Views from the Bench, 2019

American Bankruptcy Institute

Great Debates

Resolved: A creditor in possession of a debtor's collateral must surrender it to avoid a stay violation.

Hon. Michael E. Wiles, Moderator
U.S. Bankruptcy Court (S.D.N.Y.); New York

Pro: Hon. Eugene R. Wedoff (Ret.)
U.S. Bankruptcy Court (N.D. Ill.); Oak Park

Con: Craig Goldblatt
WilmerHale; Washington, D.C.

Resolved: The legal test or application of the standard of disinterestedness should be changed.

Thomas. M. Horan, Moderator
Fox Rothschild LLP; Wilmington, Del.

Pro: Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

Con: Hon. Robert E. Gerber (Ret.)
Joseph Hage Aaronson LLC; New York

Consumer Corner

By Hon. Eugene R. Wedoff (ret.)

Return of Vehicles Seized Before a Chapter 13 Filing

Does the Debtor Have to File a Turnover Motion?

Hon. Eugene R. Wedoff (ret.)
Oak Park, Ill.

Hon. Eugene Wedoff is a retired bankruptcy judge and a past ABI president. His practice is exclusively pro bono *and is limited to representing clients in bankruptcy appeals. He is also an* ex officio *member of the ABI Commission on Consumer Bankruptcy.*

Editor's Note: *This topic was one of the issues presented at the 27th Annual Duberstein Moot Court Competition, held in New York in early March. To learn more about the competition (jointly sponsored by ABI and St. John's University School of Law), please visit stjohns.edu/law/center-bankruptcy-studies/27th-annual-duberstein-moot-court-competition.*

One of the significant unresolved issues in consumer bankruptcy law is the right of a chapter 13 debtor to obtain the return of a vehicle seized before the bankruptcy was filed. The majority of the courts that have ruled on the issue, including the Seventh Circuit in *Thompson v. GMAC* and several other circuit courts, have held that creditors have a duty to return the seized vehicle to the debtor under the automatic stay set out in § 362(a)(3).[1]

However, the Tenth Circuit's recent *Cowen* decision adopted a minority interpretation, holding that the automatic stay does not apply to vehicles seized pre-petition and that a creditor need only return the collateral to a chapter 13 debtor if the bankruptcy court grants a debtor's motion for turnover.[2] ABI's *Rochelle's Daily Wire*, in reporting both this decision and a subsequent one by the Tenth Circuit, noted the potential for a grant of *certiorari* to resolve the circuit split.[3]

Before any consideration by the U.S. Supreme Court, the Seventh Circuit is being asked to address the issue. The City of Chicago has enacted ordinances that (1) allow the city to seize vehicles for parking, revenue and camera-recorded driving violations, and (2) grant the city a possessory lien on the seized vehicles.[4] Vigorous enforcement of these ordinances has resulted in thousands of chapter 13 filings in Chicago.[5]

In these cases, the debtors have cited the *Thompson* decision as requiring the city to return seized vehicles to them when it receives notice of their bankruptcy filings. However, the city has contested *Thompson*'s applicability, arguing that in order to retain its possessory lien, it is allowed to continue holding seized vehicles under § 362(b)(3), an exception to the automatic stay that allows creditor action to maintain lien perfection. The city's more basic argument is that *Thompson* was incorrectly decided, and that the Seventh Circuit should overrule it and adopt the minority interpretation of § 362(a)(3). Five bankruptcy judges have ruled on the city's arguments, and one found that the automatic stay exception applied.[6] The other four rejected that argument.[7] However, none of the judges found that *Thompson* should be overruled. The city has appealed the four decisions that denied it relief, and the Seventh Circuit has consolidated the cases for direct appeal.[8]

The narrow issue — application of the stay exception in § 362(b)(3) — will only be relevant in the appeal if *Thompson* is upheld. Unless § 362(a)(3) generally requires the return of seized collateral, there would be no need to consider a special exception for collateral subject to a possessory lien.[9] The applicability of § 362(a)(3)

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1 *See Thompson v. Gen. Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009); *Weber v. SEFCU (In re Weber)*, 719 F.3d 72 (2d Cir. 2013); *Calif. Emp't Dev. Dep't v. Taxel (In re Del Mission Ltd.)*, 98 F.3d 1147 (9th Cir. 1996) (expressly adopting *Abrams v. Sw. Leasing & Rental Inc. (In re Abrams)*, 127 B.R. 239 (B.A.P. 9th Cir. 1991), which holds that failure to return repossessed car after receiving notice of debtor's bankruptcy violates § 362(a)(3)). *Knaus v. Concordia Lumber Co. (In re Knaus)*, 889 F.2d 773 (8th Cir. 1989), applied the same reading of § 362(a)(3) to require the return of collateral to a chapter 11 debtor. *See also Motors Acceptance Corp. v. Rozier*, 348 F.3d 1305 (11th Cir. 2003); *Rozier v. Motors Acceptance Corp. (In re Rozier)*, 376 F.3d 1323 (11th Cir. 2004) (requiring return of collateral obtained pre-petition as long as collateral remained estate property after repossession). *Accord, STMIMA v. Carrigg (In re Carrigg)*, 216 B.R. 303 (B.A.P. 1st Cir. 1998); *TranSouth Fin. Corp. v. Sharon (In re Sharon)*, 234 B.R. 676 (B.A.P. 6th Cir. 1999).

2 *WD Equip. v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. 2017), rejecting the contrary opinion, *Unified People's Fed. Credit Union v. Yates (In re Yates)*, 332 B.R. 1 (B.A.P. 10th Cir. 2005). A more extensive argument for the minority interpretation is set out in *In re Hall*, 502 B.R. 650 (Bankr. D.D.C. 2014).

3 Bill Rochelle, "Tenth Circuit's Narrow View of Automatic Stay Erodes Estate Property," *Rochelle's Daily Wire* (July 14, 2017), *available at* abi.org/newsroom/daily-wire/tenth-circuit's-narrow-view-of-automatic-stay-erodes-estate-property; Bill Rochelle, "Tenth Circuit Opinion Can Be the Springboard for a 'Cert' on the Automatic Stay," *Rochelle's Daily Wire* (Oct. 18, 2018), *available at* abi.org/newsroom/daily-wire/tenth-circuit-opinion-can-be-the-springboard-for-a-'cert'-on-the-automatic-stay (unless otherwise specified, all links in this article were last visited on Jan. 25, 2019).

4 Municipal Code of Chicago, Ill., §§ 9-100-120 (impounding vehicles), 9-92-080(f) (possessory lien).

5 *See* Melissa Sanchez and Sandhya Kambhampati, "Driven Into Debt: How Chicago Ticket Debt Sends Black Motorists into Bankruptcy," *ProPublica Illinois* (Feb. 27, 2018), *available at* features.propublica.org/driven-into-debt/chicago-ticket-debt-bankruptcy ("In 2007, an estimated 1,000 Chapter 13 bankruptcies included debts to the city, usually for unpaid tickets, with the median amount claimed around $1,500 per case. By last year, the number of cases surpassed 10,000, with the typical debt to the city around $3,900.").

6 *In re Avila*, 566 B.R. 558 (Bankr. N.D. Ill. 2017).

7 *In re Shannon*, 590 B.R. 467 (Bankr. N.D. Ill. 2018); *In re Peake*, 588 B.R. 811 (Bankr. N.D. Ill. 2018); *In re Fulton*, 588 B.R. 834 (Bankr. N.D. Ill. 2018); *In re Howard*, 584 B.R. 252 (Bankr. N.D. Ill. 2018).

8 *City of Chicago v. Robbin L. Fulton*, No. 18-2527, Docket Nos. 2, 6 and 14. The author is serving as counsel to debtors in this appeal.

9 The treatment of possessory liens in bankruptcy is beyond the scope of this article, but are discussed in Eugene R. Wedoff, "The Automatic Stay Under § 362(a)(3) — One More Time," 38 *Bankr. L. Letter* No. 7, at 5-6 (July 2018); and Ralph Brubaker, "Turnover, Adequate Protection and the Automatic Stay: A Reply to Judge Wedoff," 38 *Bankr. L. Letter* No. 11, at 11-12 (Nov. 2018).

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then becomes the principal issue to be determined by the Seventh Circuit, and it is a major issue for consumer bankruptcy, since it affects not only Chicago vehicle seizures but the repossession of vehicles for ordinary auto loan defaults across the nation. There are three major arguments about the application of § 362(a)(3) to repossessed collateral: (1) the requirements for turnover under § 542(a); (2) the meaning of § 362(a)(3); and (3) compliance with general bankruptcy policy.

Turnover Under § 542(a)

Section 542(a) provides that a party holding property that a trustee can use under § 363 must deliver that property to the trustee unless it has inconsequential benefit to the estate.[10] Section 1306(b) generally places chapter 13 debtors in possession of estate property; § 1303 gives them the general rights of a trustee under § 363; and § 542(a) gives them the right to receive property that a trustee could use under § 363. Minority decisions acknowledge that chapter 13 debtors have the property rights of trustees, but argue that § 542 requires the debtors to obtain a court order before creditors are required to turn over seized property to the debtor.[11]

The difficulty with this argument is that it contradicts the text of the statute. Section 542(a) does not condition its turnover requirement on court orders, but simply states that property that can be used under § 363 "shall" be delivered. The congressional reports setting out the effect of § 542(a) confirm its plain meaning,[12] and the majority decisions have interpreted § 542(a) accordingly.[13] *Cowen* expressly declines to challenge this interpretation and only asserts that if it is correct, § 362(a)(3) is not necessary to enforce the turnover obligation, since § 105(a) would allow debtors to seek sanctions for a creditor's failure to turn over property voluntarily.[14]

The Meaning of § 362(a)

The majority interpretation of § 362(a)(3) is also grounded in the plain meaning of its terms. Section 362(a)(3) applies the automatic stay to "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate," and the majority decisions hold that a creditor "exercises control" over a debtor's vehicle by continuing to hold it after the bankruptcy filing. *Thompson* made the point this way:

> Webster's Dictionary defines ''control'' as, among other things, ''to exercise restraining or directing influence over'' or ''to have power over.'' *Merriam-Webster's Collegiate Dictionary* (11th ed. 2003). Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within this definition, as well as within the commonsense meaning of the word.[15]

On the other hand, *Cowan* focused on the action prohibited by the paragraph:

> [Section] 362(a)(3) prohibits "any act to obtain possession of property" or "any act to exercise control over property." "Act," in turn, commonly means to "take action" or "do something." *New Oxford American Dictionary* 15 (3d ed. 2010).... This section, then, stays entities from doing something to obtain possession of or to exercise control over the estate's property. It does not cover "the act of passively holding onto an asset," *Thompson*, 566 F.3d at 703, nor does it impose an affirmative obligation to turn over property to the estate.[16]

The difficulty with *Cowen*'s approach to the language is that a creditor does more than "passively hold" a seized vehicle by refusing to return it; the creditor actively prevents the debtor from regaining possession by keeping the vehicle locked or guarded. Only if the creditor were truly passive, allowing the debtor free access to the vehicle, would there be no exercise of control. In at least one bankruptcy decision, the minority interpretation is supported with an alternative argument that "property of the estate" does not include all the rights of property ownership, but only the rights to which the debtor was entitled when the bankruptcy case was filed. If the debtor had no right to possess seized property before the bankruptcy case was filed, the argument continues, the right of possession would not become property of the estate, and the creditor would not "exercise control over property of the estate" by preventing the debtor from obtaining the property.[17]

Cowen does not make this argument, so it avoids addressing the difficulty with the argument presented by § 542(a). While a chapter 13 debtor would not have had the right to possess seized property before the bankruptcy filing, § 542(a) conveys that right as soon as the bankruptcy case is filed. *Thompson* makes the point that § 542(a) "draw[s] back into the estate a right of possession that is claimed by a lien creditor pursuant to a prepetition seizure."[18] So, by depriving the debtor of the right to possess property that § 542(a) accords, a creditor would clearly exercise control over "estate property," violating § 362(a)(3).

10 Section 542(a) provides, in relevant part "[A]n entity ... in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 ... shall deliver to the trustee ... such property ... unless such property is of inconsequential value or benefit to the estate."

11 For example, *In re Hall*, 502 B.R. at 654-64, sets out a lengthy argument that § 542(a) continues a pre-Bankruptcy Code practice requiring trustees and debtors in possession to obtain turnover of estate property by moving for a court order. Pre-Code practice might inform the interpretation of ambiguous statutory Code provision language, but it may not be used to contradict the Code's language. *See Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 10, 120 S. Ct. 1942, 1949 (2000) ("[W]hile pre-Code practice 'informs our understanding of the language of the Code,' it cannot overcome that language. It is a tool of construction, not an extratextual supplement.") (citation omitted).

12 S. Rep. No. 95-989, 95th Cong., 2d Sess. 84 (1978); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977) ("Subsection (a) of this section requires anyone holding property of the estate on the date of the filing of the petition, or property that the trustee may use, sell, or lease under section 363, to deliver it to the trustee.").

13 *See, e.g., In re Knaus*, 889 F.2d at 775 ("The duty to turn over the property is not contingent upon ... any order of the bankruptcy court...."); *Thompson*, 566 F.3d at 704 (under § 542(a) "turnover of a seized asset is compulsory").

14 *Cowen*, 849 F.3d at 950.

15 *Thompson*, 566 F.3d at 702.

16 *Cowen*, 849 F.3d at 949.

17 *Hall*, 502 B.R. at 667-69.

18 *Thompson*, 566 F.3d at 704 (quoting *In re Sharon*, 234 B.R. at 683).

Bankruptcy Policy

The policies underlying §§ 362(a)(3) and 542(a), as *Thompson* explains, are to "allow the debtor to reorganize and repay the majority of his debts without having to liquidate his assets" and so let the debtor "retain the beneficial use of productive assets."[19] For chapter 13 debtors, enforcing this policy by applying the automatic stay to seized vehicles is particularly important. Chapter 13 debtors often need their vehicles to get to work or care for their children, but they typically have limited financial resources, so they would often lack the additional funds needed to obtain alternative transportation while a motion to enforce turnover was being considered by the court. Requiring a motion to be granted before the debtor can obtain the return of a seized vehicle would often make bankruptcy unable to address the debtor's financial distress.[20]

For creditors, on the other hand, complying with § 362(a)(3) imposes no extraordinary burden. The major concern raised by the minority decisions is that the creditor might be required to return a vehicle without a court order providing adequate protection. However, this situation is not significantly different from that faced by any creditor whose collateral is not adequately protected while a chapter 13 case is pending.[21]

The remedy is for the creditor to seek a court order for relief from the automatic stay, which (if the creditor is threatened with immediate and irreparable loss) can be obtained without notice to the debtor.[22] The most troubling situation for a creditor is a request for the return of a repossessed vehicle that is uninsured.[23] However, a loss of insurance (caused by the debtor's failure to pay premiums) can also occur during a case, and again, the remedy is stay relief. Creditors who have repossessed an uninsured vehicle before filing have an additional alternative: to retain the vehicle and respond to any motion for enforcement of the automatic stay with a request for stay annulment, which would retroactively validate the vehicle retention.[24] There appear to be no published decisions imposing sanctions for a creditor's refusal to return an uninsured vehicle, and there is ample indication that no such turnover would be ordered.[25]

Conclusion

Each of the arguments discussed herein will likely be addressed in the Seventh Circuit's decision in the pending appeal, and that decision might have a major effect on chapter 13 practice. abi

19 *Id.* at 705.

20 *Id.* at 707 ("If a debtor's car remains in the hands of a creditor, it could hamper the debtor from either attending or finding work, which is crucial for garnering the funds necessary to pay off his debts.").

21 *See In re Yates*, 332 B.R. at 5 ("As a practical matter, there is little difference between a creditor who obtains property of the estate before bankruptcy is filed, or after bankruptcy is filed.").

22 Fed. R. Civ. P. 4001(a)(2), providing for *ex parte* stay relief under § 362(d).

23 *See Hall*, 502 B.R. at 660 ("If immediate turnover were required, an accident might result in the collateral being destroyed, with no insurance proceeds recovered, and the lien being rendered worthless.").

24 Annulment is one of the forms of stay relief authorized by § 362(d), and its effect of retroactive validation is well recognized. *See, e.g., In re Siciliano*, 13 F.3d 748, 751 (3d Cir. 1994) ("[I]nclusion of the word 'annulling' in the statute ... indicates a legislative intent to apply certain types of relief retroactively and validate proceedings that would otherwise be void *ab initio*.").

25 While adopting the majority interpretation of § 362(a)(3), one court bluntly stated that it "takes the lack of insurance seriously and will not permit a debtor to obtain or retain possession of a vehicle that is not adequately insured." *Stephens v. Guaranteed Auto Inc. (In re Stephens)*, 495 B.R. 608, 615 (Bankr. N.D. Ga. 2013). Another court, though otherwise accepting the minority interpretation of § 362(a)(3), upheld the district's practice of finding a violation of the automatic stay by a creditor that refuses to return a seized vehicle, but only after the debtor produces proof of insurance. *In re Denby-Peterson*, 576 B.R. 66, 81-82 (Bankr. D.N.J. 2017).

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Rochelle's Daily Wire | ABI Exclusive

June 21, 2019

Seventh Circuit Solidifies a Circuit Split on the Automatic Stay

> Disagreeing with the Tenth and D.C. Circuits and siding with four other circuits, the Seventh Circuit rules that passively holding estate property violates the automatic stay.

Solidifying a split of circuits, the Seventh Circuit ruled that the City of Chicago must comply with the automatic stay by returning impounded cars immediately after being notified of a chapter 13 filing.

The decision lays the foundation for the Supreme Court to grant *certiorari* and decide whether violation of the automatic stay requires an affirmative action or whether inaction amounts to control over estate property and thus violates the stay.

The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold that a secured creditor or owner must turn over repossessed property immediately or face a contempt citation. The Tenth and the District of Columbia Circuits have ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3), which prohibits "any act . . . to exercise control over property of the estate."

The same issue was argued on May 23 in the Third Circuit, where the lower courts were siding with the minority. *See Denby-Peterson v. NU2U Auto World*, 18-3562 (3d Cir.). For ABI's report on *Denby*, click here.

The Impounded Cars in Chicago

Four cases went to the circuit together. The facts were functionally identical.

The chapter 13 debtors owed between $4,000 and $20,000 on unpaid parking fines. Before bankruptcy, the city had impounded their cars. Absent bankruptcy, the city will not release impounded cars unless the fines are paid. If the cars are not redeemed by their owners, most of them are scrapped.

In 2016, Chicago passed an ordinance giving the city a possessory lien on impounded cars.

After filing their chapter 13 petitions, the debtors demanded the return of their autos. The city refused to release the cars unless the fines and other charges were paid in full.

The debtors mounted contempt proceedings in which four different bankruptcy judges held that the city was violating the automatic stay by refusing to return the autos. After being held in contempt, the city returned the cars but appealed.

In all four cases, the owners confirmed chapter 13 plans treating the city as holding unsecured claims. The city did not object to confirmation or appeal.

In the four cases, the city never sought adequate protection for its alleged security interests under Section 363(e).

Thompson Controls

Circuit Judge Joel M. Flaum was not writing on a clean slate in his June 19 opinion, given the circuit's controlling precedent in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009). *Thompson*, he said, presented "a very similar factual situation."

Although *Thompson* came down only 10 years ago, Judge Flaum nonetheless wrote a comprehensive, 27-page opinion, perhaps sensing that the case will go to the Supreme Court on *certiorari*.

In *Thompson*, Judge Flaum said, "we held that a creditor must comply with the automatic stay and return a debtor's vehicle upon her filing of a bankruptcy petition. We decline the City's request to overrule *Thompson*." He also agreed with the bankruptcy courts "that none of the exceptions to the stay apply."

Quoting extensively from *Thompson*, Judge Flaum said that the Seventh Circuit had already "rejected" the city's contention that "passively holding the asset did not satisfy the Code's definition of exercising control." He noted that Congress amended Section 362 in 1984 by adding subsection (a)(3) and making the automatic stay "more inclusive by including conduct of 'creditors who seized an asset pre-petition,'" citing *U.S. v. Whiting Pools Inc.*, 264 U.S. 198, 203-204) (1983).

[+] Feedback

Again citing *Whiting Pools*, Judge Flaum said that Section 362(a)(3) "becomes effective immediately upon the filing of the petition and is not dependent on the debtor first bringing a turnover action." He added, the "creditor . . . has the burden of requesting protection of its interest in the asset under Section 363(e)."

Judge Flaum found support for his conclusion in Section 542(a). Again quoting *Thompson*, he said the section "'indicates that turnover of a seized asset is compulsory.'" *Thompson*, *supra*, at 704.

"Applying *Thompson*," Judge Flaum held "that the City violated the automatic stay . . . by retaining possession . . . after [the debtors] declared bankruptcy." The city, he said, "was not passively abiding by the bankruptcy rules but actively resisting Section 542(a) to exercise control over the debtors' vehicles."

Telling Chicago how to proceed in the future, Judge Flaum said the city must turn over the car and may seek adequate protection on an expedited basis. The burden of seeking adequate protection, he said, "is not a reason to permit the City to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code."

In sum, Judge Flaum declined the city's invitation to overrule *Thompson*. He said, "Our reasoning in *Thompson* continues to reflect the majority position and we believe it is the appropriate reading of the bankruptcy statutes."

Exceptions to the Automatic Stay

Judge Flaum devoted the last third of his opinion to explaining why Chicago was not eligible for any of the exceptions to the automatic stay.

Section 362(b)(3), allowing acts to perfect or continue perfection of liens, does "not permit creditors to retain possession of debtors' property," Judge Flaum said. Rather, it allows creditors to file notices to continue or perfect a lien when bankruptcy has intervened. The city, he said, could perfect its possessory lien by a filing with the Secretary of State.

Judge Flaum cited Illinois decisions holding that giving up possession involuntarily does not destroy a possessory lien. The notion that turning over cars would abrogate the possessory lien was one of Chicago's primary arguments on appeal.

Judge Flaum held that Section 362(b)(4), excepting police or regulatory powers from the automatic stay, did not apply. On balance, he said, the municipal machinery to impound cars "is an exercise of revenue collection more so than police power."

Is *Certiorari* Next?

In the term that ends this month, the Supreme Court denied a petition for *certiorari* raising the same question. *See Davis v. Tyson Prepared Foods Inc.*, 18-941 (Sup. Ct.) (cert. denied May 20, 2019).

Davis, from the Tenth Circuit, was a challenge to the Tenth Circuit's holding in *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017). In *Cowen*, the Tenth Circuit ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3) as an act to "exercise control over property of the estate." To read ABI's discussion of the denial of *certiorari*, click here.

In this writer's opinion, the Chicago parking ticket cases are a better vehicle for *certiorari* because they raise the issue more cleanly. *Davis* was a step or two removed from the question of whether overt action is required to violate the automatic stay.

Given the recent change in administration in Chicago, it is not certain that the city will pursue *certiorari*.

Eric Brunstad told ABI, "The issue is certainly not going away. I predict that eventually the Supreme Court will grant *certiorari* in a case involving the issue and resolve the conflict among the courts of appeals." Brunstad represented the debtor who unsuccessfully sought Supreme Court review in *Davis*.

Opinion Link

PREVIEW

[+] Feedback

View Opinion

Case Details

Judge Name	Joel M. Flaum
Case Citation	In re Fulton, 18-2527 (7th Cir. June 10, 2019)
Case Name	In re Fulton
Case Type	Consumer
Court	7th Circuit
Bankruptcy Tags	Automatic Stay Claims Bankruptcy Litigation Practice and Procedure Consumer Bankruptcy Business Reorganization

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January 30, 2019

The Jay Alix/McKinsey Spat Reaches the Supreme Court

> The Jay Alix certiorari petition asks the high court to resolve a circuit split and say whether vindicating the public interest confers appellate standing.

The dogfight between retired turnaround advisor Jay Alix and the McKinsey consulting firm has led to a petition for *certiorari* asking the Supreme Court to resolve a split of circuits. Alix says the high court should decide whether vindicating the integrity of the judicial system confers standing to appeal when the appellant otherwise would not satisfy the "person aggrieved" standard.

In a one-paragraph *per curiam* opinion handed down in September, the Fourth Circuit rigorously enforced the requirement that an appellant have a pecuniary interest in the outcome of an appeal to avoid dismissal for lack of standing, even if the appeal purports to uphold the integrity of the bankruptcy system.

The case comes to the Supreme Court in the aftermath of the reorganization of coal producer Alpha Natural Resources Inc. Alix, one of the creditors, persistently challenged the adequacy of the disclosures under Bankruptcy Rule 2014 made by the debtor's turnaround advisor, McKinsey Recovery & Transformation Services US LLC.

Ultimately, the bankruptcy court only required McKinsey to file an *in camera* disclosure of the names of some of its clients. The bankruptcy court went on to rule that McKinsey's disclosures were adequate and that the firm was disinterested. Through the creditor he beneficially owned, Alix appealed by challenging the sufficiency of the disclosure and seeking to have the identity of McKinsey's clients disclosed publicly.

Concluding that Alix lacked appellate standing, the district court dismissed the appeal in September 2017, prompting him to appeal to the Fourth Circuit.

In one paragraph, the appeals court affirmed "for the reasons stated by the district court." To read ABI's discussion of the Fourth Circuit's ruling, click here.

Adopted by the circuit court, the district judge had reasoned that Alix lacked appellate standing because he was not a "person aggrieved," since he had no pecuniary interest in the outcome. Even if the appellate court were to reverse and McKinsey was directed to disgorge the fees it had been paid, Alix would not benefit monetarily because additional recoveries by the estate were earmarked for more senior creditors.

Alix filed a petition for *certiorari* on January 22, represented by Harvard Law School Professor Lawrence H. Tribe and Susan M. Freeman of Phoenix.

To establish standing, courts require the appellant to be a "person aggrieved." According to the *certiorari* petition, the Second, Third, Sixth and Eleventh Circuits recognize an exception to the pecuniary interest requirement. They hold that the public interest may also create a sufficient stake in the outcome to confer appellate standing.

On the other hand, according to the *certiorari* petition, the Fourth, Fifth and Seventh Circuits do not recognize the public interest exception to the pecuniary interest test.

Alix urges the justices to grant *certiorari* and resolve the deepening circuit split. He contends there is "an exception to the test for appeals brought by parties with Article III standing in order to vindicate the public interest, especially when the integrity of the judicial system is at stake."

The circuit split is not the only reason for granting *certiorari*, Alix says. The result is contrary to the policy shown in *Stern v. Marshall* because dismissal of the appeal meant there was no Article III supervision of the Article I tribunal.

[+] Feedback

Alix also argues that the result in the Fourth Circuit is contrary to the Supreme Court's teaching in *Lexmark International Inc. v. Static Control Components Inc.*, 572 U.S. 118 (2014). According to Alix, *Lexmark* casts "grave doubt on the viability of 'prudential' doctrines that abdicate federal courts' 'virtually unflagging' obligation to resolve cases within their Article III jurisdiction."

Should the high court grant *certiorari*, an opinion expounding on *Lexmark* in the bankruptcy context might support or undercut the principle of equitable mootness that often cuts off appeals in bankruptcy cases.

If McKinsey elects to oppose the *certiorari* petition, the response is due on February 27, barring an extension of time. Even if the petition is granted this spring, argument would not be held until the term to begin in October 2019.

Opinion Link

PREVIEW

View Opinion

Case Details

Judge Name	Supreme Court
Case Citation	Mar-Bow Value Partners LLC v. McKinsey Recovery & Transformation Services US LLC, 18-974 (Sup. Ct.)
Case Name	Mar-Bow Value Partners LLC v. McKinsey Recovery & Transformation Services US LLC
Case Type	Business
Court	Supreme Court
Bankruptcy Tags	Practice and Procedure Venue/Jurisdiction

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An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for

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April 23, 2019

Supreme Court Won't Intervene in Fight Between Jay Alix and McKinsey

> Supreme Court will not rule on whether upholding the integrity of the judicial system by itself confers appellate standing.

The Supreme Court will not intervene in the dispute between retired turnaround advisor Jay Alix and the McKinsey consulting firm, nor will the high court rule on whether upholding the integrity of the judicial system by itself confers standing to appeal when the appellant is not otherwise an "aggrieved person."

Yesterday, the Supreme Court denied the petition for *certiorari* in *Mar-Bow Value Partners LLC v. McKinsey Recovery & Transformation Services US LLC*, 18-974 (Sup. Ct.). Although the Court does not give reasons for denying *certiorari*, the justices evidently were not persuaded by Alix's contention that there is a split of circuits.

Litigating through a company named Mar-Bow, Alix had hired Lawrence H. Tribe to assist in drafting the petition, hoping that the Harvard Law School professor's advice would increase the odds for a grant of *certiorari*.

The case came to the Supreme Court from the reorganization of coal producer Alpha Natural Resources Inc. One of the creditors, Alix, challenged the adequacy of the disclosures under Bankruptcy Rule 2014 made by the debtor's turnaround advisor, McKinsey Recovery & Transformation Services US LLC.

Ruling that McKinsey's disclosures were adequate and that the firm was disinterested, the bankruptcy court only required McKinsey to file an *in camera* disclosure of the names of some of its clients. Alix appealed, asking the district court to compel public disclosure of McKinsey's clients.

Concluding that Alix lacked appellate standing, the district court dismissed the appeal in September 2017, prompting an appeal to the Fourth Circuit. In a one-paragraph order, the appeals court affirmed in September 2018, "for the reasons stated by the district court." To read ABI's discussion of the Fourth Circuit's ruling, click here.

The district court found no appellate standing, reasoning that Alix was not a "person aggrieved" because he would not benefit monetarily from a reversal.

In the Supreme Court, Alix argued there was a split of circuits. According to the *certiorari* petition filed in January, the Second, Third, Sixth and Eleventh Circuits recognize an exception to the pecuniary interest requirement by holding that the public interest may also create a sufficient stake in the outcome to confer appellate standing. Alix admitted that the Fourth, Fifth and Seventh Circuits do not recognize the public interest exception to the pecuniary interest test.

The Supreme Court evidently had little interest in the case. When the Court grants *certiorari*, the petition is often discussed by the justices at more than one conference. In Alix's case, the petition was considered only at the conference on April 18, with the formal denial of *certiorari* filed yesterday along with a slew of other orders.

Opinion Link

View Opinion

Case Details

[+] Feedback

Case Citation	Mar-Bow Value Partners LLC v. McKinsey Recovery & Transformation

Transformation
Services US LLC, 18-
974 (Sup. Ct.)

Case Name	Mar-Bow Value Partners LLC v. McKinsey Recovery & Transformation Services US LLC
Case Type	Business
Court	Supreme Court
Bankruptcy Tags	Practice and Procedure Discharge/Dischargeability Business Reorganization

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An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

By The Numbers

Total cases in system	1234
Business Cases	484
Consumer Cases	533
Circuit Splits Cases	50
Supreme Court Cases	77
Total Judges	649

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July 9, 2018

U.S. Trustee Criticized for Dumping the 'Jay Alix Protocol'

> New York bankruptcy judge approves retention of a crisis manger under Section 363(b) who might be disqualified under Section 327(a).

A palpably angry bankruptcy judge excoriated the U.S. Trustee in New York for abandoning the so-called Jay Alix Protocol by contending that management consultants hired before bankruptcy cannot fill executive roles after a chapter 11 filing if the firm does not satisfy the strictures of the disinterestedness test.

However, a spokeswoman for the Department of Justice told ABI that the U.S. Trustee Program has not changed its policy.

In her July 2 opinion, Bankruptcy Judge Shelley C. Chapman of Manhattan said that forcing the debtor to jettison crisis managers who had been on board for four years before bankruptcy "would put the success of the entire reorganization at risk," producing "an absurd result, to say the least."

Four years before filing under chapter 11, Nine West Holdings Inc., formerly known as Jones Apparel Group, had hired Alvarez & Marsal North America LLC to provide the company with an interim chief executive and other management personnel. At the time, the company had given no thought to bankruptcy. Judge Chapman said that A&M was to provide "vital management services" and oversee "virtually all aspects of their day-to-day operations."

Before bankruptcy, the chief executive provided by A&M had served as a director for several of the company's subsidiaries. He was not a director of the parent company.

On filing under chapter 11, the company submitted an application to retain A&M under Section 363(b) to continue managing the debtor's daily operations. Section 363(b) gives a debtor in possession the power to use, sell or lease property of the estate.

The U.S. Trustee objected, contending that A&M could only be retained as a professional under Section 327(a). The U.S. Trustee evidently believed that the firm was not disinterested under Section 101(14) and thus did not qualify for retention under Section 327(a), perhaps on account of the CEO's service as a director of subsidiaries.

Creditors up and down the capital structure uniformly opposed the U.S. Trustee and urged the court to approve A&M's retention, Judge Chapman said.

In her 31-page opinion designated for publication, Judge Chapman overruled the U.S. Trustee's objection and approved A&M's retention under Section 363(b) to provide the debtor with an interim CEO and additional managerial personnel.

Judge Chapman focused her opinion on the Jay Alix Protocol, promulgated in the Southern District of New York 14 years ago. It appears on the website of the U.S. Trustee Program. To read the Protocol, click here.

Judge Chapman explained that the Protocol, now national policy, was developed to allow chapter 11 debtors to retain their pre-petition crisis managers by engaging the firms under Section 363(b), rather than under Section 327(a), where they might fail the disinterestedness test. The Protocol has four principal requirements: (1) The firm may serve in only one capacity; (2) the retention must be under Section 363(b), and the retained firm must disclose all relationships to show that it is not otherwise disinterested; (3) the firm must file monthly reports subject to court review; and (4) the persons providing services must be approved by and act under an independent board of directors.

Until the Nine West case, Judge Chapman said the U.S. Trustee had not objected to dozens if not hundreds of retentions over the last 14 years "where such consultants have purportedly followed the Protocol." She said the U.S. Trustee's objection "fails to mention the Protocol at all, let alone A&M's compliance in all material respects with each of its requirements." Instead, she said that the U.S. Trustee "makes the unequivocal statement that . . . '[a] debtor cannot use Section 363(b) to employ a professional person.'"

[+] Feedback

Judge Chapman said that the purpose of the Protocol "has not been violated by A&M here," because the CEO provided by the firm had not been a director of the parent corporation and thus was not in a position to approve his or his colleagues' pre- or postpetition retention and compensation.

For 14 years, Judge Chapman said, "the crisis and interim management industry has relied on the implicit consent of the U.S. Trustee that such firms can be retained . . . pursuant to Section 363 rather than Section 327 if they meet the requirements of the Protocol." By suddenly objecting in the Nine West case, she said the U.S. Trustee is "implying that there was clear error in every case in which a bankruptcy court has in the past approved" retentions under the Protocol.

"The only explanation" for the "stunning reversal of policy," Judge Chapman said, was the chief executive's "*de minimis* board service; the economic disruption that his departure would cause is of no concern to the U.S. Trustee." Blocking the firm's engagement, she said, "could . . . put the success of the entire reorganization at risk."

The Protocol, according to Judge Chapman, has allowed the "[e]ngagement of management consultancy firms prior to a bankruptcy filing and their continuing retention postpetition [to enable] companies to achieve business continuity during their darkest hour." If only Section 327 and its strict disinterestedness requirement were available, she said that "previously provided firm personnel . . . must be jettisoned when a company files chapter 11 . . . ."

Having decided that Section 327(a) was not the only pigeonhole, Judge Chapman ended her opinion by finding that A&M was not providing services of a professional because "they could have been performed by existing company personnel." Since the engagement also satisfied the business-judgment rule, she approved the retention under Section 363(b).

In response to an inquiry from ABI, Nicole Navas Oxman, a spokeswoman for the Department of Justice, said in an email that the "U.S. Trustee Program has not changed its legal position as reflected in the Jay Alix Protocol." A "key provision" in the Bankruptcy Code, she said, "requires that professionals not have served on the Board of Directors. As stated in court, we believe that provision was violated in this case."

Opinion Link

View Opinion

Case Details

Judge Name	Shelley C. Chapman
Case Citation	In re Nine West Holdings Inc., 18-10947 (Bankr. S.D.N.Y. July 2, 2018)
Case Name	In re Nine West Holdings Inc.
Case Type	Business
Court	2nd Circuit New York New York Southern District
Bankruptcy Tags	Corporate Governance Ethics Financial Advisors Practice and Procedure Professional Compensation/Fees Business Reorganization

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Faculty Biographies

Hon. Kevin J. Carey is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, first appointed in 2005 and serving as Chief Judge from 2008-11. He previously served as a U.S. bankruptcy judge for the Eastern District of Pennsylvania, appointed on Jan. 25, 2001. Judge Carey serves on ABI's Executive Committee as Vice President-Membership and is a past global chairman of the Turnaround Management Association. He is a member of the National Conference of Bankruptcy Judges and and is an honorary member of the Turnaround, Restructuring and Distressed Investing Hall of Fame. Judge Carey is a Fellow of the American College of Bankruptcy and a member of the International Insolvency Institute. In addition, he is a member of the National Conference of Bankruptcy Judges and served as a member of the Third Circuit Judicial Council's Facilities and Security Committee. He is also a contributing author to *Collier on Bankruptcy* and *Collier Forms Manual*. Judge Carey is a part-time adjunct professor in the LL.M. in Bankruptcy program at St. John's University School of Law in New York and at Temple University's Beasley School of Law in Philadelphia. He began his legal career in 1979 as law clerk to Bankruptcy Judge Thomas M. Twardowski, then clerked for the U.S. Bankruptcy Court for the Eastern District of Pennsylvania. Judge Carey received his B.A. in 1976 from Pennsylvania State University and his J.D. in 1979 from Villanova University School of Law.

Hon. Robert E. Gerber is Of Counsel with Joseph Hage Aaronson in New York and a retired U.S. Bankruptcy Judge for the Southern District of New York in New York, appointed in 2000 and reappointed in 2014. He assumed recall status in January 2015 and retired in January 2016. Judge Gerber offers services in bankruptcy and commercial arbitration, mediation, fiduciary work and consulting. While on the bench, Judge Gerber presided over a wide variety of chapter 11, chapter 7, chapter 15, § 304 and SIPA cases, including *PSINet*, *Ames Department Stores*, *Global Crossing*, *Adelphia*, *ABIZ*, *Basis Yield Alpha Fund*, *Lyondell Chemical*, *BearingPoint*, *DBSD North America*, *Chemtura*, *Pinnacle Airlines*, *Houghton-Mifflin Harcourt* and *General Motors*. He presided over more than 20 cases with over $100 million in debt, including 10 with over $1 billion in debt. Judge Gerber has published roughly 200 opinions, principally in the business bankruptcy and corporate governance areas, and throughout his tenure on the bench was named one of the nation's outstanding bankruptcy judges six times. Prior to taking the bench, he practiced with the firm of Fried, Frank, Harris, Shriver & Jacobson in New York City, specializing in securities and commercial litigation and, thereafter, bankruptcy litigation and counseling. He is an adjunct professor of law at Columbia Law School (where he teaches Columbia's Advanced Bankruptcy Seminar), a contributing author to *Collier on Bankruptcy*, and a Fellow and former director of the American College of Bankruptcy. Judge Gerber earned his B.S. with high honors in industrial engineering from Rutgers University in 1967 and his J.D. *magna cum laude* from Columbia Law School in 1970, where he was a Harlan Fiske Stone Scholar and a James Kent Scholar. He then served as a First Lieutenant in the U.S. Air Force from 1971-72.

Craig Goldblatt is a partner in the Washington, D.C., office of WilmerHale, where he specializes in bankruptcy law. The core of his practice involves bankruptcy and insolvency-related trial-level matters and appeals, particularly the representation of financial institutions and other commercial creditors in bankruptcy litigation. He has argued three bankruptcy cases before the U.S. Supreme Court and one before the *en banc* Third Circuit. Mr. Goldblatt has testified before a congressional committee on issues of bankruptcy law and policy. He has also developed a particular expertise on consumer bankruptcy matters, representing several major mortgage-servicers, holders of credit card and other unsecured debt, and bankruptcy trustees in a variety of regulatory investigations, bankruptcy disputes and appeals. Mr. Goldblatt is a conferee of the National Bankruptcy Conference and is the chair of the ABA Business Bankruptcy Committee's Subcommittee on Bankruptcy Litigation. He previously chaired the Subcommittees on Bankruptcy Appeals and on Environmental and Mass Tort Claims. Mr. Goldblatt is a Fellow of the American College of Bankruptcy, for which he chairs its Education Committee. He teaches bankruptcy as an adjunct professor at the Georgetown University Law Center and is a regular speaker at American Bar Association, ABI and other conferences on bankruptcy matters. He also serves on the board of trustees of the Lawyers' Committee for Civil Rights Under Law. Prior to joining WilmerHale, Mr. Goldblatt clerked for Hon. Richard D. Cudahy on the U.S. Court of Appeals for the Seventh Circuit and for Justice David H. Souter on the U.S. Supreme Court. He received his undergraduate degree from Georgetown University in 1990 and his J.D. from the University of Chicago Law School in 1993.

Thomas M. Horan is a partner with Fox Rothschild LLP in Wilmington, Del., in its Financial Restructuring & Bankruptcy group. He frequently represents committees, debtors, secured lenders, trustees and unsecured creditors in complex chapter 11 cases. He also represents parties in litigation before Delaware's Court of Chancery and Superior Court, and prepares opinion letters connected to Delaware transactions. His practice is divided between lead counsel roles and Delaware counsel engagements. Mr. Horan is ABI's Vice President-Communications & Information Technology, co-chair of ABI's Mid-Atlantic Bankruptcy Workshop, and is on the advisory board of ABI's Views from the Bench conference. He is AV-Rated by Martindale-Hubbell. Prior to joining Fox Rothschild in June 2018 via a merger with his prior firm, Shaw Fishman Glantz & Towbin LLC, Mr. Horan was a partner in Womble Carlyle Sandridge & Rice, LLP's Wilmington, Del., office and an associate at Morris James LLP. He received his B.A. in 1989 and his M.A. in 1992 from Fordham University, and his J.D. *cum laude* from St. John's University School of Law in 2002, where he was executive notes and comments editor for the *ABI Law Review*.

Hon. Eugene R. Wedoff served as a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago from 1987-2015 and as chief judge from 2002-07. ABI's Board Chairman, he served on ABI's Commission on Consumer Bankruptcy and devotes his present legal practice exclusively to *pro bono* representations in bankruptcy appeals. Judge Wedoff presided over the chapter 11 reorganization of United Air Lines, was a member of the Advisory Committee on Bankruptcy Rules from 2004-14 and served as its chair after 2010. His work on the Rules Committee involved both the implementation of the means test forms and creation of the national form for chapter 13 plans. Judge Wedoff was the president of the National Conference of Bankruptcy Judges from 2013-14 and also served as a member of the NCBJ's Board of Governors as its secretary and as chair of its education committee. Judge Wedoff is a Fellow in the American College of Bankruptcy, as well as a member of the National Bankruptcy Conference. He is the author of the chapter on professional employment in Queenan, Hendel and Hillinger, *Chapter 11 Theory and Practice* (LRP Publications 1994) and was an associate editor of the *American Bankruptcy Law Journal*. Judge Wedoff is a frequent lecturer and served as a member of the Federal Judicial Center's Committee on Bankruptcy Judge Education. In 2016, he received the Judge William L. Norton Jr. Judicial Excellence Award; in 2009, he received the Lawrence P. King Award from the Commercial Law League; and in 1995, he received the Excellence in Education Award from the NCBJ. Judge Wedoff graduated from the college and law school of the University of Chicago.

Hon. Michael E. Wiles is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on March 3, 2015. Previously, he was a partner with Debevoise & Plimpton LLP, where he focused on general commercial litigation and bankruptcy. Judge Wiles co-authored the *Collier Business Workout Guide* (Mathew Bender 2007) and has appeared on panels organized by the Association of the Bar of the City of New York, the American College of Investment Council and others to discuss current issues in bankruptcy litigation. He is also a member of the Committee on Bankruptcy and Reorganization of the Association of the Bar of the City of New York. His publications and written CLE materials include "May Parties Consent to Bankruptcy Court Adjudication of 'Stern Claims'" (September 2014) (presented at a continuing legal education session at the Association of the Bar of the City of New York); "Ponzi Schemes and Avoidance Actions: 3 Issues," *Law360* (March 7, 2011); "The Good Faith Defense to Fraudulent Transfer Claims" (December 2010) (presented at a continuing legal education session at the Association of the Bar of the City of New York); and "At the Crossroads: The Intersection of the Federal Securities Laws and the Bankruptcy Code," *The Business Lawyer* (November 2007). Judge Wiles received his A.B. from Georgetown University in 1975 and his J.D. from Yale Law School in 1978.