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The Ascendance of Common Law and the Demise of Equity in Bankruptcy

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The Ascendance of Common Law and the Demise of the Court of Equity

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Wisdom from the Supreme Court

'No objectively reasonable basis' is the high court standard to find civil contempt for violating the discharge injunction.

Supreme Court Rejects Strict Liability for Discharge Violations

Today, the Supreme Court rejected a strict-liability standard for the imposition of contempt for violating the discharge injunction. Instead, the justices held unanimously that the bankruptcy court "may impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order."

The opinion for the Court by Justice Stephen G. Breyer also rejected the Ninth Circuit's idea that a subjective, good faith belief about the inapplicability of the discharge injunction is a defense to contempt. It is unclear from the opinion whether the Court's standard for a discharge violation also applies to violations of the automatic stay under Section 362.

A Discharge Violation Was Unclear

The procedural history of the case in the lower courts was exceptionally complex. Suffice it to say that the debtor had transferred his interest in a closely held corporation. After the debtor received his chapter 7 discharge, two other shareholders sued him in state court for transferring his interest without honoring their contractual right of first refusal. They also sued the transferee of the stock.

After the debtor raised his discharge as a defense in state court, the parties agreed he would not be liable for a monetary judgment. The state court eventually ruled in favor of the creditors and unwound the transfer.

The creditors then sought attorneys' fees as the prevailing parties, invoking a fee-shifting provision in the shareholders' agreement. The state court ruled that the debtor "returned to the fray" and thereby made himself liable for post-discharge attorneys' fees.

Meanwhile, the debtor reopened his bankruptcy case, seeking to hold the creditors in contempt for violating the discharge injunction. The bankruptcy judge sided with the debtor and imposed sanctions. The Bankruptcy Appellate Panel reversed the finding of contempt, ruling that the creditors' good faith belief that their actions did not violate the injunction absolved them of contempt.

Meanwhile, the state appellate court and a federal district court in related litigation both ruled that the debtor's participation in the litigation did not constitute returning to the fray, thus taking away the grounds for imposing attorneys' fees and lending credence to the notion that the creditors did technically violate the injunction.

In sum, judges disagreed over whether the discharge injunction applied to the litigation to recover attorneys' fees.

The debtor appealed the BAP's opinion to the Ninth Circuit, where Circuit Judge Carlos T. Bea upheld the BAP in April 2018 and found no contempt. However, he expanded the defense available to someone charged with contempt of a discharge injunction. The appeals court held that "the creditor's good faith belief that the discharge injunction does not apply to the creditor's claim precludes a finding of contempt, even if the creditor's belief is unreasonable."

The debtor filed a petition for *certiorari*, which the Supreme Court granted in January. Oral argument was held on April 24.

The Standard Borrowed from Equity

In his 11-page opinion, Justice Breyer said the outcome was informed by Section 524(a)(2), the statutory discharge injunction, and by Section 105(a), the bankruptcy version of the All Writs Act.

Those two sections, according to Justice Breyer, "bring with them the 'old soil' that has long governed how courts enforce injunctions." The "old soil," he said, includes "the traditional standards in equity practice for determining when a party may be held in civil contempt for violating an injunction."

Justice Breyer cited Supreme Court precedent from 1885 holding that civil contempt should not be found "where there is [a] *fair ground of doubt* as to the wrongfulness of the defendant's conduct." *California Artificial Stone Paving Co. v. Molitor*, 113 U.S. 609, 618 (1885) (emphasis added by Justice Breyer).

Justice Breyer then cited *Schmidt v. Lessard*, 414 U.S. 473, 476 (1974) (*per curiam*), for the notion that "principles of 'basic fairness requir[e] that those enjoined receive explicit notice' of 'what conduct is outlawed' before being held in civil contempt."

Although subjective intent is not "always irrelevant," Justice Breyer said, "This standard is generally an *objective* one." [Emphasis in original.] Again citing high court precedent, he said that "a party's good faith, even where it does not bar civil contempt, may help determine an appropriate sanction."

Given that the "typical discharge order entered by a bankruptcy court is not detailed," Justice Breyer held that civil contempt "therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope."

The Rejected Standards

Justice Breyer rejected the Ninth Circuit's "good faith belief" standard. Recognizing the realities of life for debtors, he said that the rule proposed by the circuit court "may too often lead creditors who stand on shaky legal ground to collect discharged debts, forcing debtors back into litigation (with its accompanying costs) to protect the discharge that it was the very purpose of the bankruptcy proceeding to provide."

On the other hand, he also rejected a strict-liability standard that would authorize a contempt finding "regardless of the creditors' subjective beliefs about the scope of the discharge order, and regardless of whether there was a reasonable basis for concluding that the creditor's conduct did not violate the order."

In support of strict liability, the debtor argued that a creditor can turn to the bankruptcy court for a so-called comfort order declaring that a proposed action would not violate the discharge injunction. To that, Justice Breyer said that a "risk averse" creditor would seek a comfort order "even when there is only a slight doubt" about a violation of discharge. Often, he said, there will "be at least some doubt as to the scope of" the discharge.

Frequent use of comfort orders, Justice Breyer said, would run contrary to Section 523(c)(1), where only three categories of debts require advance determinations of dischargeability.

Frequent resort to comfort orders, according to Justice Breyer, would "alter who decides whether a debt has been discharged, moving litigation out of state courts, which have concurrent jurisdiction over such questions, and into federal courts."

Because the Ninth Circuit had not employed the proper standard, the Justice Breyer vacated the judgment of the appeals court and remanded "the case for further proceedings consistent with this opinion."

What About the Automatic Stay?

Does the Supreme Court's standard for contempt of the discharge injunction also apply to violations of the automatic stay under Section 362(a)?

Justice Breyer said that the language in Section 362(k)(1) "differs from the more general language in Section 105(a)." Section 362(k)(1) allows an individual to recover actual damages,

costs, attorneys' fees and even punitive damages (in "appropriate circumstances") for "any willful violation" of the automatic stay.

The debtor argued that lower courts have often imposed strict liability for violating the automatic stay. Coupled with the different purpose of the automatic stay, the absence of the word "willful" in the discharge context prompted Justice Breyer to reject the idea of importing lower courts' standards for violation of the automatic stay to contempt of the discharge injunction.

Parenthetically, Justice Breyer noted that the use of "willful" in Section 362(k)(1) is "a word the law typically does not associate with strict liability." However, he ducked the question, saying that "[w]e need not, and do not, decide whether the word 'willful' supports a standard akin to strict liability."

Although the Court made no holding about automatic stay violations, Justice Breyer's parenthetical observation can lay the foundation for contending there is also no strict liability for stay violations.

So, the question remains: Is the contempt standard different for automatic stay violations?

Craig Goldblatt of Wilmer Cutler Pickering Hale & Dorr LLP in Washington, D.C., observed that "the Code sets out a standard for the stay but not the discharge injunction. Bankruptcy lawyers think they serve a similar role and so read them to be parallel. But there is no textual basis for that."

"In the absence of text," Goldblatt said in a message to ABI, "the Court says you read the discharge injunction just like you would any injunction outside of bankruptcy. That is all that he needed to say to resolve this case. Because it is not a case about the automatic stay, it presented no basis to opine on how the automatic stay works."

Goldblatt therefore concluded, "*Taggart* has nothing at all to do with the automatic stay." He has argued three bankruptcy cases in the Supreme Court.

Assuming the Court said nothing about automatic stay violations with respect to individuals, what about violations of the stay protecting corporate debtors where there is no statutory standard like 362(k)(1)? Does the absence of a statutory standard for corporate debtors throw the issue back to common law regarding injunctions?

However, the standards may be different, because, as Justice Breyer observed, the automatic stay has a shorter duration and a different purpose in preventing disruptions in the administration of bankruptcy cases.

The high court's ruling on discharge violations may touch off decades of litigation over the standard for deciding whether someone violated the automatic stay.

The opinion is *Taggart v. Lorenzen*, 18-489, 2019 BL 202691, 2019 US Lexis 3890 (Sup. Ct. June 3, 2019).

Supreme Court gets around to overruling* Lubrizol *almost 35 years later.

Licensee May Continue Using a Trademark after Rejection, Supreme Court Rules

Today, the Supreme Court handed down its decision in *Mission Product Holdings Inc. v. Tempnology LLC*, 17-1657 (Sup. Ct.), reversed the First Circuit and held that rejection of an executory trademark license does not bar the licensee from continuing to use the mark. As Justice Elena Kagan said, "A rejection breaches a contract but does not rescind it."

The opinion was almost unanimous, with Justice Neil M. Gorsuch dissenting; he believes the petition for *certiorari* should have been dismissed as improvidently granted. In his view, the Court could not grant effective relief.

Justice Sonia Sotomayor wrote a concurring opinion to say that nondebtor parties to rejected trademark licenses may have more rights following rejection than parties to other types of intellectual property licenses whose rights are limited by Section 363(n).

The Court granted *certiorari* in October to resolve a split of circuits.

The Circuit Split

It took decades, but the Supreme Court ruled on May 20 that the Fourth Circuit was wrong almost 35 years ago when it held that rejection of an executory license for intellectual property precludes the nonbankrupt licensee from continuing to use the license. *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.*, 756 F.2d 1043 (4th Cir. 1985).

Lubrizol was subjected to withering criticism, prompting Congress three years later to adopt Section 365(n) and the definition of "intellectual property" in Section 101(35A). Together, they allow a nondebtor to continue using patents, copyrights and trade secrets despite rejection of a license.

Congress did not mention trademarks, leading most lower courts to interpret the omission as meaning that rejection cuts off the right to use trademarks.

In 2012, the Seventh Circuit differed with *Lubrizol* when it handed down *Sunbeam Products Inc. v. Chicago American Manufacturing LLC*, 686 F.3d 372 (7th Cir. 2012), and held that rejection does not preclude the continued use of a mark. According to Circuit Judge Frank Easterbrook, "nothing about this process [of rejection] implies that any other rights of the other contracting party have

been vaporized." If a licensor's breach outside of bankruptcy would not bar continued use of the mark, the same would hold true in bankruptcy after rejection by the licensor, he said.

In Tempnology's chapter 11 case, the debtor had granted the licensee a nonexclusive, nontransferable, limited license to use the debtor's trademarks. Following *Lubrizol*, the bankruptcy court rejected the license and ruled that the licensee could not continue using the license. The Bankruptcy Appellate Panel reversed, following *Sunbeam*.

The First Circuit reversed the BAP in January 2018. *Mission Product Holdings Inc. v. Tempnology LLC (In re Tempnology LLC)*, 879 F.3d 389 (1st Cir. Jan. 12, 2018).

In a 2/1 opinion, the First Circuit majority in *Tempnology* sided with *Lubrizol* and criticized *Sunbeam* for "largely [resting] on the unstated premise that it is possible to free a debtor from any continuing performance obligations under a trademark license even while preserving the licensee's right to use the trademark." The majority favored "the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise." To read ABI's discussion of the First Circuit's opinion in *Tempnology*, click here.

As it had done in the First Circuit, the debtor argued in the Supreme Court that allowing the licensee to continue using the trademark would force the debtor to continue shouldering the onerous burden of policing the quality of the licensee's use of the mark. Absent quality control, the debtor contended, the licensor abandons the mark, and it reverts to the public domain. Rejection frees the debtor from the burden of policing the mark and is thus a necessary adjunct to the power of rejection, according to the debtor.

Justice Kagan's Opinion

Mootness

Joined by all justices except Justice Gorsuch, Justice Kagan began by holding that the appeal was not moot.

Initially, the bankruptcy judge had only granted a plain, vanilla motion to reject the trademark license. Following rejection, the debtor returned to court, where the bankruptcy judge issued a declaration saying that rejection terminated the licensee's use of the mark. Later still, the license terminated by its own terms.

To counter the notion of mootness, the licensee contended that it had a claim for damages resulting from its inability to use the mark. The debtor responded by saying that the bankruptcy court had authorized distribution of the last funds in the estate. The licensee countered by saying it might prevail on the bankruptcy court to compel other creditors to disgorge distributions.

Justice Kagan held that the appeal remained "a live controversy." "If there is any chance of money changing hands, [the licensee's] suit remains alive." Citing the Court's precedent, she said that "courts often adjudicate disputes whose 'practical impact' is unsure at best, as when 'a defendant is insolvent.'"

The Merits: Rejection Isn't Rescission

Justice Kagan said that the text of Section 365 and "fundamental principles of bankruptcy law" lead to a conclusion that rejection is not rescission. In particular, she relied on Section 365(g), which provides that rejection "constitutes a breach of such contract" immediately before the filing of the bankruptcy petition.

Or "more pithily for current purposes," Justice Kagan said that "rejection is a breach." In turn, breach "means in the Code what it means in contract law outside bankruptcy."

As an example, Justice Kagan supposed that a debtor had leased a copy machine to a law firm. Were the debtor to reject the lease, she said the debtor could stop servicing the machine, but the debtor "cannot take it back."

Applying the same notion to trademarks, Justice Kagan said that "breach does not revoke the license or stop the licensee from doing what it allows."

Justice Kagan also bought into the idea that the power to reject does not convey the same remedies as avoidance actions, which, she said, are "exceptional cases in which trustees . . . may indeed unwind pre-bankruptcy transfers."

No Negative Inference from Section 365(n)

The debtor argued that the omission of trademarks from Section 365(n) meant that Congress intended for rejection to cut off use of a mark.

"Still," Justice Kagan said, "Congress's repudiation of *Lubrizol* for patent contracts does not show any intent to *ratify* that decision's approach for almost all others. Which is to say that no negative inference arises. Congress did nothing in adding Section 365(n) to alter the natural reading of Section 365(g) — that rejection and breach have the same results." [Emphasis in original.]

Aiding Reorganization

The debtor argued that it would be better able to reorganize if the court relieved it of the burden of policing the use of the mark. To that, Justice Kagan said, "The Code of course aims to make

reorganization possible. But it does not permit anything and everything that might advance that goal."

Justice Kagan said that Section 365 therefore does not "relieve the debtor of the need . . . to invest the resources needed to maintain a trademark. . . . The resulting balance may indeed impede some reorganizations, of trademark licensors and others."

For the Court, Justice Kagan held that rejection "has the same effect as a breach outside of bankruptcy. Such an act cannot rescind rights that the contract previously granted. Here, that construction of Section 365 means that the debtor-licensor's rejection cannot revoke the trademark license."

Danielle Spinelli, a former Supreme Court law clerk, represented the licensee. Douglas Hallward-Driemeier, a former Assistant Solicitor General, argued for the debtor. Assistant Solicitor General Zachary D. Tripp argued on behalf of the government in favor of reversing *Lubrizol*.

Justice Sotomayor's Concurrence

Justice Sotomayor said she concurred "in full." She wrote "to highlight two potentially significant features of today's holding."

First, Justice Sotomayor said the opinion does not mean that "every trademark licensee has the unfettered right to continue using licensed marks post rejection." The opinion may not apply, she said, if provisions in the license or "state law" might "bear" on continued use of the mark.

Second, and of greater significance, Justice Sotomayor said that the "holding confirms that trademark licensees' postrejection rights and remedies are more expansive in some respects than those possessed by other types of intellectual property." For instance, she said that licensees of patents, copyrights and four other types of intellectual property (which are covered by Section 365(n)) "must make all [their] royalty payments."

The Dissent

Dissenting, Justice Gorsuch said nothing about the merits. He would have dismissed the *certiorari* petition for having been improvidently granted.

The case should have been considered moot, Justice Gorsuch said, because the licensee "hasn't come close to articulating a viable legal theory on which a claim for damages could succeed. And where our jurisdiction is so much in doubt, I would decline to proceed to the merits . . . . [T]here is no need to press the bounds of our constitutional authority . . . ."

The Irony, Import and Utility of the Decision

For appellate jurisprudence, the inability of Justice Gorsuch to prevail in his view about mootness seems to mean that the Court can reach the merits even when the existence of a live controversy is in doubt.

James M. Wilton of Ropes & Gray LLP in Boston, one of the counsel for the debtor, told ABI that "the decision will enhance the negotiating leverage of trademark licensees vis a vis secured lenders and other creditors and make it more difficult for debtor-licensors to rebrand their businesses and reorganize."

In the very hypothetical that Justice Kagan mentioned, the bankruptcy of a lessor of personal property will not enable the debtor to use rejection as a means for recovering the equipment for lease to someone else at a higher price.

Ironically, some non-debtor third parties would now be better off had Congress not come to their aid. Section 365(n) is not the only Code provision where a party to a rejected contract or lease would have greater rights after *Mission Product*.

Judge Kagan mentioned real property leases, contracts for the sale of real property and time-share interests in Sections 365(h) and (i). Having balanced the interests of debtor and creditors in those sections, Congress could have given third parties fewer rights and remedies than they might otherwise have been found to have following *Mission Product*. Nonetheless, the certainty provided by Sections 365(h) and (i) is perhaps a fair trade-off.

The opinion is *Mission Product Holdings Inc. v. Tempnology LLC*, 17-1657, 203 L. Ed. 2d 876 (Sup. Ct. May 20, 2019).

Supreme Court says that activities not required by state law in nonjudicial foreclosure may be covered by the FDCPA.

Nonjudicial Foreclosure Is *Not* Subject to the FDCPA, Supreme Court Rules

The Supreme Court ruled unanimously today that nonjudicial foreclosure is not subject to regulation by the federal Fair Debt Collection Practices Act, known as the FDCPA, 15 U.S.C. § 1692-1692p.

The opinion for the Court by Justice Stephen G. Breyer contained an important caveat: Nonjudicial foreclosure is exempt from the FDCPA only with regard to actions *required* by state law.

The Circuit Split

After a homeowner defaulted on his mortgage, the lender hired a law firm, which gave notice that it was retained to conduct nonjudicial foreclosure under Colorado law. The homeowner responded with a letter purporting to invoke rights under Section 1692(g) of the FDCPA, which obliges a debt collector to halt collection activities until it provides the debtor with a "verification of the debt."

However, the law firm proceeded to initiate nonjudicial foreclosure. The homeowner then filed suit alleging violation of the FDCPA. The district court dismissed the suit, finding that the law firm was not a "debt collector" within the purview of the FDCPA. The Tenth Circuit affirmed, holding that merely enforcing a security interest through nonjudicial foreclosure is not governed by the FDCPA.

The circuits were split. The Fourth, Fifth and Sixth Circuits held that the FDCPA applies to nonjudicial foreclosure, while the Ninth and Tenth Circuits concluded that it does not. The Supreme Court granted *certiorari* on June 28, 2018, to resolve the split and heard oral argument on January 7.

The Statutory Provisions

The FDCPA applies to "debt collectors," defined in the first sentence of 15 U.S.C. § 1692a(6) as someone who "regularly collects or attempts to collect, directly or indirectly, debts owed . . . or due another." The definition makes the statute applicable to a law firm pursuing *judicial* foreclosure when the lender is entitled to a deficiency judgment.

The case turned on the meaning of the third sentence in Section 1692a(6), which applies to enforcement of security interests. "For the purpose of section 1692f(6) [governing the conduct of someone repossessing property nonjudicially]," the third sentence of Section 1692a(6) says that the "term [debt collector] also includes any person who uses [the mail or interstate commerce] in any business the principal purpose of which is the enforcement of security interests."

The third sentence applies to nonjudicial foreclosure. However, Section 1692f(6) does not impose all of the FDCPA's regulations on those who only enforce security interests. Section 1692f(6) only prohibits certain activities, such as threatening to repossess when there is no intention of repossessing or there is no right to repossess. The law firm was not alleged to have violated the proscriptions in Section 1692f(6).

The Unanimous Opinion

Writing for the Court, Justice Breyer said that the FDCPA would apply to nonjudicial foreclosure if the statute contained only the primary definition in the first sentence of Section 1692a(6). If the third sentence did not contain the reference to someone whose principal business "is the enforcement of security interests," he said that a person engaged in nonjudicial foreclosure proceedings "would qualify as a debt collector for all purposes," because foreclosure "is a means of collecting a debt."

Justice Breyer said that the primary definition of "debt collector" in the first sentence in Section 1692a(6) does not apply only to someone who attempts to collect from a debtor. Even if nonjudicial foreclosure were not a direct attempt to collect a debt, he said, "it would be an *indirect* attempt to collect a debt." [Emphasis in original.]

The third sentence in Section 1692a(6) changed the result, however. The phrase "[f]or the purpose of section 1692f(6)," Justice Breyer said, "strongly suggests that one who does no more than enforce security interests does *not* fall within the scope of the general definition. Otherwise why add this sentence at all?" [Emphasis in original.]

Justice Breyer also surmised that Congress did not intend for the FDCPA to be generally applicable to nonjudicial foreclosure "to avoid conflicts with state nonjudicial foreclosure schemes."

For "those of us who use legislative history to help interpret statutes," he said that "the history of the FDCPA supports our reading." He alluded to how competing versions of the bill would or would not have made nonjudicial foreclosure subject to regulation. The third sentence, he said, "has all the earmarks of a compromise: The prohibitions contained in Section 1692f(6) will cover security-interest enforcers, while the other 'debt collector' provisions of the Act will not."

Caveats in the Opinion

Justice Breyer added two caveats to say that specific acts in connection with nonjudicial foreclosure could conceivably be subject to the FDCPA, although nonjudicial foreclosure generally is not.

The homeowner argued that the third sentence applies only to a "repo man," meaning someone who repossesses personal property and has no interaction with the debtor. Judge Breyer rejected this contention, saying, "if Congress meant to cover only the repo man, it could have said so."

In the same paragraph, Justice Breyer went on to say it is "at least plausible that 'threatening' to foreclose on a consumer's home without having legal entitlement to do so is the kind of 'nonjudicial action' without 'present right to possession' prohibited by that section." He went on to say parenthetically, "We need not, however, decide precisely what conduct runs afoul of Section 1692f(6)."

Of greater significance, Justice Breyer said near the end of his 14-page opinion, "This is not to suggest that pursuing nonjudicial foreclosure is a license to engage in abusive debt collection practices like repetitive nighttime phone calls . . . ."

Because the case before the Court involved "only steps required by state law, we need not consider what *other* conduct (related to, but not required for, enforcement of a security interest) might transform a security-interest enforcer into a debt collector subject to main coverage of the Act." [Emphasis in original.]

The Concurring Opinion

Justice Sotomayor concurred in the opinion. Calling it "a close case," she said that Justice Breyer made "a coherent whole of a thorny section of statutory text." She was persuaded to concur because the third sentence would be superfluous "if all security-interest enforcement is already covered" by the first sentence.

Justice Sotomayor made two points: (1) "[T]oday's opinion does not prevent Congress from clarifying today's opinion if we have gotten it wrong," and (2) enforcing a security interest does not confer blanket immunity from the FDCPA.

"I would see as a different case one in which the defendant went around frightening homeowners with the threat of foreclosure without showing any meaningful intention of ever actually following through." In such a case, she said, there would be a question of whether the person was actually in the business of enforcing a security interest or "was simply using that label as a stalking horse for something else."

The case is *Obduskey v. McCarthy & Holthus LLP*, 17-1307, 139 S. Ct. 1029, 203 L. Ed. 2d 390 (Sup. Ct. March 20, 2019).

High court resolves a circuit split on Section 523(a)(2)(B) and the meaning of "financial condition."

A False Statement About One Asset Isn't Grounds for Nondischargeability

The Supreme Court resolved a split of circuits today by holding that a false statement about one asset must be in writing to provide grounds for rendering a debt nondischargeable under Section 523(a)(2).

The 15-page opinion by Justice Sonia Sotomayor focused primarily on the plain language of the statute and the meaning of the word "respecting." The opinion was unanimous, except that Justices Clarence Thomas, Samuel A. Alito Jr. and Neil M. Gorsuch did not join in a section of the decision where Justice Sotomayor buttressed her conclusion by relying on legislative history surrounding the adoption of the Bankruptcy Code in 1978.

The case pitted courts' aversion to those who lie against the statutory language and its history. In a sense, the result is akin to *Law v. Siegel*, 134 S. Ct. 1188 (2014), where the Supreme Court ruled that the bankruptcy court does not have a "roving commission" to do equity. In *Law*, the high court barred the imposition of sanctions by invading property made exempt by statute, even though the debtor persistently committed fraud.

A ruling the other way would have led to anomalous results. If a smaller lie about one asset could result in nondischargeability, a bigger lie about a debtor's entire net worth would provide no grounds for nondischargeability unless it were in writing.

While courts may not be favorably inclined toward debtors who lie orally to obtain credit, Congress made a decision in Section 523(a)(2)(B) that a materially false statement "respecting the debtor's . . . financing condition" must be in writing to provide grounds for nondischargeability of the related debt.

The Case Below

A client told his lawyers that he was to receive a large tax refund enabling him to pay his legal bills. The lawyers continued working, based on the oral representation.

Although the refund was smaller than represented, the client spent it on his business, falsely telling his lawyers that he had not received the refund. The lawyers continued working. Years later, they obtained a judgment they could not collect after the client filed bankruptcy.

Affirmed in district court, the bankruptcy judge held that the claim for legal fees was not discharged. The Eleventh Circuit reversed in a Feb. 15, 2017, opinion by Circuit Judge William Pryor, *Appling v. Lamar, Archer & Cofrin LLP (In re Appling)*, 848 F.3d 953 (11th Cir. Feb. 15, 2017). To read ABI's discussion of the Eleventh Circuit opinion, click here.

The creditor filed a petition for *certiorari*, which the Supreme Court granted on the recommendation of the U.S. Solicitor General, who later submitted an *amicus* brief supporting the debtor, arguing that the Eleventh Circuit was correct, and contending that an oral misstatement about one asset is a statement about "financial condition" that must be in writing before the debt can be declared nondischargeable.

The circuits were split. The Fifth and Tenth Circuit held that a false statement about one asset can result in nondischargeability, while the Eleventh Circuit had joined the Fourth in holding that a statement about any asset must be in writing to provide grounds for nondischargeability.

The justices heard oral argument on April 17.

Another 'Plain Language' Opinion

The creditor-petitioner argued that a statement about a debtor's overall financial condition is the only type of statement "respecting" financial condition that can result in nondischargeability under Section 523(a)(2)(B). According to the creditor, a lie about one asset is not about "financial condition." Rather, the law firm contended that a lie about one asset falls within the ambit of Section 523(a)(2)(A) and leads to a nondischargeable debt because it is a "false representation." Under (a)(2)(A), there is no requirement that a "false representation" be in writing before the debt can be nondischargeable.

As is her style, Justice Sotomayor was quick to the point. In the second paragraph of her opinion, she said that the "statutory language makes plain that a statement about a single asset can be a 'statement respecting the debtor's financial condition.'" If the statement was not made in writing, she said, "the associated debt may be discharged, even if the statement was false."

Justice Sotomayor said that the Bankruptcy Code does not define three critical terms: "statement," "financial condition," and "respecting." Only "respecting" was in dispute, she said.

Looking to several dictionaries, Justice Sotomayor said that "respecting" means "in view of: considering; with regard or relation to: regarding, concerning." At least in the context of the instant case, she said that "related to" does not have a "materially different meaning" than "about," "concerning," "with reference to," or "as regards." The words all have circular definitions, she said.

In the realm of statutory construction and drafting, Justice Sotomayor said that "respecting" "generally has a broadening effect" and "covers not only its subject but also matters relating to that subject." She rejected the notion that (a)(2)(B) only refers to overall financial condition, because that interpretation would read "'respecting' out of the statute."

Broadening her opinion further, she said that a statement is "respecting" financial condition "if it has a direct relation to or impact on the debtor's overall financial condition."

A narrower interpretation, according to Justice Sotomayor, "would yield incoherent results." For example, she said that a false statement, such as, "I am above water," could not result in nondischargeability unless it were in writing, while saying, "I have $200,000 in equity in my house" could lead to nondischargeability. "This, too, is inexplicably bizarre," she said.

Justice Sotomayor traced the language in the Bankruptcy Code to a phrase first adopted by Congress in 1926, which the circuits consistently interpreted to include even one of a debtor's assets. Having used the same word in the Bankruptcy Reform Act of 1978, she said that Congress "intended for it to retain its established meaning."

Justices Thomas, Alito and Gorsuch did not join in the last section of Justice Sotomayor's opinion, where she grounded the result in legislative history underpinning Section 523(a)(2)(B). She quoted from a 1995 Supreme Court decision citing the legislative history as saying that Congress drafted Section (a)(2) in a manner intended to prevent abuse by creditors who might otherwise trap debtors into making statements that could result in denial of discharge.

The opinion is *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 201 L. Ed. 2d 102, 86 U.S.L.W. 4362 (2018) (Sup. Ct. June 4, 2018).

Bankruptcy needs blanket judicial immunity from the Federal Arbitration Act after the Supreme Court's Schein decision.

Supreme Court Decision on Arbitration Has Ominous Implications for Bankruptcy

Justice Brett M. Kavanaugh wrote his first opinion for the Supreme Court in what *The New York Times* called a "minor arbitration case."

If Justice Kavanaugh's ruling in *Henry Schein Inc. v. Archer & White Sales Inc.* is applied rigorously in bankruptcy, it's a "really big deal," because bankruptcy judges will not be able to bar creditors from initiating arbitrations over "core" issues such as allowance of claims, objections to dischargeability of debts, and even adequate protection.

Indeed, *Schein* could be interpreted to mean that the bankruptcy court cannot bar a creditor from initiating arbitration against an individual or corporate debtor, even if the call for arbitration was frivolous.

'Wholly Groundless'

Schein was argued on October 29 and decided for the unanimous Court by Justice Kavanaugh on January 8. By contract, the parties agreed to arbitrate before the American Arbitration Association and according to AAA rules.

Later, the plaintiff filed suit under federal and state antitrust laws, seeking damages and an injunction. The contract called for arbitration "except for actions seeking injunctive relief . . . ." The rules of the AAA call for the arbitrator to decide issues of arbitrability.

Invoking the Federal Arbitration Act, 9 U.S.C. § 2, the defendant responded to the complaint by asking the district judge to refer the case to arbitration. Adopted in 1925, the FAA provides that a contract calling for arbitration "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

Following Fifth Circuit authority, the district court refused to compel arbitration, finding that the demand for arbitration was "wholly groundless" because the plaintiff was seeking an injunction. The Fifth Circuit affirmed.

The Circuit Split

The circuits were split. The Fourth, Fifth, Sixth and Federal Circuits have held that a federal court could refuse to compel arbitration if the demand was "wholly groundless."

The Tenth and Eleventh Circuits ruled to the contrary, holding that the arbitrator alone is entitled to rule on the arbitrability of the dispute, if the contract so provides.

To resolve the split, the Court granted *certiorari* on June 25.

Justice Kavanaugh's Rationale

In substance, Justice Kavanaugh said the Court had already decided the question. In 2010, the high court ruled that the parties may agree by contract that an arbitrator, not the court, will resolve threshold arbitrability questions, not just the merits of the dispute. *Rent-A-Center West Inc. v. Jackson*, 561 U. S. 63, 68−70 (2010).

Justice Kavanaugh said that "some federal courts nonetheless will short-circuit the process" by deciding the arbitrability question if the demand for arbitration is "wholly groundless." Those courts, he said, adopted the "wholly groundless" exception to *Rent-A-Center* "to block frivolous attempts to transfer disputes from the court system to arbitration."

Reversing the Fifth Circuit, Justice Kavanaugh held that the "court possesses no power to decide the arbitrability issue" if "the parties' contract delegates the arbitrability question to an arbitrator."

Justice Kavanaugh reaffirmed the principle that a court can decide whether there was a valid arbitration agreement before referring a dispute to arbitration. "But," he said, "the court may not decide the arbitrability issue" if "a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator."

Justice Kavanaugh rejected the policy argument that the "wholly groundless" exception is "necessary to deter frivolous motions to compel arbitration." He said that arbitrators can quickly and efficiently dispose of frivolous cases, imposing costs and attorneys' fees on the movant "under certain circumstances."

Because the lower courts had not considered the issue, Justice Kavanaugh remanded the case for the Fifth Circuit to rule on whether the agreement "in fact delegated the arbitrability question to an arbitrator." He said the judge "'should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so,'" quoting *First Options of Chicago Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

Fewer and Fewer Exceptions to Arbitration

The implications of Justice Kavanaugh's opinion for bankruptcy cases are better understood in the context of the progression of recent Supreme Court authority.

In 1987, the Supreme Court ruled that a court could decline to enforce an arbitration agreement if there was an inherent conflict between arbitration and the statute's underlying purpose. *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 227 (1987).

Building on *McMahon*, the Second, Fourth, Fifth and Ninth Circuits have held in bankruptcy cases that the court may decline to compel arbitration if the issue is "core" and arbitration would represent a "severe conflict" with the Bankruptcy Code.

Last year, the Second Circuit utilized that concept to override an arbitration agreement when a debtor mounted a class action contending that the creditor had violated the discharge injunction. *One Bank NA v. Anderson (In re Anderson)*, 884 F.3d 382 (2d Cir. March 7, 2018), *cert*. denied Oct. 1, 2018.

Anderson and the other circuit decisions overriding arbitration agreements in bankruptcy cases were all decided before *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612, 1624 (May 21, 2018), where the Supreme Court held last term that the language of a statute must be "clear and manifest" before a court can disregard an arbitration agreement. In *Epic*, the Supreme Court nixed a class action and required individual arbitration of a former employee's claim that the employer's failure to pay overtime violated the Fair Labor Standards Act.

Epic was a 5/4 decision, with the justices divided on ideological grounds.

Applying *Epic* and *Schein* to Bankruptcy Cases

Assume that a debtor and a creditor had a prebankruptcy agreement to arbitrate all disputes, including any arising in bankruptcy, such as the allowance of claims, counterclaims, preferences, and adequate protection. Further assume that the agreement called for the arbitrator to decide whether the dispute was arbitrable, even following bankruptcy.

If *Epic* and *Schein* were applied rigorously, the bankruptcy judge arguably would have no right to bar the creditor from initiating arbitration. If the dispute raised a core issue — such as the allowance of a claim, dischargeability or adequate protection — the bankruptcy judge might have no power to bar arbitration even if there was a "severe conflict" with bankruptcy law.

A chapter 11 debtor could find itself defending dozens of arbitrations, giving the bankruptcy judge little ability to confirm a plan or avoid liquidation. Or, an individual debtor might be fighting dischargeability in several arbitrations.

The prospect of arbitrating dischargeability is not fanciful. *See Williams v. Navient Solutions LLC (In re Williams)*, 564 B.R. 770 (Bankr. S.D. Fla. 2017) (debtor compelled to arbitrate student loan dischargeability); *but see Golden v. JP Morgan Chase Bank NA (In re Golden)*, 587 B.R. 414 (Bankr. E.D.N.Y. 2018), and *Roth v. Butler University (In re Roth)*, 18-50097, 2018 BL 427188 (Bankr. S.D. Ind. Nov. 16, 2018) (arbitration of dischargeability of student loan not permitted). For ABI's discussion, click here.

Supreme Court authority on arbitration seems headed to a pivotal case for the justices to decide whether bankruptcy represents a general exception to the enforceability of arbitration agreements.

In that regard, bankruptcy cases have an element not present in *Epic* and *Schein*. The underpinning of the Bankruptcy Code is centrality of administration. Bankruptcy law has always recognized that an individual cannot win a fresh start and a company cannot reorganize if issues related to bankruptcy must be litigated in several forums. Bankruptcy is designed so one judge decides all core disputes. Even if there is a *Stern* problem, the case goes to a district judge in the same courthouse.

Epic's requirement of a statute's "clear and manifest" exception to arbitration may be found in the centrality of administration of bankruptcy cases. And if that's not enough, the most conspicuous feature of bankruptcy is the automatic stay.

Surely, a creditor cannot continue or initiate arbitration without relief from the automatic stay. If the automatic stay is not a "clear and manifest" exception to arbitration, it's hard to imagine what is.

Justice's Kavanaugh's opinion reaffirms the power of courts to determine in the first instance whether an arbitration agreement is valid. An arbitration clause purportedly enforceable in bankruptcy could be viewed as an invalid agreement, just like an agreement is invalid if it waives the automatic stay or precludes the filing of bankruptcy.

But the question remains: Is a contract calling for arbitration of bankruptcy issues an invalid contract that the bankruptcy court can override, or does *Schein* require the bankruptcy court to refer the dispute to an arbitrator who will decide whether bankruptcy questions are arbitrable?

To read ABI's discussion of *Anderson*, click here, here and here.

The Supreme Court opinion is *Henry Schein Inc. v. Archer & White Sales Inc.*, 139 S. Ct. 524, 202 L. Ed. 2d 480 (Sup. Ct. Jan. 8, 2019).

The Demise of the Court of Equity in Lower Courts

Even if a debtor has committed fraud, at least three creditors still must join an involuntary petition if the debtor has 12 or more creditors.

Equity Can't Alter the Three Petitioning Creditors Requirement, First Circuit Rules

Courts may not disregard the numerosity requirement for an involuntary petition based on "special circumstances," even if the debtor has defrauded creditors, the First Circuit ruled.

Two bank lenders filed an involuntary petition against a doctor. At trial, the debtor established to the satisfaction of the bankruptcy court that he had 15 creditors. Rather than dismiss the petition for lack of at least three petitioning creditors as required by Section 303(b)(1), the bankruptcy court allowed the creditors to conduct discovery to establish whether there were "special circumstances" allowing the entry of an order for relief in the absence of a third petitioning creditor.

Bankruptcy Judge Enrique S. Lamoutte subsequently concluded there were "special circumstances" arising from the debtor's "scheme to misrepresent his financial condition." *In re Reyes-Colon*, 558 B.R. 563, 565 (Bankr. D.P.R. 2016). Still, Judge Lamoutte dismissed the petition for the lack of at least three petitioning creditors.

On the banks' appeal, the district court determined that the debtor had fewer than 12 creditors. Because the bankruptcy court had found that the debtor was generally not paying his debts, the district court reversed and ordered the entry of an order for relief.

The debtor appealed to the First Circuit and won a reversal in an April 24 opinion by Circuit Judge William J. Kayatta, Jr.

With regard to numerosity, Judge Kayatta in substance concluded that the district court had misapplied the burden of proof.

The debtor had filed a motion for summary judgment in bankruptcy court, attaching an expert's report listing 22 creditors. The banks argued that the debtor assumed the burden of proof to showing the existence of 12 or more creditors by having filed the motion for summary judgment.

To the contrary, Judge Kayatta said that filing the motion for summary judgment did not alter the burden of proof. By giving some evidence that he had more than 12 creditors, the burden fell on the creditors to prove that the debtor had fewer than 12. Because the banks presented no

evidence in bankruptcy court to counter the debtor's *prima facie* showing, the circuit court upheld the bankruptcy court's finding that the debtor had at least 12 creditors.

To salvage the order for relief, the banks argued for an "equitable exception" to the numerosity requirement, because the debtor had schemed to defraud creditors. The lenders based their argument on *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 375–76 (2007), where the Supreme Court said that bankruptcy courts have "inherent power" to sanction abusive litigation practices.

However, Judge Kayatta chose to follow the high court's more recent authority,
Law v. Siegel, 571 U.S. 415 (2014). The Supreme Court, he said, held that "bankruptcy courts 'may not contravene specific statutory provisions' when they exercise their statutory and inherent powers." More specifically, the Court ruled that the bankruptcy court could not invoke equitable powers to invade a debtor's exempt property to pay an administrative claim.

Judge Kayatta cautioned that *Law* does not oust the bankruptcy court of discretion "in all circumstances." Rather, he said, the bankruptcy court cannot override "'specific mandates of other sections of the Bankruptcy Code.'" *Id*. at 421.

In the case on appeal, Judge Kayatta said the bankruptcy court "would have plainly contravened Section 303(b) if it bypassed the involuntary petition's creditor numerosity deficiency via the 'special circumstances' doctrine."

Reversing the district court and upholding the bankruptcy court's dismissal of the involuntary petition, Judge Kayatta said that *Law* "provides no basis for simply deeming the creditor numerosity requirement to be inapplicable."

N.B.: Appellate practice mavens should read the opinion in full text. Judge Kayatta discusses circumstances when a party may not have waived an issue on appeal by failing to discuss the topic in the intermediate appellate court or by relying on the opinion of the trial court.

The opinion is *Popular Auto Inc. v. Reyes-Colon (In re Reyes-Colon)*, 922 F.3d 13 (1st Cir. April 24, 2019).

The bankruptcy court is no longer a court of equity; here's another example.

Equity Can't Bar a Chapter 13 Discharge After the Debtor Makes All Plan Payments

Building on *Law v. Siegel*, a district judge in Kansas upheld Bankruptcy Judge Robert E. Nugent and ruled that the debtors were entitled to chapter 13 discharges because they had completed their plan payments on time, even though the debtors' misconduct would have resulted in a loss of discharge if the bankruptcy court had a reservoir of equitable power to overcome the command of the statute.

The debtors amended their plan several times after confirmation. In the last year of the plan, the chapter 13 trustee filed a motion to dismiss the case because the debtors were behind in plan payments and had not paid all their income taxes. Before the hearing on the motion to dismiss and before the end of the five-year plan, the debtors had paid their taxes and all plan payments.

At the hearing on the motion to dismiss, Judge Nugent of Wichita, Kan., found "ample cause to dismiss the case under Section 1307(c)" given the debtors' material defaults and lack of good faith. More particularly, the debtors had misrepresented and concealed a dramatic increase in income, failed to disclose bank accounts, and incurred debt without the trustee's consent, all in violation of the plan and confirmation order.

If he had discretion, Judge Nugent said, he would deny a discharge and dismiss the case. He nonetheless held that he was compelled to enter the debtors' discharges because Section 1328(a) provides that "the court shall grant the debtor a discharge" after "completion of all payments under the plan . . . ." District Judge Eric F. Melgren of Wichita upheld Judge Nugent in an opinion on October 31.

The outcome in part was a function of the difference in language between the two pivotal statutes. Where Section 1328(a) says the court "shall" grant a discharge if the debtors complete plan payments, Section 1307(c) says the court "may" dismiss or convert a case for any of several misdeeds, of which these debtors were guilty.

Focusing on the word "shall," Judge Melgren said that "several courts" have held that the court must grant a discharge once the debtor has completed plan payments. The trustee cited two cases where the court granted dismissal motions after the completion of all plan payments.

Judge Melgren said the cases cited by the trustee were not "persuasive" because neither of them cited Section 1328(a).

Upholding Judge Nugent, Judge Melgren found support by analogy in one of Judge Nugent's own cases, *In re Mills*, 539 B.R. 879, 884 (Bankr. D. Kan. 2015). In *Mills*, Judge Nugent held that "shall," appearing in Section 1307(b), gives the debtor an absolute right to dismiss because the court only has discretion to dismiss or convert, since Section 1307(c) uses the word "may."

In *Mills*, Judge Nugent found support in *Law v. Siegel*, 571 U.S. 415 (2014), where the Supreme Court held that a bankruptcy court could not exercise equitable powers to invade a debtor's homestead exemption to pay administrative expenses incurred as a result of the debtor's misbehavior.

In the case on appeal, there were abundant reasons to deny the debtors' discharges. According to Judge Melgren, they had not disclosed their increased income, withheld material information, "demonstrated disregard for the bankruptcy process," and "abused the provisions, purpose and spirit of chapter 13." Upholding the debtors' discharges, he said, was "an unsatisfying result as it appears the Debtors gamed the system to their advantage."

Paraphrasing Judge Nugent, Judge Melgren nevertheless upheld the debtors' discharges, holding that a court "cannot and should not rewrite the words of a statute even in an effort to obtain an equitable result."

The opinion is *Davis v. Holman (In re Holman)*, 594 B.R. 769 (D. Kan. Oct. 31, 2018).

Judge Perkins in Illinois says the 'sufficiently rooted' test from* Segal v. Rochelle *did not survive* Butner *and the adoption of the Bankruptcy Code.

Did *Segal* Survive *Butner* in Defining Property of the Estate?

Following the Fifth and Seventh Circuits, Bankruptcy Judge Thomas L. Perkins of Peoria, Ill., joined those courts believing that *Segal v. Rochelle,* 382 U.S. 375 (1966), no longer determines whether an asset is estate property.

Interpreting the former Bankruptcy Act, the Supreme Court ruled in *Segal* that a tax-loss carryback refund was estate property because it was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property' under §70a(5)." *Id.* at 380.

In 1979, in a case also decided under the former Bankruptcy Act, the Supreme Court handed down *Butner v. U.S.,* 440 U.S. 48 (1979), again defining property interests. The high court was resolving a circuit split to decide whether state or federal law determines whether a security interest in property extends to rents and profits. Without citing *Segal* or referring to the "sufficiently rooted" standard, the Supreme Court held, "Unless some federal interest requires a different result, . . . [p]roperty interests are created and defined by state law."

Around the time the Court was deciding *Butner*, Congress adopted new bankruptcy laws. In Section 541(a), the Bankruptcy Code gave an expansive definition to estate property, which includes "all legal and equitable interests of the debtor in property as of the commencement of the case."

The legislative history to Section 541(a) does not mention "sufficiently rooted" but says that the result in *Segal* "is followed."

The Bonus Case

Judge Perkins was tasked with identifying a definition of estate property in a case involving an annual bonus.

The debtor had the same employer for several years and was eligible for an annual bonus. The debtor had been awarded a bonus every year. The bonus was entirely discretionary, and the employer had the right to terminate the program at any time.

The chapter 7 trustee contended that a *pro rata* portion of the bonus should be estate property. Because the filing date was in August, the parties stipulated that 62.7% was "rooted in the prebankruptcy past."

Ruling that none of the bonus was estate property, Judge Perkins explained in his May 9 opinion why he would not decide the question "through application of the 'sufficiently rooted' test." Instead, Judge Perkins said that the debtor "did not have a prepetition property interest in the bonus as a matter of Illinois law."

The Erosion of *Segal*

Judge Perkins said there is uncertainty when an asset has its origin "in the prepetition time frame" but is "subject to the postpetition occurrence of one or more contingencies." He examined post-*Butner* caselaw to settle on the proper standard.

But first, Judge Perkins distinguished *Segal* on the facts. There, the right to a refund was "a property interest in existence on the petition date," he said. According to Judge Perkins, *Segal* "dealt not with an expectance but, rather, with a property interest subject to a contingency."

"There is little doubt," Judge Perkins said, that "the second part of *Segal's* test, whether the property interest is so entangled with the debtor's fresh start that it should be excluded from the estate, is no longer a relevant factor." He then proceeded to parse whether "sufficiently rooted" is alive and well after *Butner*.

Judge Perkins cited the Fifth Circuit for holding that "sufficiently rooted" did not survive the adoption of Section 541. *In re Burgess,* 438 F.3d 493, 498-99 (5th Cir. 2006).

Closer to home, Judge Perkins said the Seventh Circuit "has expressed skepticism about the usefulness of the 'sufficiently rooted' test even in the context of tax refunds," citing *In re Meyers,* 616 F.3d 626, 628 (7th Cir. 2010). In *Meyers*, the appeals court apportioned a postpetition refund between the debtor and the estate.

Without mentioning *Segal*, the Seventh Circuit held, according to Judge Perkins, that "a prepetition property interest becomes property of the estate only to the extent that the debtor had a right to enforce the interest as of the petition date."

Casting doubt on the longevity of *Segal*, Judge Perkins pointed out that *Butner* neither cited *Segal* nor referred to "sufficiently rooted." The notion in *Segal* that principles of federal bankruptcy law prevail over state law, he said, "contradicts *Butner's* holding that state law should determine the nature and extent of a debtor's property interests for property of the estate purposes."

Perhaps because he was bound by Seventh Circuit precedent, Judge Perkins held that "*Segal* should not be interpreted as setting forth a federal standard to be layered on to the property of the estate analysis under Section 541, where property interests arising under state law are at issue."

Restating the standard to suit the facts of the case, Judge Perkins said that an asset is not estate property "without regard to whether the interest may be said to be 'rooted' in the debtor's pre-bankruptcy past," when "state law provides that a potential property interest of a debtor was merely an expectancy as of the petition date."

Finding abundant Illinois precedent, Judge Perkins ruled that none of the bonus was estate property because a bonus under a discretionary program "is a mere expectancy" in which the debtor had no property interest on the filing date.

Observations

Segal is not at odds with the result reached by Judge Perkins. Property under *Segal* does not fall into the estate simply from being "rooted" in the prebankruptcy past. It must be "sufficiently" rooted.

A discretionary bonus not earned until paid is not "sufficiently" rooted in the prebankruptcy era, in this writer's view.

Segal's use of "sufficiently" implies the bankruptcy court's use of equitable powers, rather than the slavish adherence to a bright-line formulation. *Segal's* invocation of equitable powers is a principle that should not have changed with the adoption of the Bankruptcy Code, because bankruptcy courts fundamentally remain courts of equity, however much some courts may limit equitable powers in an attempt to divine the plain meaning of the statute.

Butner was decided only 13 years after *Segal*. The Supreme Court ordinarily does not overrule its own authority *sub silentio*, especially when both cases dealt with the former Bankruptcy Act.

The fact is, *Butner* and *Segal* confronted entirely different questions. *Butner* turned on *whether* a property interest existed, whereas *Segal* was deciding *when* the property interest arose. It is therefore not surprising that the Supreme Court developed different tests and saw no reason for citing *Segal* in *Butner*.

In addition, *Butner* can be harmonized with *Segal* by viewing state law as a guidepost for deciding whether property is *sufficiently* rooted in the prebankruptcy era.

Disclosure: The Rochelle in *Segal v. Rochelle* was this writer's father. He was the trustee and argued the case in the Supreme Court as his own lawyer.

The opinion is *In re Brown*, 18-81242, 2019 BL 168813 (Bankr. C.D. Ill. May 9, 2019).