Judges Hot Topics

R. Scott Williams, Moderator
Rumberger, Kirk & Caldwell, P.A.; Birmingham, Ala.

Hon. Robert D. Drain
U.S. Bankruptcy Court (S.D.N.Y.); New York

Hon. Michael A. Fagone
U.S. Bankruptcy Court (D. Me.); Portland

Hon. Robert E. Gerber (ret.)
Joseph Hage Aaronson; New York

Hon. Deborah L. Thorne
U.S. Bankruptcy Court (N.D. Ill.); Chicago

ABI Annual Spring Meeting

April 14-17, 2016
Washington, D.C.

Judges Hot Topics

Hon. Robert D. Drain
Hon. Michael A. Fagone
Hon. Robert E. Gerber (Ret.)
Hon. Deborah L. Thorne

Moderator

R. Scott Williams
Rumberger, Kirk & Caldwell
Birmingham, Alabama

Hot Topic Number One
What is "Actual Fraud"?

A pending case in front of the United States Supreme Court is *Husky International Electronics, Inc. v. Ritz*. This bankruptcy case turns on the Court's interpretation of "actual fraud". Two circuits broadly interpreted the fraud to mean where a debtor obtains money through a scheme that is intended to cheat creditors. On the other hand, another circuit has ruled there is not actual fraud unless the debtor actually lies to the creditor. On March 1, 2016, the Supreme Court heard oral arguments on this particular issue as to what is "actual fraud".

The code section at issue addressing whether Mr. Ritz's debt is dischargeable is Bankruptcy Code § 523(a)(2)(A) which prohibits a debtor from discharging "any debt…for money, property, services, or extension, renewal, or refinancing of credit, to the extent obtained by … false pretenses, a false representation or actual fraud." The position of Husky International is backed by the Justice Department. Their argument centers on the fact that actual fraud was added as part of the original bankruptcy code in 1978, and that actual fraud arises from common law. Namely, their position is when a transfer of money is made and when the person or entity knows the transfer is being made to defraud the creditors, then "actual fraud" occurs. On the other hand, Ritz has argued that the transfer is dischargeable since no affirmative misrepresentation was ever made to Husky. In fact, Ritz states and the record reveals that the only direct communication between Ritz and Husky was a brief telephone conversation four years into the contractual relationship. The question before the Court turns on the issue of what is "actual fraud" and how the Supreme Court defines it for purposes of non-dischargeability under the Bankruptcy Code.

Hot Topic Number Two
Surcharges in Bankruptcy

A recent case discussing surcharges under § 506(c) of the Bankruptcy Code is *In re Domistyle, Inc.,* 215 WL 9487732. The *Domistyle* case came down on December 29, 2015 from the Third Circuit and goes to the issue of surcharging bankruptcy estates. Namely, in *Domistyle*, the bankruptcy trustee had moved to abandon the debtor's real property and surcharge expenses that had been paid to maintain the property from the start of the case. The real property's primary lienholder objected and appealed. The Fifth Circuit held that a surcharge against real property was not limited to expenses incurred by the trustee with specific and exclusive intent to benefit the secured creditor and that a surcharge could be imposed wherein each dollar of pre-abandonment expense preserved at least one dollar of value. This opinion is at conflict with other authorities on interpreting § 506(c). Section 506(c) states as follows:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

The leading case in contrast to the *Domistyle* case is that of *In re Trim-X, Inc.*, 695 F.2d 296 (7th Circuit, 1982). In *Trim-X*, the Second Circuit disallowed a trustee's surcharge expenses setting up a potential conflict among the circuits that may have to be resolved by the Supreme Court.

Hot Topic Number Three
Reaffirmation

Currently, the Bankruptcy Code arguably inartfully addresses certain reaffirmation situations. In particular, Bankruptcy Code § 521(a)(2) provides for an individual debtor to schedule assets and liabilities. The provisions of Bankruptcy Code § 524(c) provides for the effective discharge where there is an agreement between the holder of the claim and the debtor. The question arises is whether courts will allow a debt that is not reaffirmed to "ride through" the bankruptcy case. The ride through question is even more troubling when there are presumptions of undue hardship for reaffirmation. This question is arising in courts as to how to allow individual debtors both acknowledge debt and have that debt ride through even if there is no reaffirmation agreement approved by the court.

Hot Topic Number Four
Chapter 11 Trustee Compensation

The recent case of *In re New England Compounding Pharmacy, Inc.*, 2016 WL 211533 has an interesting discussion of Chapter 11 trustee compensation. In particular, this case discusses Bankruptcy Code § 330(a)(7) which says trustee compensation shall be reasonable and be treated as a commission as set forth in § 326. In evaluating the Chapter 11 trustee's appropriate compensation, Judge Boroff recognized overarching theme found in the case law has generally resulted in "the fundamental inquiry is the same – have the trustee's or professional's actions in this case benefitted the bankruptcy estate to such an admirable degree that a mere multiplication of the hours expended by the hourly rate fails to adequately compensate the individual for the work they have done." *Id*. at 11. Judge Boroff went on to say that the trustee's

work in the case had been "exemplary", but noted that there was no uniform standard at which to arrive at a fee enhancement figure.

The Court concluded that the outcome in the case justified a substantial fee award but had to grapple with inartful language concerning appropriate compensation of Chapter 11 trustees when considering the interplay of Sections 326 and 330 of the Bankruptcy Code.

Hot Topic Number Five
The Appointment of 1114 Committees

Currently, the appointment of 1114 committees has again become a topic in cases. Congress enacted Section 1114 to provide for a mechanism to protect retiree benefits (not pensions) in bankruptcy. Prior to the passage of 1114, the courts treated such benefits as executory contracts which debtors at the beginning of cases sought to terminate. In response, Congress enacted 1114 to create a heightened standard for the termination or modification of those retiree benefits and to allow retiree committees a "seat at the table" in determining the fate of a bankrupt company.

Currently, modern cases are often being filed with debtors knowing, but not tacitly acknowledging, that they will be seeking to modify 1114 benefits. Often the case is well past the initial financing stages and may be well on its way toward a restructuring when the issue of termination of benefits arises. 1114(d) provides that the court come upon motion of a party in interest, and after notice of hearing, shall order the appointment of a retiree committee if the debtor seeks to modify or terminate the benefits. The reality is that once the case is well under way, it seems disingenuous and contrary to the spirit of 1114 to not allow a fully participating 1114 committee to become involved in the bankruptcy. Often, many of the major decisions and

financing issues have already been addressed by the Court and resolved amongst the other creditors. This leaves 1114 committee on the outside looking in as it relates to having to see the table, which is contrary to Congress's intention.

The response to this is not clear. Should judges actively protect 1114 committees where they know or suspect the issue will be arising later in the case? Does the U.S. Trustee have an obligation to be on the lookout and to file the motion called for under 1114(d) when there is a reasonable likelihood that retiree benefits are likely to be at issue in a reorganization? Can or should retiree committees be able to hold up the process by asking the court to reopen and reexamine issues when they have never been appointed at the time of the initial decisions? These questions are implicated in some of the recent that have been filed.