Bankruptcy Medley: Recent News and Cases of Interest

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RECENT CIRCUIT CASES OF INTEREST

by Jeffrey Brinen and Keri Riley

A. Tenth Circuit

***In re Shupbach Investments, LLC*, 2015 WL 6685416 (10th Cir. Nov. 3, 2015)**

The Debtor, Shupbach Investments, LLC, retained Mark Lazzo as its counsel in March 2011, and filed a Chapter 11 petition on May 16, 2011. The Debtor failed to file an application to employ Lazzo, though Lazzo submitted a Declaration of Compensation reflecting his retainer and hourly rate. Lazzo claimed that he prepared an application for employment, but it was lost in the first day motions and never filed. After being contacted by the UST about this issue, Lazzo filed an employment application on June 17, 2011. The application did not request post facto approval from the petition date.

On September 1, 2011, Lazzo filed a supplemental employment application in which he requested approval of his employment post facto to the petition date. Several creditors objected, and after a hearing the bankruptcy court granted Lazzo's application. The bankruptcy court ruled that he had substantially complied with the requirement to seek approval of employment because: 1) he filed his disclosure form on the petition date; 2) the circumstances surrounding the filing of the case justified an untimely application; and 3) the UST had not objected to his application.

The Debtor filed a plan of reorganization, and a group of secured creditors filed a competing plan of liquidation ("Creditor Plan"). The Creditor Plan provided for transfer of the Debtor's property to the secured creditors, cancellation of Jonathan and Amy Shupbach's ownership interest in the Debtor (they were the sole owners), dissolution of the Debtor, and a liquidating trust. The Debtor and the Shupbachs initially objected to the Creditor Plan, but withdrew their objections, and that plan was confirmed.

The Debtor filed multiple fee applications covering Lazzo's work from May 13, 2011 to March 14, 2013. Despite a number of objections, the bankruptcy court determined that Lazzo was entitled to fees incurred after confirmation of the Creditor Plan, and declined to reconsider its previous post facto approval of Lazzo's employment. Creditors appealed, and the BAP reversed. The BAP held that Lazzo had not shown justification for the post facto employment, and that confirmation of the Creditor Plan terminated the Debtor's status as a debtor-in-possession, stripped the Debtor of all rights, powers, and duties of a bankruptcy trustee, and ended the bankruptcy court's authority to award Lazzo fees for post-confirmation work.

The Debtor appealed to the Tenth Circuit, which affirmed the BAP's ruling. "Although neither §327(a) nor Fed. R. Bankr. P. 2014 – which implements that statute – expressly requires that the

approval [of employment] must precede the attorney's engagement, courts have generally read such a requirement into the statute as a matter of judicial administration." Also, the Kansas local bankruptcy rule required the filing of an application to employ with a chapter 11 petition. The Tenth Circuit cited to its ruling in *Land v. First Nat'l Bank of Alamosa (In re Land)*, 943 F.3d 1265, 1267 (10th Cir. 1991), that retroactive approval of an attorney's employment "is only appropriate in the most extraordinary circumstances" and that "simple neglect will not justify nunc pro tunc approval." The BAP concluded that Lazzo's inadvertent neglect in failing to timely file an employment application is, as a matter of law, not an extraordinary circumstance. Therefore, there is no need to remand to the bankruptcy court to consider and determine that issue.

The bankruptcy court erroneously determined that confirmation of the Creditor Plan did not prevent the allowance of attorneys' fees incurred post-confirmation, as the Debtor remained a debtor-in-possession (in part because the liquidating trustee was not a qualified "trustee" under §322), and thus, could continue to employ counsel under § 327. Further, the bankruptcy court found that Lazzo's post-confirmation services were necessary to the administration of the estate.

The BAP reversed, and the Tenth Circuit affirmed the BAP. The Tenth Circuit found that the BAP correctly identified the issue as whether the Debtor remained a debtor-in-possession, for when a debtor's status as a debtor-in-possession terminates, that also terminates an attorney's authorization under §327. *Lamie v. U.S. Tr.*, 540 U.S. 526, 532 (2004). Debtor-in-possession status terminates not only upon appointment of a qualified trustee, but also upon confirmation of a Chapter 11 plan. Further, the Debtor's obligation to cooperate with the liquidating trustee and the bankruptcy court to carry out the terms of the Creditor Plan did not allow the Debtor to remain a debtor-in-possession.

***Redmond v. Jenkins (In re Alternate Fuels, Inc.)*, 789 F.3d 1139 (10th Cir. 2015)**

Alternative Fuels, Inc. ("AFI"), a coal mining company, filed a Chapter 11 petition in 1992 and confirmed a plan. It operated under that plan until 1996, at which time it ceased operating and abandoned its assets. During this period, Larry Pommier served as AFI's field engineer.

After it ceased to operate in 1996, AFI was acquired by a new owner, who formed Cimarron Energy Co. to handle mining operations under AFI permits, and provided the State of Missouri with reclamation bonds. The bonds were secured by CDs worth $1.4 million. The mining was completed by 1999, but AFI remained obligated to reclaim the land.

Appellant Jenkins purchased 100% of AFI after mining operations shut down in 1999. His purpose was to have AFI reclaim the land, obtain the proceeds from the CDs, and sell any remaining equipment. AFI entered into a series of three promissory notes ("Notes") totaling $2 million in favor of a company owned by Jenkins. The Notes were payable in five years or when the reclamation bonds were released.

In 2002, AFI filed suit against state officials for interfering in the reclamation process (the "Cabanas suit"). In exchange for Jenkins' continued funding of AFI and as security for the Notes, AFI assigned $3 million of its potential recovery in the Cabanas Suit to Jenkins. AFI was paid approximately $5 million as a result of the Cabanas suit. AFI then filed a second bankruptcy case for assistance in determining the priority of payment to its creditors.

Jenkins filed a proof of claim for $4.3 million, which included $3.8 million for the Notes, secured by AFI's assignment of $3 million of the Cabanas Suit proceeds. Pursuant to §105 the bankruptcy court recharacterized the transfers evidenced by the Notes as equity. Alternatively, the bankruptcy court found that because Jenkins failed to sufficiently document the amount of his claim, it should be equitably subordinated under §510(c). The BAP affirmed.

The Tenth Circuit reversed on all grounds. The court stated that the authority to recharacterize debt is included in the courts' general equitable powers under §105(a). Further, that the 13-factor test for recharacterization outlined in *In re Hedged-Investments Assoc., Inc*., 380 F. 3d 1292, 1297 (10th Cir. 2004) remains valid.

Jenkins cited *Travelers Casualty v. Pacific Gas & Electric*, 549 U.S. 443 (2007) and *Law v. Siegel*, 134 S. Ct. 1188 (2014), to support his argument that the court's authority to recharacterize comes solely from §502(b). The Tenth Circuit rejected Jenkins' argument, as it improperly conflates disallowance of a claim under §502 with recharacterization under §105. The court stated that disallowance is proper when there is no basis in fact or law for recovery from the debtor, whereas recharacterization is an inquiry into the true nature of a transaction underlying a claim. The court then applied the *Hedged-Investments* test, pursuant to which it determined that recharacterization of Jenkins' claim was improper.

The court also held that equitable subordination was not appropriate. There are three conditions necessary for equitable subordinations: 1) inequitable conduct; 2) injury to the other creditors or an unfair advantage for the claimant resulting from the claimant's conduct; and 3) consistency with provisions of the Bankruptcy Code. There are three categories of inequitable conduct: 1) fraud, illegality, and breach of fiduciary duty; 2) undercapitalization; or 3) claimant's use of the debtor as a mere instrumentality or alter ego. The court's analysis is less stringent if the claimant is an "insider" or "fiduciary". Under either standard (more stringent or less), the Court found Jenkins' conduct did not warrant equitable subordination.

***Brumfiel v. United States Bank*, 2015 WL 4496197 (10th Cir. July 24, 2015)**

The Debtor borrowed funds to purchase a home. The loan was evidenced by a note and deed of trust on the home. After defaulting by failing to make mortgage payments, US Bank as trustee of a mortgage loan trust that then held the note, initiated a public trustee foreclosure under C.R.C.P 120. Shortly thereafter, the Debtor filed a Chapter 7 bankruptcy case. The Debtor received a discharge, and her bankruptcy case was closed in May 2012. The Rule 120 proceeding remained pending.

In October 2012, Brumfiel filed a federal action against U.S. Bank and its counsel, seeking monetary damages and injunctive relief. Brumfiel alleged that the Rule 120 procedure violated her right to due process by limiting the issues to whether a default occurred, and whether an order authorizing sale is proper under the Service Members Civil Relief Act. Also, that Rule 120 does not allow an appeal. Brumfiel also targeted a Colorado statute that allows a holder of debt to seek foreclosure without producing an original note and deed of trust.

The District Court ultimately dismissed Brumfiel's complaint under Fed.R.Civ.P. 12(b)(1) for lack of standing to pursue claims for monetary relief, as the bankruptcy estate owned the claims and only a bankruptcy trustee could assert them. The claims for injunctive relief were deemed moot because US Bank had dismissed the Rule 120 proceeding and filed a judicial foreclosure action instead.

The Court held that under 11 U.S.C. §521(a)(1), Brumfiel was required to list all of her assets, including legal claims and causes of action, pending or potential. Because Brumfiel failed to disclose the claims she brought against US Bank and its counsel, ". . . the trustee neither administered nor abandoned them at the close of the bankruptcy case, and they remained property of the estate." (citing 11 U.S.C. § 554(d)). Accordingly, Brumfiel lost the right to bring the claims.

B. Other Circuits

***Bodin Concrete, L.P. v. Concrete Opportunity Fund II, LLC (In re: Bodin Concrete, L.P.)*, 616 Fed. Appx. 738 (5th Cir. July 10, 2015)**

Debtor filed for Chapter 11 bankruptcy, sold most of its assets, and then proposed a plan of reorganization approximately one year later. The plan proposed to pay fifty percent of the unsecured claims within 30 days of the effective date, and the balance over the following five years ("Original Plan"). Concrete Opportunity Fund II, LLC ("COF") purchased a small claim in the case, filed an objection to the Debtor's disclosure statement, and then filed its own plan ("COF Plan") that would pay seventy-five percent of unsecured claims within 10 days of the effective date and the balance seventy-five days later. The COF Plan included a $750,000 cash infusion. The Debtor filed several amended plans that were increasingly beneficial to the unsecured creditors. The Debtor's final proposed plan ("Final Plan") provided for payment of one-hundred percent of the unsecured claims within one day of the effective date, and included a $750,000 cash infusion to match the COF Plan. The Final Plan was confirmed.

Concrete sought reimbursement of its legal fees and expenses for substantial contribution under 11 USC §503(b)(4). The Debtor objected and an evidentiary hearing was held. The bankruptcy court awarded Concrete an administrative expense claim of $50,000, which was approximately two-thirds of its request. The district court affirmed, and the Debtor appealed to the Fifth Circuit Court of Appeals.

The Fifth Circuit affirmed. "Substantial contribution" is not a statutorily defined term, but the Court stated that "services which make a substantial contribution are those which foster and enhance, rather than retard or interrupt the progress of reorganization" and the services "must be considerable in amount, value, or worth." Although substantial contribution is determined on a case-by-case basis, the Court stated that the bankruptcy court "should weigh the cost of the claimed fees and expenses against the benefits conferred upon the estate which flow directly from those actions." The bankruptcy court found that COF's proposed plan pressured the Debtor to propose a more favorable plan that benefitted all unsecured creditors in the case, and that constituted substantial contribution.

***McMillan v. Schmidt (In re McMillan)*, 614 Fed. Appx. 206 (5th Cir. 2015)**

Thomas Aigner entered into a Joint Prosecution Agreement with Donal Schmidt and Timothy Wafford prior to filing an involuntary petition against Harry McMillan. McMillan had previously consulted for a company owned by Schmidt and Wafford. When relations broke down between McMillan, Schmidt, and Wafford, Schmidt and Wafford sought out Aigner and entered into a Joint Prosecution Agreement with the goal of forcing McMillan into bankrutpcy. Under the Joint Prosecution Agreement, Aigner, who had a judgment against McMillan, transferred a portion of his interest to Schmidt and Wafford, and gave Schmidt and Wafford control over the involuntary petition. Aigner was the only party to sign the involuntary petition.

The bankruptcy court dismissed the involuntary petition, holding that Schmidt and Wafford acquired an interest in the claim for the purpose of commencing an involuntary petition, and were therefore not qualified creditors to petition for an involuntary bankruptcy case under Section 303. McMillan sought fees, costs, and damages against Aigner, Schmidt, and Wafford following the successful dismissal of the involuntary petition. The bankruptcy court declined to enter an award in favor of McMillan, finding that Aigner filed the involuntary petition in good faith. The bankruptcy court further held that while Schmidt and Wafford may not have acted in good faith, they were not petitioners and were therefore not before the court. The district court affirmed, holding that Schmidt and Wafford were not served with process under Rule 7004 and the bankruptcy court therefore did not have *in personam* jurisdiction over them.

On appeal to the Fifth Circuit, McMillan argued that Schmidt and Wafford were petitioners under Section 303(i) because they were instrumental in causing the involuntary petition to be filed, and the bankruptcy court could therefore impose fees, costs, and damages without needing to initiate an Adversary Proceeding. The Court held that the ability to obtain fees and damages was limited to the petitioning creditors, including the creditors who had signed the involuntary petition or joined in it later. The Court further held that because Schmidt and Wafford were not signatories on the original involuntary petition, they were not parties to the contested matter, and therefore, the bankruptcy court could not impose fees, costs, and damages against them unless McMillan initiated an adversary proceeding. Therefore, the Fifth Circuit Court of Appeals affirmed the decision of the courts below.

***Ellmann v. Baker (In re Baker)*, 791 F.3d 677 (6th Cir. 2015)**

Debtors owned a home that was foreclosed and sold at a sheriff's sale in 2007. In 2008, the Debtors filed a Chapter 13 bankruptcy, and did not disclose any interest in the house or claims related to it. The case was converted to Chapter 7 and the Debtors received a discharge in August 2008.

After the foreclosure sale the holder of the deed commenced an eviction action, and the Debtors entered into a consent judgment. The bankruptcy case was subsequently closed on February 13. 2009. In March 2009, the Debtors filed suit in state court against the holder of the deed and its counsel, seeking to set aside the foreclosure. The action lasted 4 years, though the Debtors never sought to reopen their case to amend their schedules and disclose the lawsuit.

The Chapter 7 trustee learned of the lawsuit, had the case reopened in November 2013, and began settlement discussions with the defendants. The Debtors amended their schedules in December 2013, and disclosed the lawsuit with a value of $3 million. The Debtors also each claimed a wildcard exemption of $5,300 in the lawsuit.

The trustee objected, claiming that the Debtors: 1) interfered in the administration of the case by failing to disclose the lawsuit; 2) attempted to conceal the lawsuit; 3) claimed the exemptions in bad faith. The trustee further asserted that even if the Debtors were unaware of the claims when their bankruptcy case closed, they should have amended to disclose the claims when they became aware of them.

The bankruptcy court approved of the trustee's settlement of the lawsuit. However, on the basis of *Law v. Siegel*, 134 S. Ct. 1188 (2014), the court denied the trustee's objection to the Debtors' amended exemptions. The District court affirmed, and the trustee appealed.

The trustee argued that unlike this case, the bankruptcy case in *Siegel* had never been closed, and therefore, that case did not apply. The Sixth Circuit rejected the trustee's position that *Siegel* did not apply in cases that had been reopened, indicating that the trustee failed to explain the importance of such a distinction. Further, that the reasoning in *Siegel* (i.e., that bankruptcy courts cannot override explicit mandates of other sections of the Bankruptcy Code) is compelling whether or not a case has been reopened.

The trustee also argued that the Debtors' amendments were untimely under Bankruptcy Rule 1009(a), which states that, ". . . schedule . . . may be amended by the debtor as a matter of course at any time before the case is closed". However, the trustee failed to make this argument in his written objection, and accordingly, the Sixth Circuit held that such argument was waived.

***Sullivan v. Glenn*, 782 F.3d 378 (7th Cir. 2015)**

The Debtors, real estate developers, were in financial straits and asked a loan broker named Karen Chung to arrange a short-term loan of $250,000. Chung contacted a friend and occasional client, Brian Sullivan, about the loan. Sullivan agreed to lend the Debtors $250,000, payable in two to three weeks with interest of $5,000 per week. The Debtors needed the funds for longer than a few weeks, but Chung advised them and Sullivan that a bank had agreed to extend a line of credit to the Debtors in the amount of $1 million, but that it would not become available for a few weeks. Prior to closing on the bridge loan, Sullivan inquired about the status of the line of credit and was advised by an employee of Chung that the Debtors had been approved. In fact, unbeknownst to the Debtors or Sullivan, the line of credit had never been applied for, much less approved. Sullivan extended the bridge loan to the Debtors, requiring a promissory note from both the Debtors and Chung to secure repayment.

Chung and the Debtors subsequently filed separate Chapter 7 bankruptcy cases. Sullivan initiated an adversary proceeding against Chung, obtaining a judgment that his debt was non-dischargeable because the credit was extended as a result of Chung's fraud. Sullivan also initiated an adversary proceeding against the Debtors, alleging that Chung's fraud should be imputed to the Debtors because Chung was their agent. The bankruptcy court found in favor of the Debtors, declining to impute Chung's fraud to the Debtors. The District Court affirmed.

On appeal to the Seventh Circuit, Sullivan argued that Section 523(a)(2)(A) applied to the debt, not the debtor, and that because the debt had been incurred through fraud, it was non-dischargeable, even though the Debtors had not committed the fraud. Sullivan further argued that under an agency theory, Chung's fraud while acting as the Debtors' agent could be imputed to the Debtors. The Seventh Circuit held that applying a strict interpretation and using the "debt not the debtor" approach would lead to inequitable results and create the potential for innocent third parties to be left with a non-dischargeable debt as a result of an unknown fraud. The Court further held that while Chung was the Debtors' agent, the Debtors could not be held responsible for the fraud of the agent unless they knew or should have known of the agent's fraud, or were recklessly indifferent with respect to the acts of their agent. Because the Debtors did not know of Chung's fraud and had believed that a line of credit from the bank was being obtained in accordance with their ordinary business practices, Chung's fraud could not be imputed to them. The Seventh Circuit Court of Appeals therefore affirmed the decisions of the courts below.

***Dietz v. Calandrillo (In re Genmar Holdings)*, 776 F.3d 961 (8th Cir. 2015)**

In April 2007, Calandrillo purchased a boat manufactured by Hydra-Sports, a subsidiary of Genmar Tennessee, a subsidiary of Genmar Holdings. Calandrillo claimed the boat was defective and initiated arbitration. On February 19, Calandrillo entered into a settlement with Genmar Tennessee, Inc., together with its parents and subsidiaries: Calandrillo agreed to convey

title to the boat to Genmar Tennessee free and clear of any liens and encumbrances, and Hydra-Sports agreed to pay Calandrillo $205,000 as follows: a) payment to the bank holding a lien on the boat as necessary to obtain a lien waiver; and b) the balance to Calandrillo's attorneys' trust account, but no sooner than 15 days after Genmar Tennessee receives the lien waiver from the bank.

The next day, the bank received $140,000 from a Genmar entity and issued a lien waiver. On February 25, Calandrillo executed a bill of sale conveying the boat to Genmar Tennessee, and on March 4, he sent documents assigning title to Genmar Tennessee. On March 23, Genmar Holdings sent the $65,000 balance to Calandrillo. On June 1, Genmar Holdings and its subsidiaries (including Tennessee) filed for bankruptcy. The trustee initiated an adversary proceeding seeking recovery of the $65,000 payment as a preferential transfer.

Calandrillo claimed that the new value exception in 11 U.S.C. § 547(c)(1) applied, as conveyance of the boat in exchange for the $65,000 payment constituted "new value." The Court stated that the critical inquiry is whether the parties intended a contemporaneous exchange for new value. In this case Calandrillo completed the conveyance on March 4 when he conveyed the title documents to Genmar Tennessee, and he received the payment on March 23. Nonetheless, this time lag does not, by itself, determine the parties' intent.

The Court held that the exchange did not constitute new value, and the payment was a preferential transfer. The settlement provided that payment would not be made any sooner than 15 days after Genmar Tennessee received the lien waiver and title documents, and Calandrillo provided no explanation for this mandatory delay. This is inconsistent with a contemporaneous exchange. "Thus, on its face the settlement agreement reflected that what might have been a contemporaneous exchange of a boat for $205,000 was instead a short-term loan of $65,000 to the debtor. A debtor's repayment of a loan within ninety days of bankruptcy is an avoidable preference."

***Pensco Trust Co. v. Tristar Esperanza Props., LLC (In re Tristar Experanza Props, LLC)*, 782 F.3d 492 (9th Cir. 2015)**

Appellant purchased a 15% interest in Tristar in 2005. In 2008, Appellant exercised her right to withdraw from Tristar, and Tristar elected to purchase her membership. The parties had a dispute over valuation, and the matter was submitted to arbitration. The arbitrator provided Appellant with a net award of damages in 2010 for approximately $410,472. After Tristar failed to pay, Appellant obtained s state court judgment for the award.

Tristar filed a Chapter 11 petition in 2011. Appellant filed a claim based upon her state court judgment, and Tristar filed an adversary proceeding against Appellant seeking to subordinate her claim under §510(b) and (c). The bankruptcy court entered summary judgment in favor of Tristar on the §510(b) claim. The BAP affirmed, stating that the claim was so ". . . rooted in [Appellant]'s equity status that subordination is mandatory." The Ninth Circuit affirmed.

§510(b) should be broadly construed, "and reaches even ordinary breach of contract claims, so long as there is a sufficient nexus between the claim and purchase of securities." Appellant argued that she did not seek damages in the arbitration, but only a determination of the value of her membership interest. However, the Court points out that the arbitrator provided an "award of damages," which Appellant then used to obtain a money judgment.

Appellant also argued that her claim does not arise from the purchase and sale of securities, as her equity was converted to debt prior to the petition date. Some courts have followed this reasoning. The Ninth Circuit takes that position that the status of the claim on the petition date does not end the §510(b) inquiry. "The critical question for purposes of a §510(b), then, is not whether the claim is debt or equity at the time of the petition, but rather whether the claim arises from the purchase or sale of a security. The claim must be subordinated if there is a sufficient 'nexus or causal relationship between the claim and the purchase' or sale of securities." The phrase "arises from" is broadly interpreted, which comports with Congressional intent.

There are two rationales for mandatory subordination: 1) the dissimilar risk and return expectations of shareholders and creditors; and 2) the reliance of creditors on the equity cushion provided by shareholder investment. Appellant assumed the risk that an equity position entails.

***Double Bogey, L.P. v. Enea*, 794 F.3d 1047 (9th Cir. 2015)**

Double Bogey, L.P. was involved in an ongoing dispute with Appian Construction, Inc., an entity wholly owned by Paul and Sylvester Enea, regarding Appian's mismanagement of Double Bogey's real estate investments. Double Bogey was unable to recover any of its investment, and in 2009, Appian and the Eneas separately filed voluntary petitions under Chapter 7 of the Bankruptcy Code. Double Bogey subsequently brought an adversary proceeding for non-dischargeability of its debt pursuant to 11 U.S.C. § 523(a)(4), alleging that Appian committed defalcation while acting in a fiduciary capacity, and that the Eneas were also liable for the non-dischargeable debt as alter egos of Appian. The bankruptcy court found in favor of the Eneas, holding that while the Eneas were alter egos of Appian, this was not sufficient to establish that they were fiduciaries of Double Bogey, and the non-dischargeability claim therefore failed. The bankruptcy court's decision was affirmed by the district court.

On appeal to the Ninth Circuit, Double Bogey argued that because the Eneas were alter egos of Appian and because Appian was a fiduciary of Double Bogey, the Eneas were also fiduciaries. The Ninth Circuit Court of Appeals stated that a fiduciary relationship must exist prior to and without reference to the wrongdoing that caused the debt. The Court held that while the alter ego doctrine serves as a procedural mechanism to impose liability on an individual for the wrongdoing of a company, it does not create substantive duties. The alter ego doctrine allows for collection against the individual after liability exists, but does impose fiduciary obligations on the individual prior to the creation of the liability. Accordingly, the Ninth Circuit held that the

alter ego doctrine could not be used to establish a fiduciary relationship for the purposes of §523(a)(4), and affirmed the decision of the court below.

***Green Point Credit, LLC v. McLean (In re McLean)*, 794 F.3d 1313 (11th Cir. 2015)**

In 2006, the Debtors filed a Chapter 13 bankruptcy case, listing Green Tree Servicing as an unsecured creditor. The Debtor's case was subsequently converted to a Chapter 7, and the Debtors received their discharge. Green Tree received notice of the discharge order when it was entered. A few years later, the Debtors filed a second Chapter 13 case. Green Tree filed a proof of claim in the Debtors' Chapter 13 bankruptcy case, resulting in a substantial increase in the payments required under the Chapter 13 Plan. The proof of claim filed in the Debtors' second bankruptcy case represented the same claim that was discharged in the first bankruptcy case. The Debtors objected to the proof of claim and filed an adversary proceeding, alleging that Green Tree violated the discharge injunction and seeking to recover damages from the emotional distress caused by Green Tree's proof of claim. Green Tree withdrew its proof of claim, but the Debtors persisted with the adversary proceeding and, after a trial, the bankruptcy court found in favor of the Debtors. The bankruptcy court ruled that Green Tree violated the discharge injunction, and awarded compensatory and non-compensatory "coercive" sanctions against Green Tree. The district court affirmed the bankruptcy court's ruling, noting that the coercive sanctions imposed may be punitive, but that such sanctions were appropriate because Green Tree acted with reckless disregard of the risk of violating the discharge injunction.

On appeal to the Eleventh Circuit, Green Tree argued that the filing of the proof of claim did not violate the discharge injunction because it filed the claim against the bankruptcy estate, not the Debtors. Given the separate legal status of the estate, Green Tree argued that the proof of claim would not have an effect on the Debtors' personal liability. In analyzing §542(a)(2), the Eleventh Circuit stated that because of the statute's role in giving the debtor a fresh start, the statute is "an expansive provision that is sensitive to the diversity of ways a creditor might seek to collect a discharged debt." The Court held that the test for whether the creditor violates the discharge injunction is whether the objective effect of the creditor's action is to pressure a debtor to repay a discharged debt, regardless of the what legal entity that the creditor filed its claim against. Based on this test, the Court held that the filing of the proof of claim constituted an act to recover the debt as a personal liability because it triggered an increase in bankruptcy plan payments, and the Eleventh Circuit therefore affirmed the decisions of the courts below with respect to the violation of the discharge injunction.

In reviewing the sanctions imposed by the bankruptcy court, the Eleventh Circuit held that the non-compensatory sanctions imposed by the bankruptcy court were punitive in nature, and therefore required a degree of procedural protections that had not been afforded to Green Tree at the time that the sanctions were awarded. The Court further held that in order to recover damages for emotion distress, the Debtors had to: 1) suffer significant emotional distress, 2) clearly establish the significant emotional distress at trial, and 3) demonstrate a causal connection

between the significant emotional distress and the violation of the discharge injunction. Because the findings of fact were insufficient to support this conclusion, the Eleventh Circuit vacated the award of compensatory and non-compensatory sanctions, and remanded the case for further proceedings.

MISCELLANEOUS TOPICS

A. Cyber Security and Data Privacy.

1. Pending in the United States Supreme Court; Spokeo, Inc. v. Robins.

The United States Supreme Court granted certiorari in a case under the Fair Credit Reporting Act ("FRCA"). *Spokeo, Inc. v. Robins*, ___ U.S. ___, 135 S. Ct. 1892 (April 27, 2015). The United States Court of Appeals for the Ninth Circuit held that a consumer satisfied the injury-in-fact requirement for Article III standing under FRCA by alleging that the defendant, a website operator providing personal information about consumers, had willfully violated FCRA and its required "reasonable procedures" to ensure the accuracy of information when preparing consumer reports. *Robins v. Spokeo, Inc*., 742 F.3d 409, 412 (9th Cir. 2015). The defendant's website collects and reports information about individuals, "including contact data, marital status, age, occupation, economic health, and wealth level." *Id.* at 410. The plaintiff's "allegations of injury were sparse," but he claimed that the defendant's website contained false information about him. *Id*.

The Ninth Circuit reversed the district court's dismissal, which was premised on a lack of standing in light of no "actual or imminent harm" to the plaintiff, and concluded that a viable cause of action under the FCRA does not require a showing of actual harm where a consumer sues for a willful violation of the statute. Accordingly, a consumer can maintain a viable claim for violation of statutory rights without suffering actual damages.

The Ninth Circuit recognized that Article III limits standing, but relied upon *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992), for the proposition that Congress is not prohibited from "'elevating to the status of legally cognizable injuries concrete, *de facto* injuries that were previously inadequate in law.'" *Spokeo*, 742 F.3d at 413 (quoting *Lujan*, 504 U.S. at 578). Statutory standing was properly conferred in this case because the alleged violation involved the consumer's statutory rights, not the statutory rights of other people, and the interests protected by those statutory rights were sufficiently concrete and particularized that Congress could confer standing. The consumer had personal interests in the handling of his credit information, whether or not actual damages resulted from an inaccurate website report.

Although it is not a bankruptcy case, the *Spokeo* cases raises issues concerning the need to list potential creditors holding unmatured, contingent claims that might exist for businesses that compile and report consumer information. *See also Wright v. Experian Info. Solutions, Inc.*, 805 F.3d 1232 (10th Cir. 2015) (affirming summary judgment against consumer who had commenced action against credit reporting agencies under Fair Credit Reporting Act state law, claiming that credit reports were inaccurate and agencies acted unreasonably in reporting federal tax lien).

2. Bankruptcy Filings (and Potential Filings) Prompted by Data Security Issues.

In re Altegrity, Inc., Case No. 15-10226 (Bankr. D. Del. Feb. 8, 2015). Debtor was parent company to employment screening company (U.S. Investigations Services, Inc.) responsible for background checks and security clearances for current and future federal employees. U.S.

Investigations Services, Inc. was subject to an alleged "state-sponsored data intrusion" in 2014, resulting in the exposure of tens of thousands of Department of Homeland Security employees' information, along with those of the U.S. Immigration and Customs Enforcement and U.S. Customs and Border Protection divisions.

The Department of Justice had alleged separately in a whistleblower lawsuit that security clearance data had been released to the Office of Personnel Management before undergoing the contractual quality review, as a means of shortcutting the process and bilking taxpayer funds. The government cancelled the contracts and ultimately settled the whistleblower lawsuit for some $30 million. Under the confirmed Chapter 11 plan, U.S. Investigations Services, Inc. is to be liquidated, with Altegrity and its related security clearance entities surviving.

Impairment Resources, LLC, Case No. 12-10850 (Bankr. D. Del. March 9, 2012). Debtor was a Delaware corporation with offices in California, Massachusetts, and Hawaii, providing personal injury claims review services for approximately 600 employers, and to workers compensation and auto casualty insurers. Two computer hard-drives that contained claims information, including detailed medical information for approximately 14,000 people, had been stolen from the Debtor's offices in San Diego, California. California (like many states) requires that such data breaches be reported to the Attorney General and Department of Labor officials. The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") and the HIPAA Breach Notification Rule, 45 CFR §§ 164.400-414, similarly require HIPAA covered entities and their business associates to provide notification following a breach of unsecured protected health information. The estimated $2.5 million in regulatory fines and penalties and the cost to indemnify its clients for liability claims led to the Debtor's Chapter 7 filing.

In re MtGox Co., Ltd. (a/k/a Mt. Gox KK), Case No. 14-13229 (Bankr. N.D. Tex. March 9, 2014). Debtor was a digital currency exchange (bitcoin) seeking Chapter 15 recognition for its main bankruptcy filing in Tokyo, Japan. As a result of hacking attempts, the Debtor had "lost" an estimated 750,000 of its customers' bitcoins and around 100,000 of its own bitcoins, which amounted to about $473 million at the time. The bitcoin is a decentralized digital currency (a peer-to-peer digital asset and payment system) with encrypted code stored locally on a hard disk or flash drive. Bitcoins allow for verifiable but semi-anonymous transactions without a bank or credit card.

Ashley Madison data breach. In July 2015, hackers stole the user data of Ashley Madison, a commercial website billed as enabling extramarital affairs. Users whose personal details were leaked filed a $567 million class-action lawsuit in Canada against Avid Dating Life (a Toronto based company) and Avid Media, the owners of Ashley Madison. Additional lawsuits have been filed by Ashley Madison users in California, Texas, Missouri, Georgia, Tennessee and Minnesota. They all seek class-action status to represent the estimated 37 million registered users of Ashley Madison.

3. Bankruptcy Sales of Personal Identifying Information (PII).

Section § 332 of the Bankruptcy Code was added in 2005, along with amendments to § 363(b)(1) to require the appointment of a consumer privacy ombudsman when the debtor (or

trustee) proposes to sell personally identifiable information collected from consumers. Section 101(41A) defines "personally identifiable information" and the sale and ombudsman requirements are limited to "consumer" data and sales that are contrary to a debtor's privacy policy. *See In re Nortel Networks, Inc*., No. 09-10138 KG, 2009 WL 3224748 (Bankr. D. Del. Sept. 22, 2009) (concluding that "none of the Debtors' customers that are subject to the sale of the Debtors' Assets are individuals, and the Debtors do not have a consumer privacy policy, so section 363(b)(1) does not apply, and a consumer privacy ombudsman is not required"). "Personally identifiable information" encompasses more than just customer lists.

These provisions were added to the code to address some of the early Federal Trade Commission ("FTC") enforcement actions, such as *In re Toysmart.com, LLC*, Case. No. 00-13995-CJK (Bankr. D. Mass. June 9, 2000), in which the FTC sought to preclude or restrict the sale of consumer data in bankruptcy cases. The FTC sued Toysmart.com, an online seller of educational toys and a debtor in Chapter 11 in Massachusetts, alleging violations of § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a), from the Debtor's disclosure, sale or offering for sale personal customer information, contrary to the terms of its privacy policy (which stated that personal information would never be disclosed to third parties). The FTC sought a permanent injunction and other equitable relief pursuant to § 13(b) of the FTC Act, 15 U.S.C. § 53(b) to block the proposed bankruptcy auction. *F.T.C. v. Toysmart.com, LLC*, 00-11341-RGS, 2000 WL 34016434 (D. Mass. July 21, 2000). The matter was settled with conditions on the terms of the Debtor's bankruptcy sale. *See id*. Individual states also objected to the proposed sale under various state consumer protection laws. The PII ultimately was removed from the sale when one of the largest investors in the Debtor (Walt Disney Co. or its affiliate) agreed to buy the PII and destroy it to ensure privacy and to facilitate the sale of the Debtor's non-PII assets.

The tension between non-bankruptcy law governing data security and the Bankruptcy Code persist in more recent cases, including *In re RadioShack Corp., et al.*, Case No. 15-10197 BLS (Bankr. D. Del. Feb. 5, 2015). RadioShack purportedly had collected PII for some 117 million customers and its privacy policy contained provisions precluding the sale of PII. Facing sale objections from the FTC and the attorneys general of some 23 states, RadioShack, agreed to destroy the bulk of the personal customer information maintained in its files.

Under a mediated agreement involving the appointed privacy ombudsman, the asset purchaser was to receive two categories of PII: (1) customer e-mail addresses that were active within the two-year period before RadioShack filed for bankruptcy; and (2) transaction data for the prior five-year period limited to seven transaction categories (store number, transaction date/time, SKU number, SKU description, SKU selling price, tender type, and tender amount). All other customer information (older e-mail addresses, telephone numbers, and a litany of other transaction specific data were to be destroyed). Affected customers were also to be notified of the sale of the PII and given an opportunity to opt out (seven day notice to remove their information from the transaction).

The FTC and the state regulators undoubtedly will continue to police bankruptcy sales that violate non-bankruptcy law and the terms of internal privacy policies. That is particularly true as "big data" continues to grow and businesses develop new ways to leverage data for market advantage through social media analytics, internet tracking, and business informatics. *See*

In re Borders Group, Inc., No. No. 11–10614 (MG), 2011 WL 5520261 (Sept. 27, 2011) (Orders Pursuant to Sections 332, 363, 365 and 105 and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure: (i) Approving Bidding Procedures With Respect to the Sale of Certain IP Assets, Including Expense Reimbursement for a Stalking Horse Bidder, Setting the Sale Hearing Date, and Appointing a Consumer Privacy Ombudsman; and (ii) Approving and Authorizing the Sale of IP Assets to the Highest and Best Bidder Free and Clear of all Liens, Interests, Claims and Encumbrances and the Assumption and Assignment of Certain Related Executory Contracts, and Waiving the Requirements of Bankruptcy Rules 6004(h) and 6006(d)).

B. Student Loan Issues in Bankruptcy.

1. Some Background.

Student loan debt is estimated to exceed $1 trillion nationally – second only to consumer mortgage debt and larger than auto loans and credit cards. *See* Kelley Holland, *The High Economic and Social Costs of Student Loan Debt*, http://www.cnbc.com/2015/06/15/ (June 15, 2015) (reporting "more than $1.2 trillion in outstanding student loan debt, 40 million borrowers, an average balance of $29,000"). That debt load has nearly tripled over the last decade; it affects student borrowers and has a broader impact on families where parents often co-sign or guaranty loans to finance higher education. *See Measuring Student Debt and Its Performance*, Federal Reserve Bank of New York Staff Reports No. 668 (April 2014), available at <https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr668.pdf. Some have likened the student loan burden a "debt bomb" that already has negative effects on the broader economy. *See, e.g., The Student-Loan Siphon*, http://www.wsj.com/articles/the-student-loan-siphon-1440803595 (Aug. 28, 2015) (reporting on Federal Reserve Bank of Philadelphia study concerning the negative effects of student loan debt on entrepreneurship).

2. Some History.

Student loans enjoy special treatment under the Bankruptcy Code and case law today, but that has not always been the case. In 1965, the Higher Education Act established the guaranteed student loan program, which was amended in 1976 in response to stories of abusive bankruptcy filings by debtors seeking to discharge government loans. The amendments prohibited federal student loans from being discharged in bankruptcy until five years had passed (from repayment) and if before, for "undue hardship." Upon enactment of the Bankruptcy Code in 1978, the Higher Education Act provisions were repealed and replaced by § 523(a)(8). As originally codified, § 523(a)(8) continued to allow for discharge of student loans that were five years in repayment or older, also retaining the "undue hardship" discharge provision. *See* 4 Collier on Bankruptcy ¶ 523.LH[3], pp. 523-146 to -148 (Alan A. Resnick & Henry J. Sommer eds., 16th ed.).

The 1990 Bankruptcy Code amendments increased the time limit for dischargeability, permitting student loans that were seven years in repayment or older to be discharged, along with the same undue hardship exception. *See id*. Eight years later, though, the time parameters for discharge were eliminated altogether, "leaving 'undue hardship' as the sole basis for discharging an educational loan . . . ." *Id*. at ¶ 523.LH[3][b]. The only amendment since then, in 2005, expanded the reach of this "self executing" discharge exception to include some private educational loans – not just loans that are funded, insured, or guaranteed by a governmental unit.

See id.; *Tennessee Assistance Corp. v. Hood*, 541 U.S. 440, 450 (2004). There is pending legislation that would unwind the last of these changes. *See* Fairness for Struggling Students Act of 2015, S. 729, 114th Cong., 1st Sess. (March 12, 2015) (referred to Judiciary Committee).

3. The Lay of the Land for Discharge: "Undue Hardship."

Since 1998, "[u]nless the debtor affirmatively secures a hardship determination, the discharge order will not include a student loan debt." *Hood*, 541 U.S. at 450. The United States Court of Appeals for the Tenth Circuit is among the majority of circuits applying the three-part "Brunner test" to determine undue hardship, derived from *Brunner v. New York State of Higher Education Services*, 831 F.2d 395 (2d Cir. 1987). *See Educational Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1305-06 (10th Cir. 2004). Under that test, a student loan may be discharged if:

> (1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for him or herself and dependants if forced to repay the loans; (2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) the debtor has made good faith efforts to repay the loans.

See id. The "Brunner test" applies in some nine circuits. *See Educational Credit Mgmt. Corp. v. Tetzlaff (In re Tetzlaff)*, 794 F.3d 756, 758 (7th Cir. 2015); *Educational Credit Mgmt. Corp. v. Frushour (In re Froushour)*, 433 F.3d 393, 400 (4th Cir. 2005); *Oyler v. Educational Credit Mgmt. Corp. (In re Oyler)*, 397 F.3d 382, 385 (6th Cir. 2005); *Polleys*, 356 F.3d at 1309; *U.S. Dep't. of Educ. V. Gerhardt (In re Gerhardt)*, 348 F.3d 89, 91 (5th Cir. 2003); *Hemar Ins. Corp. of Am. v. Cox (In re Cox)*, 338 F.3d 1238 (11th Cir. 2003); *United Student Aid Funds, Inc. v. Pena (In re Pena)*, 155 F.3d 1108, 1112 (9th Cir. 1998); *Pennsylvania Higher Educ. Assistance Agency v. Faish (In re Faish)*, 72 F.3d 298, 306 (3d Cir. 1995).

Recent case law in the Tenth Circuit follows suit. *See, e.g., College Assist v. Gubrath (In re Gubrath)*, 526 B.R. 863 (D. Colo. 2014) (affirming discharge of nearly $300,000 in student loans based on bankruptcy court's undue hardship findings), *appeal filed*, Case No. 15-1008 (10th Cir. Mar. 7, 2014) (pending); *accord Murray v. Educational Credit Mgmt. Corp.(In re Murray)*, No. 15-6016, 2015 WL 3929582 (Bankr. D. Kan. June 24, 2015) (noting Brunner test and dismissing dischargeability complaint in Chapter 13 case on ripeness grounds).

The United States Court of Appeals for the Eight Circuit applies a "totality of the circumstances" test, which the Bankruptcy Appellate Panel for the First Circuit has followed. *See Long v. Educational Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 554 (8th Cir. 2003); *see also Brondson v. Educational Credit Mgmt. Corp. (In re Brondson)*, 435 B.R. 791, 801 (B.A.P. 1st Cir. 2010). That test:

> requires a debtor to prove by a preponderance of evidence that (1) his past, present, and reasonably reliable future financial resources; (2) his and his dependents' reasonably necessary living expenses;

> and (3) other relevant facts or circumstances unique to the case, prevent him from paying the student loans in question while still maintaining a minimal standard of living, even when aided by a discharge of other prepetition debts.

Id. at 798 (quoting *Lorenz v. Am. Educ. Servs./Pa. Higher Educ. Assistance Agency (In re Lorenz)*, 337 B.R. 423, 430-31 (B.A.P. 1st Cir. 2006)).

Despite the stringent and fact specific "undue hardship" requirements, for roughly ten years some student loan debtors had success in obtaining "discharge by declaration" in Chapter 13 cases. Without first seeking a determination of "undue hardship," a plan confirmation order providing for student loan discharge could operate to discharge those obligations – at least before *United Student Aid Funding v. Espinosa*, 559 U.S. 260 (2009). It is settled now that "a Chapter 13 plan that proposes to discharge a student loan debt without a determination of undue hardship violates §§ 1328(a)(2) and 523(a)(8). Failure to comply with this self-executing requirement should prevent confirmation of the plan even if the creditor fails to object, or to appear in the proceeding at all." *Id*. at 276-77.

4. Eligibility Cases Under § 707(b).

Since enactment of the "presumption of abuse" and the means test for Chapter 7 debtors in 2005, 11 U.S.C. § 707(b), courts have struggled with consumer cases involving student loan debts. Those obligations are not enumerated in the allowable expenses under the means test, but courts "have allowed the existence of a student loan obligation to serve as the type of special circumstance that will rebut the presumption of abuse." *In re Howell*, 477 B.R. 314, 315 (Bankr. W.D.N.Y. 2012) (denying United States Trustee's motion to dismiss and citing *In re Sanders*, 454 B.R. 855 (Bankr. M.D. Ala. 2011); *In re Martin*, 371 B.R. 347 (Bankr. C.D. Ill. 2007); *In re Delbecq*, 368 B.R. 754 (Bankr. S.D. Ind. 2007); *In re Haman*, 366 B.R. 307 (Bankr. D.Del.2007); *In re Templeton*, 365 B.R. 213 (Bankr. W.D. Okla. 2007)). Other courts have declined to find student loan obligations a "special circumstance" to preclude dismissal. *See In re Vaccariello*, 375 B.R. 809 (Bankr. N.D. Ohio 2007) (conditionally dismissing Chapter 7 case to allow debtors opportunity to convert to Chapter 13).

Courts have also considered whether student loans are "consumer debts" to trigger the presumption of abuse in the first place; the inquiry focuses on a "profit motive" and actual use of the funds. *See, e.g., In re De Cunae*, No. 12-37424, 2013 WL 6389205 *4 (Bankr. S.D. Tex. Dec. 6, 2013) ("student loan proceeds that are used for direct educational expenses with the intent that the education received will enhance the borrower's ability to earn a future living are not consumer debts" where debtor borrowed to finance degree in dentistry); *see also Stewart v. United States Trustee (In re Stewart)*, 175 F.3d 796, 807 (10th Cir. 1999) ("comfortably conclud[ing]" based on the evidentiary record that loans to fund medical education were "consumer debts" when used to pay living expenses); *In re Rucker*, 454 B.R. 554, 558 (Bankr. M.D. Ga. 2011) (refusing to "apply a per se rule to characterize student loan debts as consumer debt or nonconsumer debt under § 707(b)" and requiring evidence concerning the "purpose of the debt").

"Structured Dismissals" within the Tenth Circuit

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I. Introduction

The United States Bankruptcy Court for the District of Utah has published the first opinion within the Tenth Circuit analyzing and authorizing the "structured dismissal" of a chapter 11 case. *See In re Naartjie Custom Kinds, Inc.*, 534 B.R. 416 (Bankr. D. Utah 2015) (Thurman, J.) In *Naartjie*, Judge Thurman addressed two issues: first, whether the bankruptcy court has statutory authority to grant a "structured dismissal," and second, whether the debtor met its burden of establishing cause for the court to grant such a relief. Answering both of these questions in the affirmative, the court joined a growing number of jurisdictions, including the Third Circuit, where structured dismissals are now a viable alternative to traditional exit strategies from chapter 11 cases. This article introduces the debate about the propriety of structured dismissals by comparing *Naartjie* to the Third Circuit's decision in *Jevic Holding Corp*., 787 F.3d 173 (3rd Cir. 2015) decision – an opinion from the highest court to have weighed in on the debate. It concludes with ten "practice pointers" to consider when seeking or opposing an order authorizing a structured dismissal in the Tenth Circuit.

II. Structured Dismissals Generally

Generally, "structured dismissals are simply dismissals that are preceded by other orders of the bankruptcy court (e.g., orders approving settlements, granting releases, and so forth) that remain in effect after dismissal." *Jevic Holding*, 787 F.3d at 181. "Unlike old-fashioned one sentence dismissals order – 'this case is hereby dismissed' – structured dismissal orders often include some or all of the following additional provisions: 'releases' (some more limited than others), protocols for reconciling an paying claims, 'gifting' of funds to unsecured creditors and

provisions providing for the bankruptcy court's continued retention of jurisdiction over certain post-dismissal matters.'" *In re Strategic Labor, Inc*., 467 B.R. 11, 18 (Bankr. D. Mass. 2012) (quoting Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: a Viable and Growing Alternative After Asset Sales*, 29 Am. Bankr.Inst. J. 1, 56 (June 2010)). The most contentious features of some structured dismissals are provisions that authorize distribution of funds outside the priority scheme prescribed by § 507 of the Bankruptcy Code.

III. Structured Dismissals in Practice: *Jevic* and *Naarjie*

The recent decisions of the Third Circuit in *Jevic* and the Utah Bankruptcy Court in *Naartjie* illustrate the nature of and issues surrounding structured dismissals.

A. *Jevic* and Structured Dismissals that Deviate from Section 507's Priority Scheme

As of December of 2015, the Third Circuit was the highest court to have opined on the propriety of "structured dismissals" under the Code. In *Jevic*, the Third Circuit upheld the bankruptcy court's order authorizing a dismissal of a Chapter 11 case pursuant to a settlement agreement that, among other things, included broad exculpatory clauses and authorized the distribution of estate assets outside the priority scheme of § 507 of the Code.

Jevic was a typical case with an atypical outcome. In 2006, CIT Group financed Sun Capital Partners' leveraged buyout of Jevic Transportation, Inc. *See Jevic*, 787 F.3d at 175. Jevic was a trucking company in decline, and as part of the acquisition, CIT advanced an $85 million revolving credit facility to Jevic secured by substantially all of Jevic's assets. *Id.* The acquisition did not alter Jevic's fate, and by May of 2008, the company had been forced to enter into a forbearance agreement with CIT, which also required a $2 million guarantee from Sun. *See id.* On May 19, 2008, Jevic ceased business operations and notified employees that they would be terminated. *See id.* at 175-176. The next day, the company filed a petition for

protection under Chapter 11 of the Code in Delaware. *See id.* at 176. As of the petition date, Jevic owed $53 million to CIT and Sun. *See id.* It owed also over $20 million in tax and general unsecured claims. *See id.*

The court appointed a committee of unsecured creditors, which filed an adversary proceeding asserting fraudulent and preferential transfer claims against CIT and Sun. *See Jevic*, 787 F.3d at 176. In essence, the committee alleged that "Sun, with CIT's assistance, acquired Jevic with virtually none of its own money based on baseless projections of almost immediate growth and increasing profitability." *Id.* Meanwhile, a group of truck drivers filed a class action against Jevic and Sun, alleging that the defendants had violated the Worker Adjustment and Retraining Notification ("WARN") Act by failing to give the workers 60 days' written notice of their layoffs. *See id.*

By March of 2012, the estate's sole remaining assets consisted of $1.7 million in cash and the committee's action against CIT and Sun. *See Jevic*, 787 F.3d at 176. The $1.7 million were subject to Sun's lien, and although the committee had partially succeeded in defeating a motion to dismiss the fraudulent and preferential transfer claims, it had concluded that the estate lacked sufficient funds to finance prosecution of its action. Accordingly, the committee, Sun, Jevic, CIT and Sun reached a settlement agreement whereby: (1) all parties would exchange releases, (2) the committee's fraudulent and preferential transfer action would be dismissed with prejudice, (3) CIT would deposit $2 million into an account earmarked to pay the estate's administrative expenses, including the fees of the committee's and the debtor's professionals, (4) Sun would assign its lien in the remaining $1.7 million to a trust for the payment of tax and administrative creditors first, and the remainder to unsecured creditors on a pro rata basis, and (5) the chapter 11 case would be dismissed. *See id.* at 177. Although the truck drivers

participated in the settlement discussions, the parties could not agree on a settlement of the WARN Act claims, which the drivers valued at $12.4 million, inclusive of 8.3 million entitled to priority under § 507(a)(4) of the Code. *See id.* Consequently, the drivers were not included in the settlement presumably because Sun, who remained a defendant in their WARN Act lawsuit, did not want to fund litigation against itself. *See id.* The effect of the drivers' exclusion from the settlement would be that the drivers would receive nothing from the estate, even on the $8.3 million wage claim, but all other general unsecured would receive about four percent of their claims. *See id.* at 177, 177 n.1.

The truck drivers and the United States Trustee objected to the proposed settlement, arguing, in part, that the proposed distribution violated the priority scheme prescribed by § 507 of the Code. *See Jevic*, 787 F.3d at 178.[1] The drivers argued that the Code does not authorize "structured dismissals," but rather only three ways for the debtor to exit chapter 11: (1) confirmation of a plan, (2) conversion to chapter 7, or (3) "plain dismissal with no strings attached." *See id.* at 180. The Third Circuit addressed these objections in reverse.

First, the Third Circuit affirmed the district court and bankruptcy court's conclusion that while structured dismissals are not expressly authorized by the Code, they are not prohibited by the Code either. *See Jevic*, 787 F.3d at 181. Specifically, the Third Circuit held that "though § 349 of the Code contemplates that dismissal will typically reinstate the pre-petition state of affairs by revesting property in the debtor and vacating orders and judgments of the bankruptcy court, it also explicitly authorizes the bankruptcy court to alter the effect of dismissal 'for cause' – in other words, the Code does not strictly require dismissal of a Chapter 11 case to be a hard reset." *Id.*

[1] The drivers also claimed that the committee of unsecured creditors violated its fiduciary duties to the estate because the settlement it negotiated excluded the drivers. *See Jevic*, 787 F.3d at 178.

Second, the Third Circuit rejected the argument that "even if structured dismissals are allowed, they cannot be approved if they distribute estate assets in derogation of the priority scheme of § 507 of the Code." *See Jevic*, 787 F.3d at 182. In essence, the drivers argued that § 103(a) required settlements in Chapter 11 cases to comply with § 507's priority scheme. *See id.*[2] Although the Third Circuit acknowledged "some tacit support in the caselaw for the [d]river's position," it concluded that "neither Congress nor the Supreme Court has ever said that the [absolute priority rule] applies to settlements in bankruptcy." *Id.* at 182-83. The Third Circuit noted that the Fifth and Second Circuits "had grappled with whether the priority scheme of § 507 must be followed when settlement proceeds are distributed in Chapter 11 cases." *Id.* (citing *Matter of AWECO, Inc.*, 725 F.2d 293, 295-96 (4th Cir. 1984) (declining to approve a settlement agreement because unsecured creditor would be paid ahead of senior claims); *In re Iridium Operating LLC*, 478 F.3d 452, 463-64 (2nd Cir. 2007) (rejecting the *AWECO* ruling as too rigid because and finding that the absolute priority rule is not necessarily implicated in settlements outside of plans of reorganization)). The Third Circuit agreed with the Second Circuit's approach, and held that "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code only if they have specific and credible grounds to justify the deviation." *Id.* at 184 (citation and quotation omitted).

Having concluded that the bankruptcy court had authority to grant structured dismissals, and that the "structure" could include distributions outside the priority scheme of § 507, the Second Circuit found that although it was a "close call," the bankruptcy court had "sufficient reasons" to approve the settlement in *Jevic* and overrule the Trustee's and the truck drivers' objections. *See Jevic*, 787 F.3d at 184-85. The court emphasized that there was "no evidence

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[2] Section 103(a) provides, "[e]xcept as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title, and this chapter, sections 307, 362(0), 554 through 557, and 559 through 562 apply in an case under chapter 15." 11 U.S.C. § 103(a).

calling into question the Bankruptcy Court's conclusion that there was 'no realistic prospect' of a meaningful distribution to Jevic's unsecured creditors apart from the settlement under review." *Id*. at 185. Instead, it was apparent that if the court did not approve the proposed settlement, the unsecured creditors would not receive anything at all because the estate lacked sufficient funds to prosecute the fraudulent claims against Sun and CIT, both of which claimed they would not enter into the same settlement with a trustee were the case converted to chapter 7. Thus, the court concluded, the movants had shown cause for approval of a structured dismissal that deviated from § 507, "[a]lthough this result is likely to be justified only rarely." *Id.* at 186.[3]

B. *Naartjie* – a Simple Structure

Naartjie was a much narrower decision than *Jevic*. *See Naartjie*, 534 B.R. 416.

Naartjie was a children clothing retailer that filed Chapter 11 intending to reorganized using pre-arranged financing. *See id.* at 418. The financing fell through shortly after the petition date, and the debtor shifted to an orderly liquidation. *Id.* Over the next six months, the court approved multiple orders authorizing the debtor to sell significantly all of its assets pursuant to § 363 of the Code. *See id.* Following the proof of claim deadline, four principal creditor constituencies emerged: (1) a group of secured noteholders claimed a senior lien against virtually all of the debtor's assets in the amount of $8.8 million; (2) a trade creditor of the debtor – Target Ease – asserted a $7 million claim, of which $2.1 was entitled to administrative priority and $2.6 million consisted of a reclamation claim;(3) a shipping company asserted a claim secured by a maritime line in the amount of $339,923.47; and (4) general unsecured creditors. *See id.*at 418-19.

[3] Judge Scirica dissented, arguing that it was not clear that the only alternative to the settlement was a chapter 7 liquidation. *See Jevic*, 787 F.3d at 186. He emphasized that the settlement at bar was not substantially distinguishable from *sub rosa* plans, and emphasized that this was not a "gifting" case because the assets to be distributed were assets of the estate since the settlement resolved the estate's fraudulent transfer claims. *See id.* at 187-88.

The parties sought and obtained approval of a settlement agreement to distribute the estates' assets as follows: (1) payment of all allowed administrative claims subject to a negotiated budget, and priority claims up to $382,000; (2) payment of $140,000 to the shipping company in satisfaction of its claim; (3) all remaining funds to be distributed among the secured creditors (45%), the trade creditor Target Ease (30.5%), and the unsecured creditors excluding Target Ease (24.5%). All parties agreed to mutual releases and to seek dismissal of the case or confirmation of a plan. *See id.* at 419. No one objected to the settlement proposal, and the court approved it pursuant to Rule 9019 and the factors set out in *In re Kopexa Realty Venture Co.*, 213 B.R. 1020 (BAP 10th Cir. 1997).

After liquidating all assets, and consummating much of the settlement agreement, the debtor moved for approval of a structured dismissal under §§ 305(a) and 349 of the Code, whereby (1) all of the court's orders would remain in full force; (2) the court would retain jurisdiction over the approval of professional fees and any disputes arising from the interpretation and implementation of an order approving the dismissal; (3) the court's dismissal order would incorporate the exculpation clauses and releases negotiated through the settlement agreement; and (4) the debtor and committee of unsecured creditors would distribute all funds pursuant to the terms of the settlement agreement. *See Naartjie*, 534 B.R. at 420.

No party with an economic interest in the estate objected, and the senior secured creditors, the committee and Target Ease supported the motion for approval of the structured dismissal. *See Naartjie*, 534 B.R. at 521. The U.S. Trustee objected, however, arguing that the Code does not authorize the approval of "structured dismissals" because "there are only three ways to exit a Chapter 11 case: (1) by confirmation of a plan pursuant to § 1129; (2) by

dismissal of the case pursuant to § 1112(b); or (3) by conversion of the case pursuant to §1112(b)." *See id.*

The court granted the debtor's motion, holding that §305(a) authorized dismissals of any case if the interest of creditors and the debtor would be better served by such dismissal or suspension. *Naartjie*, 534 B.R. at 422. The court then turned to the determinative question: "may the Court alter the effect of dismissal?" *Id*. Quoting § 349(b), the court held that "[t]his subsection describes the effect of dismissal, but it qualifies the effect by providing that the Court may, for cause, order otherwise. It follows that, if cause is shown, a bankruptcy court may alter the effect of dismissal. The statute is clear and unambiguous on this point." *Id*. at 422-23. Furthermore, analyzing § 349's legislative history, the court concluded that "[t]he effect of dismissal is to put the parties, as much as practicable, back in the positions they occupied pre-bankruptcy." *Id*. at 423. "But, if cause is shown, such as when a structured dismissal will better serve the interests of the creditors and the debtor, the bankruptcy court may order otherwise and alter the effect of dismissal." *Id*.

Having concluded that it had statutory authority to authorize a structured dismissal, the court found that the debtor had shown cause for dismissal under § 305(a) because (1) "it [was] clear that the proposed structured dismissal [was] the most efficient and economic[cal] way to administer" the case; (2) the parties' rights were protected and preserved since the court's orders would remain in full force and effect; (3) the parties would have access to a forum where they could enforce those orders (i.e, the bankruptcy court); and (4) the settlement agreement was an out-of-court workout that equitably distributed the assets of the estate. *See Naartjie*, 534 B.R. at 426 (applying factors adopted in *In re Zapas*, 530 B.R. 560, 572 (Bankr.E.D.N.Y. 2015), *In re AMC Investors, LLC*, 406 B.R. 478, 488 (Bankr.D.Del. 2009), *In re RCM Global Long Term*

Capital Appreciation Fund, Ltd., 2000 B.R. 514, 525 (Bankr.S.D.N.Y. 1996), *In re Picacho Hills Util. Co.*, No. 11-13-10742 TL, 2013 WL 1788298, at *9 (Bankr.D.N.M. Apr. 26, 2013)).

The court found that the debtor had also met the standard for altering the effect of dismissal under § 349. *Naartjie*, 534 B.R. at 426. In addition to the bases discussed above, it found that despite receiving notice of both the settlement motion and the motion for approval of a structured dismissal, "no economic stakeholder [] objected." Moreover, there was little for the debtor to do in the case, other than distributing the assets. The court concluded that the motion was "not an attempt to work around the protections of § 1129; it is simply the rare case where cause is shown to alter the effect of dismissal." *Id.* Thus, the court concluded, the movants had shown cause for alternating the effect of dismissal under § 349.

IV. Ten Factors to Consider When Proposing or Opposing a Structured Dismissal

As Judge Thurman noted in *Naartjie*, that case was part of a "growing trend of structured dismissals." *Naartjie*, 534 B.R. at 421. Given their perceived or actual benefits, including speed and lower cost, structured dismissals are likely to become more common over the next few months or, at least, are highly likely to be litigated more frequently. In seeking approval of or opposing structured dismissals, practitioners should consider the following:

1. Statutory Relief: Consider whether dismissal should be or is sought under §§ 305(a) or 1112(b). As Judge Thurman noted in *Naartjie*, "[s]ection 305(a)(1) is a narrower provision for dismissing a Chapter 11 case than § 1112(b)." *Naartjie*, 534 B.R. at 422. Under § 305(a), a court may dismiss a case if "the interests of creditors and the debtor would be better served by" the dismissal. 11 U.S.C. § 305(a)(1). By contrast, under § 1112(b), the court may appoint a trustee, convert or dismiss a chapter 11 case, "whichever is in the best interest of creditors and the estate." 11 U.S.C. § 1112(b). Courts are less likely to grant relief under §

305(a) than 1112(b) particularly because the court's decision under § 305(a) is not subject to appellate review pursuant to § 305(c) of the Code. Nevertheless, movants may be tempted to seek relief under § 305(a) over § 1112(b) to limit the range of potential relief – i.e., to avoid the possibility that the court may appoint a trustee or convert the case rather than dismiss it. Section 305(a) is particularly attractive where all parties with an economic interest in the outcome of the case have reached a settlement.

2. Focus on "Cause" Under § 349: At this point, the debate on whether the court has statutory authority to grant a structured dismissal is largely academic. Even the courts that have denied motions for approval of structured dismissals have recognized that they have the statutory authority to alter the effect of dismissal under § 349(b) of the Code. Although "cause" for altering the effect of § 349 is a developing concept, the Naartjie opinion provides some guidance on factors that may be considered when determining whether the movant has met this burden. *See Naartjie*, 534 B.R. at 426 (considering the notice provided to the parties, objections filed, and whether movant was attempting "work around the protections of the Bankruptcy Code").

3. Anticipate the U.S. Trustee's Objection: In virtually every reported opinion, the U.S. Trustee has objected to motions seeking approval of structured dismissals. The reasons for the U.S. Trustee's distaste for structured dismissals are articulated in an article by the Associate General Counsel for Chapter 11 Practice at the Executive Office for the U.S. Trustee titled *Structured Dismissals, or Cases Dismissed Outside of the Code's Structure*, 30 Am. Bankr. Inst. J. 20 (March 2011). Practitioners proposing or opposing structured dismissals can anticipate the U.S. Trustee's position and address, to the extent possible, the concerns raised in this article.

4. Timing: Movants should seek relief under § 349(b) as soon as it becomes significantly likely that confirmation of a plan is not a viable option, but after resolution of as

many preliminary matters as possible. Correspondingly, opponents should highlight loose ends that may affect negatively the rights of creditors or other stakeholders. For example, the court may reject a structured dismissal motion where claim disputes are outstanding.

5. Consider *sub rosa* Jurisprudence: Strictly speaking, a proposal constitutes a *sub rosa* plan where it dictates the terms of a reorganization plan. *See Jevic*, 787 F.3d at 188 (Scirica, J., dissenting); *see also, In re Shubh Hotels Pittsburgh, LLC*, 439 B.R. 637, 644-45 (Bankr. W.D. Penn. 2010) ("a transaction would amount to a *sub rosa* plan or reorganization if it: (1) specifies the terms of any future reorganization plan; (2) restructures creditors' rights; and (3) requires that all parties release claims against the Debtor, its offices and directors, and its secured creditors"). Structured dismissals, by definition, do not implicate the confirmation of a plan, and thus are distinguishable from *sub rosa* plans. Structured dismissals, however, implicate the same policy concerns as *sub rosa* plans. Accordingly, practitioners should consult case law analyzing *sub rosa* plans and may rely on it by analogy particularly when opposing structured dismissals motions.

6. 9019 Settlements and Asset Sales: Most successful structured dismissals follow approval of a settlement under Rule 9019, the sale of substantially all assets of the debtor under § 363, or both. The practical reason for this sequence is that by the time the court has to determine whether there is cause for altering the effect of § 349, all other major disputes in the case have been resolved. This is particularly true in cases like *Naartjie*, where all constituents with an economic interest in the case reach a settlement (or, at least, are represented during settlement discussions). Thus, in seeking structured dismissals, movants increase the likelihood of succeeding if they first obtain relief, were applicable, under § 363 and seek consensus from stakeholders in the form of a settlement under Rule 9019.

7. But if no Consensus, Invoke *Jevic*: Failure to obtain consensus from all stakeholders with an economic interest in the case, however, is not a dispositive post *Jevic*. The effect of that opinion appears to be that so long as objecting creditors like the truck drivers in *Jevic* can vindicate their rights elsewhere or against another party, the court may approve a structured dismissal that violates the absolute priority rule. In other words, movants should seek consensus, but if they must, then they should abandon only creditors who can fend for themselves.

8. Remain Vigilant: Opponents of structured dismissal motions should object to any Rule 9019 or §363 motion that sets up the dismissal motion. For example, in *Naartjie*, the Rule 9019 Motion that predated the structured dismissal motion contemplated a filing of the latter. In dismissing the case, the court noted that no party had objected to the earlier motion. *See Naartjie*, 534 B.R. at 426.

9. Prove Efficiency: One of the primary justifications for granting a structured dismissal motion is the movant's ubiquitous proffer that the structured dismissal will save the estate significant resources over an expensive plan confirmation process. Typically, however, the estate is not fully administered as of the date the court enters an order approving a structured dismissal. Thus, part of the "structure" will likely include process for wrapping up the case. Practitioners should be careful not to surprise the court with professional fees or administrative expenses incurred post-approval of a structured dismissal that disprove its professed efficiency.

10. Equitable Mootness: The *Jevic* dissent points out that the doctrine of equitable mootness was not applicable to a court's order approving a structured dismissal because that doctrine applies only where a plan of reorganization is confirmed. *See Jevic*, 787 F.3d at 186 (Scirica, J., dissenting) (citing *In re Semcrude*, L.P., 728 F.3d 314 (3d. Cir. 2013). It is unclear,

however, whether Judge Scirica's rationale holds true in the Tenth Circuit, specially when the structured dismissal is approved pursuant to a rule 9019 motion, or where the court dismisses the case under § 305(a). *See e.g., Rindlebach v. Jones*, 532 B.R. 850, 856-58 (Bankr. D. Utah 2015) (appeal from order approving settlement equitably moot). Opponents of structured dismissal motions should therefore consider whether and when to ask a court to stay an order pending post-ruling motions.