a)(6) -willful and malicious injury to person/property non-dischargeable)
    - DR gets to keep the beach house
* Can this DR file for Ch. 13?
  + Chapter 13 has debt ceilings - §109(e): DR must have non-contingent and liquidated debts less than
    - $394,725 in unsecured
    - $1,184,200 in secured
* Issue: At this point, there is just a lawsuit filed (unsecured obligation that would put it over the threshold). But, the DR can still file for Ch. 13 bc this lawsuit is contingent and the threshold only looks at non-contingent, liquidated debts
* Modification: The court determines that the value of the neighbor’s lawsuit claim is $50k
  + Note: it is still contingent even if the bankruptcy court puts a value on the claim. The bankruptcy court putting a value on the lawsuit is not a judgment, so it is still considered contingent. Need a final judgment (court ruling at the time of bankruptcy filing) for it to be non-contingent and included in the threshold amount in 109
  + Skeel: Once there is a final judgment pre-bankruptcy, it is liquidated, non-contingent, and secured claim (there is a property interest)
* What happens if the neighbor objects to the Ch. 13 plan?
  + Would have to apply the §1325(a)(4) -Best Interest Of Creditors Test. Determine how much neighbor would’ve gotten in a chapter 7 liquidation case to see if this payout (15k) is less than that amount
    - Unsecured CR would get 25k btw the two of them bc cottage is worth 100k, but subject to 75k mortgage. This would result in 12,500 each bc their claims are valued at the same 50k amount.
* Result: since 12,500 is less than the 15k promised under the Ch 13 plan, the neighbor does not have a valid objection under §1325(a)(4) - Best Interests Test
  + Note: it would be possible for the neighbor to invoke §1325(a)(3) -Good Faith Requirement for Filing.
  + Could also look to §1325(b)(1) - Determine whether the DR has devoted all of his disposable income to the plan

## Overview of Chapter 13

* Multi-year repayment plan that must be confirmed by creditors
* Basic Eligibility Requirements:
  + DR must be a “natural person”/individual with regular income
    - Note: source of income is irrelevant. Spouses of DR with regular income are eligible for Ch. 13 even if they themselves to not have regular income
  + DR must have non-contingent and liquidated debts less than…
    - $394,725 in unsecured
    - $1,184,200 in secured
  + DR must also satisfy other requirements:
    - §109(h) - DR must meet credit counseling requirements
    - §1325(a)(7) - DR must have filed petition in good faith

### Challenges to Chapter 13 Plan

* DR is subject to the Good Faith Filing Requirement (§1325(a)(7))
* DR’s plan must satisfy Best Interest of CR Test if plan is challenged (§1325(a)(4))
* DR must devote all disposable income to plan if CR objects (§1325(b)(1))
  + If below median income, use IRS standards to determine disposable income amount. Otherwise, court makes an ad hoc determination
  + Note: use the calculations based on the means test to determine the amount of disposable income DR has

### Chapter 13 Discharge

* §1328(a) - Super Discharge
  + Do NOT get a discharge unless DR makes all payments on debts as proposed in Ch 13 plan. Do not get any benefit if fail to meet the requirements of the plan. If fail, debts return to the original amount rather than the proposed amount in the plan
  + Note: different than chapter 11, which discharges obligations upon confirmation of the plan (ex: if under the plan you propose paying CR 20 cents on the dollar then that is all CR is entitled to demand in the event DR defaults)
* §1328(b) - Hardship Discharge
  + Good faith effort to pay + not DR’s fault that he couldn’t repay
  + Note: courts are pretty tough. Limited exception (similar to the student loan undue hardship exception)

## DR’s Power To Modify Secured Claims Under Ch. 13

* §1325(a)(5) - Allows DRs to modify some agreements/security interests
  + Note: Dewsnup has not been construed to apply in Ch. 13 plan. If property is worth less, CR has a secured claim to the extent of the value of the property
* §1322(b)(2) - Limitation on ability to modify some secured claims
  + Cannot modify a home mortgage that is secured just by the DR’s primary residence
  + Example: House is worth 50k, mortgage secured by just the house (which is DR’s primary residence) is 75k. Once bifurcated under §506(a), Bank really has a 50k secured claim and 25k unsecured claim. BUT, the entire mortgage cannot be modified under Chapter 13 plan because of §1322(b)(2)
* Nobelman v. American Savings Bank
  + Facts: Bank loaned DR 68k to buy house, took a security interest in the residence. DR filed for Ch. 13 at time when the house was valued at only 23k. So, Bank was an undersecured CR
  + DR argued it should only have to make payments under Ch. 13 plan up to 23k, interpreting §1322(b)(2) to apply only to the secured portion of the home mortgage
  + Holding: §1322(b)(2) applies to the whole mortgage, so DR cannot re-write/modify the unsecured portion after §506(a) bifurcation
* When does the special §1322(b)(2) protection apply?
  + ONLY when home mortgage is secured by only the DR’s principal residence
    - Key word in §1322(b)(2) special protection = ONLY
    - Note: standard additions to security interests for mortgages ok (such as insurance on the house)
  + NOT when mortgage is secured by things beyond the principal residence
    - Examples: SI on things in the house (paintings/computers), fixtures (e.g. microwave attached to the wall)
* Wilson v. Commonwealth Mortgage Co
  + Facts: Mortgage is secured by DR’s residence and “any and all appliances, machinery, furniture, equipment now or hereafter installed on premises”
  + Holding: 1322(b)(2) exception does not apply to this mortgage because it is not only secured by the DR’s principal residence
  + Note: 1322(b)(2) protection also does not apply to a mortgage that is secured by a vacation home (rather than DR’s primary residence)
    - NOT when mortgage is secured by another residence that is not DR’s primary residence (e.g. beach house). In this case, mortgage on the beach house can be written down/stripped down and bifurcated into secured and unsecured claims
* What happens if entire second mortgage is under water?
  + Note: second mortgages (often called “home equity loans”) are very common. Double-edged sword—way to consolidate other types of debt and get a lower interest rate. Problem is that it pulls DR into §1322(b)(2), which means you cannot re-negotiate down these claims and it may cost you your house.
  + Some courts say DR can stripdown a second mortgage that is totally under water -as opposed to under secured-(*Tanner*), but Skeel suggests that it is unclear given *Caulkett* (holding that *Dewsnup*’s policy of a lien riding through bankruptcy applies to a fully underwater lien) means it is no longer so clear that you can allow stripdown for fully underwater mortgage
  + Argument still allow stripdowns:
    - Not so inclined to fuel the second mortgage market. So might conclude that we do not really want to help that market and so we should still allow the stripping down of fully underwater second mortgages
  + Argument not to allow stripdown:
    - Completely underwater mortgage is not a really allowed secured claim (ct rejected this arg in Caulkett)

### Hypothetical - Mortgage Write-Down

* Setup - House worth 75k
  + First Mortgage = 100k.
  + Second Mortgage = 50k. (completely underwater)
  + Mortgage 1 is a mortgage on the house, computers in the house, painting.
  + Mortgage 2 is exclusively secured by home
* Question: Is the DR going to be able to write down the mortgages on the house in Chapter 13 case?
  + **Yes**, §1322(b)(2) protection for home mortgages does not apply here because the mortgage is secured by more than just the DR’s primary residence (also secured by the computers, painting)
* Can you stripoff Mortgage 2 (completely underwater)?
  + This depends: *Tanner* would say yes, but Skeel believes *Caulkett* decision suggests otherwise

# Chapter 11 -Corporate Reorganization

## Key Provisions

* **§1104(a) - Allows for appointment of a Trustee if necessary in Ch. 11 case**
* **§1104(c) - Examiners**
* **§1102 - Creditor’s Committee**

### §1107 - Debtor-in-Possession

* Subject to any limitations of trustee, debtor in possession shall have all the rights (except that to compensation) and powers to perform all functions and duties of the trustee
  + D.I.P. financing agreements of contracts have emerged and curtailed the freedoms that debtor of a possession has

### §1121 - Proposing the Plan (DIP exclusive agenda control for at least first 120 days)

* For the first 120 days, only DR may file a plan. If DR files a plan within 120 days of filing for bankruptcy, DR has 60 additional days (ending 180 days from filing petition) to obtain acceptance of the plan
* §1121(d) -- Court can reduce/increase these periods, but exclusive periods cannot be extended beyond 18 months (for 120 day period) and 20 months (for 60 day period)

### §1122 - Classification of Claims

* DR may classify CR into classes, which function as voting units
* Important because voting on acceptance/rejection of plan is done by classes
* Requirements:
  + Claims/interests may be placed in a class only if such claim/interest is “substantially similar” to other claims/interests of the class
    - Substantially Similar: includes equal priority rank in liquidation
  + All claims/interests in a class must be treated alike
* US Trucking: some differences between CRs treated equally can warrant classification in different classes
* Greystone: DR cannot strategically classify classes just to gerrymander an affirmative vote on a reorganization plan

### §1126(c) - Voting on a Ch. 11 Plan

* A class of claims has accepted a plan if such plan has been accepted by…
  + (1) Creditors that hold at least 2/3rd in amounts AND
  + (2) Represent more than ½ the number of the allowed claims of such class held by CRs that have accepted or rejected such plan
* Note: only impaired classes vote. Unimpaired classes are deemed to accept plan
* Figter: a CR with multiple claims gets to vote his claims independently (e.g. if have two claims, have two votes)

### §1124(1) - “Impairment” (could mean CRs receiving less than amount of their claim; getting different value for their claim -like shares/stock in reorganized company instead of money)

* Note: important because only impaired classes vote. Unimpaired classes are deemed to accept plan.
* Broad definition, which includes almost all claims/interests in chapter 11 reorganization
* “Impairment is present UNLESS plan leaves unaltered rights of holder”
* Only NOT impaired if rights are (1) unaltered or (2) there is a cure for DR’s default
  + “Cure”--Cash payments may not be considered a cure if under the terms of the agreement the CR was going to receive payments over a period of time with interest. Arguably a CR paid in full under Ch. 11 would still be an impaired class because under loan agreement would have received more (i.e. would’ve received the interest also)
  + Skeel: for our purposes assume that a CR that is paid in full in cash is NOT impaired even though some of the caselaw says otherwise

### §1126(e) - Disqualification of Votes for Plan

* Designate = disqualify
* Allows court to disqualify vote accepting or rejecting plan that was not done in good faith after a motion by party, notice, and a hearing
* What counts as bad faith/ulterior motive?
  + Buying blocking position in several classes to prevent confirmation of a compelling plan
  + Attempt to get more than CR rightly deserves (obtain benefits they are not entitled to)
  + Attempt to block plan in favor of their own competing plan
* Note: CR not necessarily acting in bad faith if motivated by desire to protect their own interests (Figter)

### §1129(a) - Consensual Plan

* §1129(a)(3) - Good Faith Requirement
  + Note: CR acting self-interestedly to preserve his claim is not necessarily acting in “bad faith.” Only reaches level of bad faith when CR is demanding things he is not entitled to
* §1129(a)(7) - Best Interest Test
  + If a plan is approved by all impaired classes of claims/interests in §1126(c) and (d), dissenting members of each class are bound so long as they best interest test is met
  + Best Interest Test Analysis: dissenters must receive at least as much as they would have received under a Chapter 7 liquidation plan
* §1129(a)(8) - Requirement that all classes have to vote yes
* §1129(a)(10) - If any impaired classes of CRs, at least one impaired class has to vote yes
  + Note: this requirement doesn’t matter for an (a) -consensual plan because you also still have (a)(8) requirement that ALL classes vote yes. This matters for a cramdown/non-consensual plan because no matter when, there still must be at least ONE impaired class that votes yes to confirm a plan
* §1129(a)(11)-Feasibility requirement for the plan

### §1129(b) -- Non-Consensual Plan [Cramdown]

* Have to meet all requirements of §1129(a) EXCEPT (a)(8)-unanimous voting requirement
  + (a)(3) - Good Faith Requirement
  + (a)(7) - Best Interest Test
  + (a)(10) - If any impaired classes of CRs, at least one impaired class has to vote yes
    - Note: An impaired class that contains an insider is ineligible to satisfy this requirement. An impaired class of “interests” also does not count (e.g. class of stockholders)
  + (a)(11)-Feasibility requirement for the plan
* Cannot discriminating unfairly
  + I.e. cannot treat one class differently than another even though they are comparable
  + Basic rules: similarly situated CR must receive similar treatment; all claims classified together must be treated alike; laws against treating any particular CRs poorly
* Absolute Priority Rule
  + If a class objects, cannot give anything to lower down groups
  + Negative implication that parties can agree to take less than entitled to
* Note: there was a cramdown in the Detroit bankruptcy and people weren’t happy. Argument that the plan discriminated unfairly because it gave pension-holders more than similarly situated CRs

### §1129(b)(2)(B) - Absolute Priority Rule

* If class of unsecured CRs objects, lower classes get NOTHING
* This rule bars junior interest holder’s receipt of any property on account of his prior interest
  + Normally dealing with shareholders who get value in reorganized company based on prior position as shareholder
* Note: some jurisdictions follow the new value exception, whereby existing equity holders can retain equity in reorganized company by having their equity interest valued and contributing this amount of cash to DR for use under plan
* §363(c)(1) - Sale/Lease of Property In Ordinary Course
  + Debtor-in-possession may sell/lease property of estate without court approval if done in the ordinary course of DR’s business (without notice to CRs or court authorization)
    - Allows DR in business of selling goods/leasing equipment may continue to operate after filing
    - Should allow DR to continue selling/leasing on same terms it employed before filing OR same terms generally followed in the industry
* §363(b)(1) - Going Concern Sales under §363
  + If debtor-in-possession wants to sell/lease property of estate “other than in the ordinary course of business,” it can do so after notice and a hearing
  + E.g. Chrysler case

## Key Players in Chapter 11 Case

* Debtor-In-Possession (§1107)
  + Has trustee powers, like avoiding preferential transfers or fraudulent transfers it made as a DR before bankruptcy
    - Premised on assurance that the officers and managing employees can be relied on to carry out fiduciary responsibilities of the trustee
  + Does NOT investigate its own past conduct
  + Only one who can propose a reorganization plan within the first 120 days of the case (gives the managers agenda control for at least the first 4 months of the case and potentially for longer. Capped at 18 months)
* Trustee (§1104(a))
  + A trustee is only appointed in Ch. 11 case if absolutely necessary. This occurs in exceptional cases when there has been cause (including fraud, dishonesty, incompetence, gross mismanagement of affairs by current management)
  + Appointment is done by US Trustee unless trustee is elected by creditors but a 20% vote
  + Can appoint trustee if it is in the best interests of CRs, estate, etc.
  + Can appoint trustee instead of dismissing a case
* Examiner (§1104(c))
  + Instead of appointing a trustee in chapter 11 case, courts may appoint an examiner who is seen as a middle ground
  + Role/Duties:
    - Can be limited to investigation powers or expanded to include almost all functions of trustee
    - Generally would look for preferences, fraudulent conveyances, accounting inconsistencies, look into behavior of high level officials
  + Examiner can be appointed on request of a party if…
    - (1) Appointment is in the interests of CRs, any security holders, or the estate OR
    - (2) Unsecured non-trade and non-insider claims exceed $5M
    - May be appointed when negotiations between parties reach an impasse
* Creditor’s Committee (§1102)
  + Generally comprised of persons holding the 7 largest unsecured claims
  + Act as primary negotiating body for reorganization effort
  + Powers of Creditor’s Committee:
    - Serve as a voice for unsecured CRs
    - Negotiate with debtor-in-possession about terms of reorganization plan
    - Propose rival plan (after DR exhausts his statutory exclusivity period)
    - Carry out investigations of DR’s financial condition
    - Can prosecute estate causes of action
    - Can employ professionals to carry out these functions
  + Note: fees incurred would be expenses of administration

## Proposing/Accepting the Chapter 11 Reorganization Plan

### Two ways for Ch 11 plan to be approved

* (1) Consensual Plan (§1129(a))
  + §1129(a)(3) - Good Faith Requirement
    - Note: CR acting self-interestedly to preserve his claim is not necessarily acting in “bad faith.” Only reaches level of bad faith when CR is demanding things he is not entitled to
  + §1129(a)(7) - Best Interest Test
    - If a plan is approved by all impaired classes of claims/interests in §1126(c) and (d), dissenting members of each class are bound so long as they best interest test is met
    - Best Interest Test Analysis: dissenters must receive at least as much as they would have received under a Chapter 7 liquidation plan
  + §1129(a)(8) - Requirement that all classes have to vote yes
  + §1129(a)(10) - If any impaired classes of CRs, at least one impaired class has to vote yes
    - Note: this requirement doesn’t matter for an (a) -consensual plan because you also still have (a)(8) requirement that ALL classes vote yes. This matters for a cramdown/non-consensual plan because no matter when, there still must be at least ONE impaired class that votes yes to confirm a plan
  + §1129(a)(11)-Feasibility requirement for the plan
* (2) Non-Consensual Plan (§1129(b)) (Cramdown)
  + Have to meet all requirements of §1129(a) EXCEPT (a)(8)-unanimous voting requirement
  + §1129(a)(3) - Good Faith Requirement
  + §1129(a)(7) - Best Interest Test
  + §1129(a)(10) - If any impaired classes of CRs, at least one impaired class has to vote yes
    - Note: An impaired class that contains an insider is ineligible to satisfy this requirement. An impaired class of “interests” also does not count (e.g. class of stockholders)
  + §1129(a)(11) - Feasibility requirement for the plan
  + Cannot discriminating unfairly
    - I.e. cannot treat one class differently than another even though they are comparable
  + Absolute Priority Rule
    - If an unsecured class of creditors objects, cannot give anything to lower down groups
    - If a class is not paid in full, junior creditors cannot receive anything (stockholder interests are always junior to any class of claims)
    - Shareholders are not allowed to keep their equity interest in reorganized Ch. 11 unless unsecured CRs class consents (§1129(a)) OR is paid in full over the life of the plan
    - This is because priority rules designate unsecured CRs above equity holders
    - Incentive for DR who wants to allow continued equity participation to offer plan that unsecured creditor classes will accept
    - Negative implication that parties can agree to take less than entitled to
  + §1129(b)(2)(B)(iii) - bars junior interest holder’s receipt of any property on account of his prior interest

### Possible Objections CRs Could Raise to Ch. 11 Plan

1. Plan doesn’t satisfy the §1129(a) requirements or §1129(b) requirements for confirmation
2. Best interest of CRs problem
   * Note: any objecting creditor can raise best interest objection even if their class as a whole votes yes to the plan
3. Good faith problem
4. Feasibility Issue
   * Note: feasibility becomes an issue when company is not writing down their debts enough (aka coming out of bankruptcy with too much debt)
5. Classification of CRs problem
6. Violation of absolute priority rule

### Who is Eligible to Vote for Proposed Ch. 11 Plan?

* Impaired classes only (for Skeel’s purposes NOT classes that are paid in full in cash)
* CRs can buy/sell claims and then have number of votes that corresponds to number of claims CR holds
* *In Re Figter Limited*
  + Facts:
    - DR: Figter (apartment complex)
    - CR: Teachers (secured CRs who thought it was partially unsecured)
    - DR proposed a plan Teachers did not like. Teachers bought 21 of 23 unsecured claims in Class 3 to vote down plan. Already was the only CR in Class 1.
  + Arguments:
    1. Teachers should be disqualified from voting in Class 3 because acted in bad faith
    2. Even if Teachers acted in good faith, it cannot vote on 21 claims separately
  + Holding:
    - Teachers acted in good faith. Acted to protect its genuinely believed valid interest as CR. Not ulterior motive
    - Teachers could vote each of its 21 claims separately because §1126(c) talks in terms of number of claims not number of CRs

### Business Justification Test - Second Guessing DR’s Classification of Creditors (*US Truck* / *Greystone*)

* Limitations on DR’s Ability To Classify Similar Claims Differently:
  + DR cannot classify similar claims separately just to gerrymander the vote and ensure an impaired class will vote yes [Greystone]
  + DR can classify similar claims separately if there are legitimate business justifications for doing so [Greystone]
    - DR can classify similar claims separately if groups of claimants have significantly different non-creditor interests that might affect their votes [US Trucks]
* *In Re US Truck Co*
  + Facts: CRs (Teamsters) argue DR does not meet requirements for plan acceptance because DR improperly classified claims by not putting T’s claim in same class as others with similar interest. Contend DR did this strategically so that it would have at least one class of impaired creditors’ approval of plan
  + Issue: can a DR keep a CR from joining a class of similarly situated CRs?
  + Holding: there were some differences between Teamsters’ claim and others in desired class making classification DR chose appropriate
* *Matter of Greystone III Joint Venture*
  + Facts: Single asset real estate case. CR (Phoenix) is under-secured. DR classified Phoenix’s deficiency claim in separate class from other trade unsecured claims to make sure it could use cramdown powers (secure one impaired class’s approval)
  + Holding: cannot classify similar claims differently in order to ensure an affirmative vote on a reorganization plan
  + Note: tenants were not an impaired class (could not actually vote) because DR assumed their leases, which meant that they did not hold “claims” against DR (only would hold claims against DR if DR rejected their leases)
  + Skeel: this doesn’t tell us specifically what is ok, just says that there are some limits on DR’s ability to separate CRs into classes

### Absolute Priority Rule (§1129(b)(2)(B))

* Each member of a senior class of claims/interests must receive full compensation before members of a junior class or equity holders could receive anything
  + Note: if class of impaired CRs (those who technically receive something different than what they bargained for) is paid in full, class will not have an absolute priority rule violation
* Absolute priority rule applies in Ch. 11 to a class of claims/interests that rejects the plan
* What does the absolute priority mean for shareholders?
  + Shareholders are not allowed to keep their equity interest in reorganized Ch. 11 unless unsecured CRs class consents (§1129(a)) OR is paid in full over the life of the plan
  + This is because priority rules designate unsecured CRs above equity holders
* New Value Exception To Absolute Priority Rule:
  + New value exception allows existing equity holders to retain or buy back their equity in the DR by having the equity interest valued and contributing this amount of cash to DR to be used under the DR’s plan
* Three Main Approaches
  + Reinhardt Approach
    - Old owners can retain interest in reorganized entity IF…
      * Owner makes a capital contribution that is new, substantial, money/money’s worth, necessary for successful reorganization, reasonably equivalent to the value of interest received
      * DR’s plan may give old owners exclusive right to purchase ownership interest in new entity
  + Easterbrook Approach
    - Leaves the question to CRs. When there is value to be gained by allowing a lower class to kick in new value and keep its interest, the CRs should be willing to go along with it
  + *Bank of America v. 203 North LaSalle*
    - Issue: whether a DR’s pre-bankruptcy equity holders may, over the objection of a senior class of impaired CRs, contribute new capital and receive ownership interests in reorganized entity?
    - Holding: cannot provide equity holders with exclusive opportunity free from competition and without benefit of market valuation
    - §1129(b)(2)(B)(iii) - bars junior interest holder’s receipt of any property on account of his prior interest
    - Note: seems to take market test view (like Reinhardt except no exclusive right to purchase equity in new entity)

## §363 Sales - Possible Alternative to Full CH. 11 Reorganization

### §363(c)(1) -Sale/Lease of Property In Ordinary Course

* Debtor-in-possession may sell/lease property of estate without court approval if done in the ordinary course of DR’s business (without notice to CRs or court authorization)
  + Allows DR in business of selling goods/leasing equipment may continue to operate after filing
  + Should allow DR to continue selling/leasing on same terms it employed before filing OR same terms generally followed in the industry

### §363(b)(1) - Going Concern Sales under §363

* If debtor-in-possession wants to sell/lease property of estate “other than in the ordinary course of business,” it can do so after notice and a hearing
* Common approach now. Beauty of these sales is that you can fix the financial distress situation quickly and easily without going through the whole confirmation of a plan mess
* E.g. Chrysler case
* *In Re Chrysler* (2nd Cir)
  + §363(b) sale OK even if DR selling all assets so long as “good business reason” for doing so
  + Facts: Old Chrysler wanted to sell all assets to New Chrysler (set up for this) for $2B.
  + Complaint: Circumventing reorganization through this sale /sub rosa plan of reorganization
    - Looks like a violation of absolute priority rule - higher priority CRs were owed 6.9B and got 2B and unsecured creditors got paid a lot more; suppliers were paid in full, retired union members got paid in full
    - Other argument - unfair discrimination (some unsecured claims get paid a lot others don’t); response to this: payment was being made by New Chrysler, not Old Chrysler and this doesn’t affect the value that was given
      * If Chrysler was worth over 2B, the value that was given because of this organization would have been different
  + Bankruptcy court granted motion to sell substantially all of DR’s (Chrysler’s) assets under §363(b)
  + Holding: §363(b) sale is ok even though it involved substantially all of DR’s assets
  + Satisfies “good business reason” requirement-- with its revenues were sinking, factories dark, massive debts growing, Chrysler fits within the melting ice cube standard
* *Lionell* - Business Justification for §363(b) Sale
  + Says there must be a business justification to go through a 363 sale rather than Ch. 11 reorganization
  + “Melting ice cube” argument - idea that if we don’t act quickly, the value will evaporate almost immediately (need to sell now because value is deteriorating rapidly and do not have time to wait for a full reorganization)
* *Braniff* - §363(b) Sale **Cannot** Be Used When Sub Rosa Plan Of Reorganization
  + Sub rosa plan of reorganization = disguised reorganization plan
  + Skeel: even though the second cir gave short change to this argument in Chrysler, Skeel thinks this is a sub rosa problem. Looks like a disguised reorganization plan. Why?
    - Part of the plan involved New Chrysler taking on some of Old Chrysler’s debts and agreeing to pay some of the unsecured CRs
      * E.g. VEBA 55%, $4.6B/Trade CRs $5.3B
    - Would have an absolute priority rule problem -Argument that it is really a reorganization plan because $2B sales price is going to the senior lienholders (secured CRs) while the other CRs (even unsecured CRs) are getting close to being paid in full.
  + Argument against sub rosa plan: this is a sale and $2B is really what the assets are worth. Further argument is that New Chrysler is free to do whatever they want so long as the $2B is a fair price. Can take on debts and it has nothing to do with the sale. Since there was a good business reason for the sale it is ok (court’s reasoning)

## Chapter 11 Summary HYPO

* Setup:
  + The Debtor has assets worth somewhere between $1000 and $3000. Debtor has three creditors: Bank, whom Debtor owes $1000, and who holds a perfected security interest in Debtor's equipment, which is worth $1000 at all relevant times; Union, whom Debtor owes $500; and Supplier, whom Debtor also owes $500
  + Debtor proposes a reorganization plan that classifies the parties as follows:
    - Class 1: This class consists of the Bank. Bank's $1000 loan to Debtor will be reinstated under the plan, all defaults will be cured, and the bank will retain its security interest in Debtor's equipment
    - Class 2: This class consists of both Union and Supplier
      * Each will receive 500 shares of stock in the reorganized debtor.
      * Note: since stock is different than what CRs went in with, they are still considered impaired even though technically it looks equal (gave $500 and get 500 shares)
    - Class 3: This class consists of the Debtor, who is the sole shareholder of Debtor
      * Debtor will retain 1000 shares in the firm after it is reorganized.

### Question One: If Bank and Union (and Debtor) favor the plan, but Supplier is unhappy with it, can the plan be confirmed over Supplier's objection? What objections could Supplier raise to the plan?

* Fail §1129(a)(8) requirement that every class of CRs must vote yes for a consensual plan
  + §1126(c) says that in order for a class to vote in the affirmative for a proposed plan, (2) more than 1/2 of number of CRs in the class AND (2) at least 2/3 in amounts of claims must vote yes.
  + Here, the Supplier is ½ of the CRs in the class and holds ½ of the amount of claims in that class. Thus, because of the Supplier’s opposition, Class 2 will not vote in favor of the plan. This precludes a unanimous vote
* Fails cramdown option in §1129(b) because no class of impaired CRs is voting yes. In this case, only Class 2 and Class 3 are impaired. Class 2 is going to vote not and Class 3 is ineligible to count as the one impaired class voting for the plan because the DR is an insider.
* Might have a best interest of CRs problem, but we would need to know what the business is worth/what a liquidation would bring and we don’t really know enough
* Might have a Good faith problem - probably IS in good faith. Hard to rebut
* Feasibility requirement problem - probably not. Since the value of the assets is btw 1-3k and Bank is owed only 1k, this plan is likely feasible.
  + Note: feasibility becomes an issue when company is not writing down their debts enough (aka coming out of bankruptcy with too much debt)
* Could make a classification argument - say it was inappropriate to create classes this way because a supplier and union are a little bit different by nature
* Answer: **This plan fails**
* Modification 1 - Suppose the DR proposes paying the Bank 1k in cash
  + Note: this potentially helps get the plan confirmed under the §1129(b) -cramdown option. Why? Because Class 1 (Bank) could be seen as an impaired class that is now eligible to vote on the plan. This is a very creative way for DR to get an impaired class to vote yes so the plan could be confirmed.
  + Skeel: we are going to assume that if a CR is paid in full, they are NOT impaired. Assume that even when a claim is bifurcated into a secured claim and unsecured claim (at least assume it is unimpaired for the secured portion of the claim).
* Modification 2 - Suppose the Supplier is indifferent to the plan. Hedge fund comes around and wants to buy claims (wants to purchase distressed debt strategically)
  + What should the hedge fund do?
    - Might want to buy enough claims to force a unanimous vote yes for a favorable plan. At a minimum, would want to buy at least 334 shares because then the hedge fund would have veto power over a consensual plan it didn’t like (334 shares is a little over 1/3 of the amount of claims so couldn’t get the 2/3 vote required for an affirmative vote).
      * Note: court can disqualify votes under §1126(e) if it seems like they are just buying a blocking position. Hedge fund would need to be careful. Buying debt in bankruptcy is fine, but it is not fine to buy just to blow up a favorable plan.
    - Hedge fund wants to target the fulcrum class - the highest priority unsecured class that is NOT getting paid in full. If CRs are paid in full, they are not impaired and cannot vote so hedge fund’s desire to buy debt to control reorganization plan will be futile
* Modification 3: Suppose hedge fund buys 5 claims from suppliers (only 5 supplier claims) and half of the Union claim. Now have 750 out of 1000 in amount
  + Does hedge fund have control over Class 2? YES, could guarantee a vote/confirmation of plan under §1129(b) cramdown option because because now hedge fund would have a majority in number and over 2/3 in amount
  + When hedge fund buys five of the supplier claims, that is five claims (and five votes), not one. Focus is on number of claims, not claim holders
  + Note: It is claims, not claim-holders, that is important in voting context (§1126; *Figter*)

### Question 2: If Debtor amends the reorganization plan, and puts Union and Supplier in separate classes (but does not otherwise change their treatment-- ie, each still would receive 500 shares of stock in the reorganized debtor), could the amended plan be confirmed over Supplier's objection

* Amended re-org plan
  + Class 1: Bank (loan repaid)
  + Class 2: Union (500 shares)
  + Class 3: Supplier (500 shares)
  + Class 4: DR (1000 shares)
* Why might a DR do this?
  + If DR knew that the Suppliers would reject the plan and the Union would vote in favor of it, might separate the two to ensure that at least one impaired class of CRs votes yes and satisfy §1129(b) -cramdown option
* What would be the Supplier’s objections?
  + Improper classification - unclear
    - Could say that the union and suppliers can be separated even though they are treated the same because they have different interests. Union comprised of employees who arguably have a greater interest in the reorganization of the corporation than suppliers (US Truck-DR’s classification of CRs is ok it makes sense/there is a business justification)
    - Could say that DR cannot classify just to gerrymander vote (Greystone - cannot separate unsecured CR and Bank’s deficiency claim which are treated the same just to get a favorable class vote)
    - Note: this classification looks odd if trying to argue Class 3 /4 are different kinds of creditors because they are given the same treatment. DR could signal a difference between the two groups of CRs by giving them different treatment. YET, this may raise a disco problem (discriminating unfairly).
  + Absolute priority rule problem --
    - Absolute priority rule: if class of CRs objects, cannot give any classes below the objecting CRs anything
    - Here, it might be a problem that Class 4 (DR who is given 1000 shares) gets anything because Suppliers (in Class 3) objected
    - But, this scenario might fit into the new value exception to the absolute priority rule
      * If DR gave new money, may be able to retain shares despite a seeming absolute priority violation. SCOTUS never said for sure that the new value rule was legitimate. OK based on market test (if there was an auction). Might be OK if DR waived exclusivity (aka others had an opportunity to put up the new value)
    - Note: only way this scenario would not violate absolute priority rule without new value exception is if the above classes were being paid in full
      * So, Supplier would have to be paid in full ($500). 500 shares would have to be $500. Possible only if the value of this company is at the high end of the range because have 2,000 shares and 1k payment required
    - Wouldn’t ask this q: Does this plan violate the absolute priority rule? Value of company is somewhere between1K and 3K dollars, but if DR is worth anything less than 3K, this wouldn’t satisfy absolute priority rule; would only satisfy the absolute priority rule if supplier was paid in full; if assets were worth 3K, Union and Supplier would be paid in full (even though Supplier’s class is voting no, they’re being paid in full)
      * Absolute priority rule: if a class votes no, either it has to be paid in full or nobody beneath it can get anything
    - If the supplier had 5x $100 claims, the hedgefund would want to purchase at least 4 of them in order to get the 2/3 of the amount of the total claims (would count as 4 claims not 1 bundled claim, under Figter)
* Suppose DR promises a cash contribution of $250 to the reorganization in exchange for keeping half of its stock (*La Salle*) - new value exception
* Needs to be some sort of market test - hard to know if what DR is contributing is equitable, which is why this requirement exists
  + Two ways to satisfy (with some uncertainty)
    - Let other people bid on the stocks
    - If debtor waived exclusivity, the prospect of competing plans might justify a new value contribution