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Proposed Legislative Changes to Bankruptcy Appeals: Bankruptcy Appellate Panels and Direct Certification

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I. CURRENT LAW

A. Bankruptcy Appellate Panels:

Bankruptcy appellate panels were first established with the enactment of the 1978 Bankruptcy Code. Pre-Code, appeals from decisions of bankruptcy judges were adjudicated in the first instance by the district court. The drafters of the Code faced problems with this appellate procedure. *First*, bankruptcy appeals—which often required expedition—were viewed as disruptive and burdensome to district courts or, when not handled expeditiously by the district court, were viewed as unnecessarily delaying the bankruptcy case. *Second*, a common perception arose among litigants that district courts were unwilling to second-guess the decisions of bankruptcy judges.[1] The drafters of the Code considered various proposals regarding bankruptcy appeals, including requiring all bankruptcy appeals to proceed directly to the courts of appeals. That proposal was strongly opposed by court of appeals judges, who were concerned that it would overload their dockets.[2] As a compromise, the bankruptcy appellate panel construct was included in the Bankruptcy Code, but only on an "experimental" basis, and Congress left it to the discretion of each circuit whether to create such a panel.[3]

Following the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), Congress passed the Bankruptcy Amendments and

[1] George, Lloyd D., *The Bankruptcy Appellate Panels: An Unfinished Experiment*, 1982 BYU L. REV. 205, 206-08.

[2] *Id.* at 211-12.

[3] *Id.* at 215.

Federal Judgeship Act of 1984, which provided that an appeal could only be heard by a bankruptcy appellate panel with the consent of all parties.

In 1994, Congress enacted the Bankruptcy Reform Act of 1994, which included an amendment of 28 U.S.C. §158 (the section of the Judicial Code governing appeals in bankruptcy cases). The current statute requires the judicial council of a circuit to establish a bankruptcy appellate panel service composed of bankruptcy judges in that circuit to hear and determine, with the consent of all the parties, appeals that would otherwise be appealable to district courts under section 158(a) unless the judicial council finds that (A) there are insufficient judicial resources available in the circuit; or (B) establishment of such service would result in undue delay or increased cost to parties in cases under title 11. 28 U.S.C. §158(b)(1). If authorized by the Judicial Conference of the United States, the judicial councils of two or more circuits may establish a joint bankruptcy appellate panel. 28 U.S.C. §158(b)(4). Furthermore, the statute provides that even if a bankruptcy appellate panel service has been established, bankruptcy appellate panels can only hear appeals if authorized to do so by the district court for the district from where the appeal originated. 28 U.S.C. §158(b)(1). The statue also provides that consent of all parties is required for an appeal to heard by a bankruptcy appellate panel, but consent is deemed provided unless a party opts out. 28 U.S.C. §158(c).

Currently, only the First, Sixth, Eighth, Ninth, and Tenth Circuits have bankruptcy appellate panels.

B. <u>Direct Certification</u>:

The current statutory provisions providing for direct certification of bankruptcy appeals were enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). This mechanism was created to expedite bankruptcy appeals and minimize uncertainty in the area of bankruptcy law (since decisions rendered by a district court or bankruptcy appellate panel on appeal are not binding precedent).[4]

Section 158(d)(2) allows for direct appeal to the court of appeals—both with respect to appeals from final orders and interlocutory appeals. 28 U.S.C. §158(d).

The basis for the certification must be one or more of the following circumstances listed in subsection (d)(2)(A)(i)-(iii): (i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court, or involves a matter of public importance; (ii) the judgment, order or decree involves a question of law requiring resolution of conflicting decisions; or (iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken.

The bankruptcy court, district court, or bankruptcy appellate panel "shall" make the certification if it determines that at least one of the circumstances specified in section 158(d)(2)(A)(i)-(iii) exists. Alternatively, the involved court "shall" certify the judgment when it receives a request to that effect made by a majority of the appellants and a majority of appellees.

Even if such a certification is made, however, section 158(d)(2)(A) provides that the court of appeals will not take jurisdiction of the appeal unless it exercises its discretion to authorize a direct appeal of the judgment, order, or decree.

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[4] Laura B. Bartell, *The Appeal of Direct Appeal - Use of the New 28 U.S.C. § 158(d)(2)*, 84 AM. BANKR. L.J. 145, 184 (2010); Judith A. McKenna & Elizabeth C. Wiggins, *Alternative Structures for Bankruptcy Appeals*, 76 AM. BANKR. L.J. 625, 627 (2002); H.R. REP. NO. 109-31, pt. 1, at 148 (2005) ("In addition to the time and cost factors attendant to the present appellate system, decisions rendered by a district court as well as a bankruptcy appellate panel are generally not binding and lack stare decisis value.").

II. PROPOSED AMENDMENTS

A. Bankruptcy Appellate Panels:

28 U.S.C. §158(b) should be revised as follows:

(1) ~~The judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit who are appointed by the judicial council in accordance with paragraph (3), to hear and determine, with the consent of all the parties, appeals under subsection (a) unless the judicial council finds that—~~

~~**(A)** there are insufficient judicial resources available in the circuit; or~~

~~**(B)** establishment of such service would result in undue delay or increased cost to parties in cases under title 11.~~

~~Not later than 90 days after making the finding, the judicial council shall submit to the Judicial Conference of the United States a report containing the factual basis of such finding.~~

The judicial council of each circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit to hear and determine, with the consent of all the parties, appeals under subsection (a), except that the bankruptcy appellate panel for the District of Columbia circuit shall be combined with that of the Fourth Circuit. Each bankruptcy appellate panel shall be comprised of no fewer than 6 bankruptcy judges.

(2) If authorized by the Judicial Conference of the United States, the judicial councils of 2 or 3 circuits may combine the bankruptcy appellate panel services established under paragraph (1) into a joint bankruptcy appellate panel service comprised of bankruptcy judges from the districts within the circuits for which such panel is established, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section. Each joint bankruptcy appellate panel shall be comprised of no fewer than 6 bankruptcy judges, and at least 1 judge from each circuit covered by that joint bankruptcy appellate panel.

~~**(A)** A judicial council may reconsider, at any time, the finding described in paragraph (1).~~

~~**(B)** On the request of a majority of the district judges in a circuit for which a bankruptcy appellate panel service is established under paragraph (1), made after the expiration of the 1-year period beginning on the date such service is established, the judicial council of the circuit shall determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.~~

~~**(C)** On its own motion, after the expiration of the 3-year period beginning on the date a bankruptcy appellate panel service is established under paragraph (1), the~~

~~judicial council of the circuit may determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.~~

~~**(D)** If the judicial council finds that either of such circumstances exists, the judicial council may provide for the completion of the appeals then pending before such service and the orderly termination of such service.~~

(3) Bankruptcy judges appointed under paragraph (1) **or (2)** shall be appointed and may be reappointed under such paragraph**s**.

(4) ~~If authorized by the Judicial Conference of the United States, the judicial councils of 2 or more circuits may establish a joint bankruptcy appellate panel comprised of bankruptcy judges from the districts within the circuits for which such panel is established, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section.~~

~~**(5)**~~ An appeal to be heard under this subsection shall be heard by a panel of 3 members of the bankruptcy appellate panel service, except that a member of such service may not hear an appeal originating in the district for which such member is appointed or designated under section 152 of this title.

~~**(6)** Appeals may not be heard under this subsection by a panel of the bankruptcy appellate panel service unless the district judges for the district in which the appeals occur, by majority vote, have authorized such service to hear and determine appeals originating in such district.~~

28 U.S.C. §158(c) should be revised as follows:

(1) Subject to subsections (b) and (d)(2), each appeal under subsection (a) shall be heard by a 3-judge panel of the bankruptcy appellate panel service established under subsection**s** (b)(1) **or (b)(2)** unless—

(A) the appellant elects at the time of filing the appeal; or

(B) any other party elects, not later than 30 days after service of notice of the appeal;

to have such appeal heard by the district court.

(2) An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules.

B. Direct Certification:

28 U.S.C. §158(d) should be revised as follows:

(1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

(2)

(A) The appropriate court of appeals shall have jurisdiction of appeals described in the first sentence of subsection (a) if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or all the appellants and appellees (if any) acting jointly, certify that—

(i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

(ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions;

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken; **or**

(iv) good cause—including without limitation, a substantial likelihood that any decision in the appeal by the district court or bankruptcy appellate panel is substantially likely to be followed by an appeal to the court of appeals—exists;

and, **with respect to appeals described in subsection (a)(3)**[5], if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

(B) If the bankruptcy court, the district court, or the bankruptcy appellate panel—

(i) on its own motion or on the request of a party, determines that a circumstance specified in clause (i), (ii), or (iii) of subparagraph (A) exists; or

(ii) receives a request made by a majority of the appellants and a majority of appellees (if any) to make the certification described in subparagraph (A);

[5] This refers to interlocutory orders and decrees.

then the bankruptcy court, the district court, or the bankruptcy appellate panel shall make the certification described in subparagraph (A).

(C) The parties may supplement the certification with a short statement of the basis for the certification.

(D) An appeal under this paragraph does not stay any proceeding of the bankruptcy court, the district court, or the bankruptcy appellate panel from which the appeal is taken, unless the respective bankruptcy court, district court, or bankruptcy appellate panel, or the court of appeals in which the appeal is pending, issues a stay of such proceeding pending the appeal.

(E) Any request under subparagraph (B) for certification shall be made not later than 60 days after the entry of the judgment, order, or decree.

III. SUMMARY OF CHANGES

A. Bankruptcy Appellate Panels:

First, each circuit would be required, without exception, to create a bankruptcy appellate panel service (though panel service for the circuit for the District of Columbia would be combined with that of the Fourth Circuit).

Second, two or three circuits could combine their bankruptcy appellate panel services if authorized by the Judicial Conference of the United States. (Where two circuits combined their bankruptcy appellate panels, the panel would apply the law of the circuit of the bankruptcy court from where the appeal came).

Third, each bankruptcy appellate panel service (or joint bankruptcy appellate panel service) would be required to have at least six bankruptcy judges and, with respect to joint bankruptcy appellate panel services, at least one bankruptcy judge from each circuit covered by that panel service.

Fourth, district court authorization would no longer be required; however, consent of all parties to the appeal would still be required.

B. Direct Certification:

First, the amendments provide an additional ground for certifying an appeal directly to the court of appeals: good cause. Good cause would exist, for example, if it were substantially likely that any decision in the appeal by the district court or bankruptcy appellate panel would be followed by an appeal to the court of appeals.

Second, with respect to appeals from interlocutory orders and decrees (other than those described in (a)(2)), the courts of appeals would retain discretion to decline to hear such appeals. The courts of appeals would no longer have such discretion with respect to appeals from final judgments, orders, and decrees (or those described in (a)(2)) that have been certified for direct appeal; if such appeals are certified, the courts of appeals must hear them.

IV. ARGUMENTS IN FAVOR OF THE AMENDMENTS

A. Bankruptcy Appellate Panels:

The proposed changes to 28 U.S.C. §158(b) & (c) would:

1. Reduce the workload of district courts by permitting cases to bypass the district court altogether if the parties so elect.
2. Reduce the workload of courts of appeals. According to a study of bankruptcy appeals in the Ninth Circuit from 1987, the rate of appeal from district court decisions was 25% whereas the rate of appeal from bankruptcy appellate panel decisions was only 10%.[6] In addition, if given the option to appeal to a bankruptcy appellate panel, parties may elect to do that rather than seek direct appeal to the court of appeals (which they might otherwise be inclined to do if the only alternative were to appeal to the district court).
3. Increase the quality of appellate decisions. On issues of law, courts of appeals review bankruptcy court decisions de novo, and generally ignore the intervening decision of the district court. Accordingly, district court judges have little incentive to dedicate significant time and resources to adjudicating bankruptcy appeals, and are likely to simply defer to the "expertise" of bankruptcy courts, leading to a lack of litigant confidence in

[6] Gordon Bermant & Judy B. Sloan, *Bankruptcy Appellate Panels: The Ninth Circuit's Experience*, 21 ARIZ. ST. L.J. 181, 209 (1989).

district court adjudication of bankruptcy appeals.[7] A bankruptcy appellate panel comprised of experts in the area of bankruptcy law is more likely to devote time and attention to bankruptcy appeals. Indeed, statistics show that bankruptcy appeal decisions from bankruptcy appellate panels are more likely to be affirmed than those from district courts, and are cited more frequently.[8]

4. Increase certainty in the area of bankruptcy law. While the decisions of bankruptcy appellate panels, like appellate decisions of district courts, are not binding precedent, decisions by a panel of three bankruptcy judges will likely provide more guidance for litigants, and serve as more persuasive authority for courts, than those by a single district court judge.[9] Statistics shows that bankruptcy appellate panel decisions receive more positive citations by other federal courts compared to district court decisions in bankruptcy appeals.[10]

B. <u>Direct Appeal:</u>

The proposed changes to 28 U.S.C. §158(b) would:

1. Reduce the burdens on the judicial system by removing an unnecessary step in the appellate process, especially in appeals that are likely to reach the court of appeals anyway.
2. Conserve litigant resources by more quickly resolving bankruptcy appeals. Based on a study of appeals from 2007 – 2009, "direct appeals of bankruptcy cases are generally resolved in the circuit court more quickly than the median time for all bankruptcy appeals to the circuit court, and are always resolved more quickly than the time that would have been necessary for both an appeal to the district court or BAP and an appeal to the circuit court based on the median time interval statistics."[11]

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[7] *Id.* at 215 (explaining that in a survey of bankruptcy practitioners' views of BAPs, respondents indicated by margin of two-to-one that they considered BAP opinions to be "better products" than district court opinions); George, *supra* note 1, at 206-08.

[8] Jonathan Remy Nash & Rafael I. Pardo, *An Empirical Investigation into Appellate Structure and the Perceived Quality of Appellate Review*, 61 VAND. L. REV. 1745, 1747, 1777, 1804-05 (2008); Christopher F. Carlton, *Greasing the Squeaky Wheels of Justice: Designing the Bankruptcy Courts of the Twenty-First Century*, 14 BYU J. PUB. L. 37, 61 (1999).

[9] McKenna & Wiggins, supra note 4, at 628 ("Bankruptcy appellate panel (BAP) judges provide specialized bankruptcy expertise that their bankruptcy colleagues (and, to a slightly lesser extent, district judges) value highly as a source of authority.").

[10] Nash & Pardo, supra note 8, at 1804-05.

[11] Bartell, supra note 4, at 184; *see also* McKenna & Wiggins, supra note 4, at 629 ("For cases that continue on through the court of appeals, the time spent at the district court or BAP adds substantially to the total time on appeal.").

3. Increase certainty in the area of bankruptcy law. If more bankruptcy appeals proceed directly to the court of appeals, decisions with binding precedential effect will be issued more often and more quickly.[12]

4. Improve the efficiency of direct appeals from final orders and judgments by eliminating courts of appeals' discretion as to whether to grant or deny direct review.

5. Place a thumb on the scale in favor of direct appeals, consistent with the statements of multiple justices in oral argument, and the opinion of the Court, in *Bullard v. Blue Hills Bank*, 135 S.Ct. 1686, 1695-96 (2015) (addressing interlocutory appeals).

6. Not materially increase the workload on courts of appeals. *First*, the establishment of the direct appeals procedure in 2005 did not lead to a flood of appeals in the court of appeals. A study of bankruptcy appeals from 2005 – 2009 estimates that during those years, only 81 direct appeals were even sought (62 of which were granted), which represented between 0 and 3.48% of all bankruptcy appeals in a given circuit.[13] *Second*, many cases that would be subject to direct appeal would likely have ended up in the court of appeals eventually anyway. *Third*, in appeals from final orders and judgments, these amendments would eliminate the burden on courts of appeals to decide whether or not to accept the certified appeal for direct appeal. *Fourth*, the amendments to 28 U.S.C. §158(b) to establish bankruptcy appellate panels in every circuit may provide an offset: litigants may elect to appeal to the bankruptcy appellate panel rather than seek direct certification.

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[12] *Id.* at 208 (concluding, based on empirical evidence, that "direct appeals have accomplished the goal of creating binding precedents and thereby minimizing repetitive relitigation of the same issue"); *see also* McKenna & Wiggins, supra note 4, at 651-52 ("With so much written yet so little that is binding, lawyers can cite relevant authority for any proposition, with no ethical obligation to cite opposing authority because it is not controlling.").

[13] *Id.* at 164, 166-167.

Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.

In *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.*, the United States Supreme Court resolved a circuit split by deciding that the tax exemption under section 1146(a) of the Bankruptcy Code does not apply to sales made pursuant to 363(b) of the Bankruptcy Code prior to the confirmation of a plan for reorganization and thus the debtor was liable for their Florida stamp taxes.[1] In Justice Thomas' majority opinion, the court held that the most natural reading the statute's language, "under a plan confirmed under §1129," is as a bright-line test that limits the exemption to transfers made under the authority of a plan that had previously been confirmed. The debtor contended that if Congress had intended to require a previously confirmed plan they would have worded it so. The debtor also argued that "under" could mean "in accordance with" rather than in reference to an existing plan meaning "authorized by."[2] However, the Court determined that this interpretation "places greater strain" on the statutory text than a simpler, bright-line construction.[3] The court also found it persuasive that the statutory context suggests exclusively postconfirmation transfers are covered considering the location of section 1146(a) of the Bankruptcy Code in Chapter 11's section captioned "POSTCONFIRMATION MATTERS."[4] The bright-line construction is favorable to principles of federalism which would suggest a narrower interpretation to prevent federal interference with a local tax scheme.[5] Regarding Chapter 11's twin objectives of "preserving going concerns and maximizing property available to satisfy creditors," the court holds that the statute strikes a balance between reorganization, restructuring debts, and maximizing the value of the bankruptcy

[1] *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 35 (2008).
[2] *Id*. at 42.
[3] *Id*. at 33.
[4] *Id*. at 46.
[5] *Id*. at 48-49.

estate. They refused to assert their own policy views over legislation passed by Congress.[6] The Court notes the policy problems with the statute but refuses to take the initiative to act in the absence of congressional action.[7]

Justice Breyer, with whom Justice Stevens joined in dissent, argued against temporal limits on timing of sales and was unable to find a reasonable purpose for such a limit. Breyer interpreted the language to allow an exemption for preconfirmation transfers. Significantly, Bryer inquired into whether it furthers the policy objectives of Chapter 11 and determine that "it makes no difference whether a transfer takes place before or after the plan is confirmed." Often the preconfirmation bankruptcy process takes considerable time and in some cases it is "more advantageous for the debtor to begin to sell as many assets as quickly as possible in order to insure that the assets do not lose value."[8] That delayed sale could seriously harm creditors or the reorganized enterprise by depriving the debtor of extra revenue it could have obtained through a timely sale. Ultimately, Justices Breyer and Stevens concluded that Congress had no "conceivable reason" to create such a bright-line rule and that the majority interpretation conflicts with the statute's purpose.[9]

Exemption Statute

Section 363(b)(1) of Chapter 11 of the Bankruptcy Code:

"The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate…"[10]

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[6] *Id*. at 51.
[7] *Id*. at 52.
[8] *Id*. at 57.
[9] *Id*. at 59.
[10] 11 U.S.C.A. § 363(b) (2012).

Section 1146(a) of Chapter 11 of the Bankruptcy Code:

"The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under §1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax."[11]

Section 363 allows a trustee or debtor in possession to make certain sales outside of the ordinary course of business which provide the funding for the bankruptcy proceedings and allow the distressed organization many benefits including greater leverage with creditors, fewer disclosure statements, removal of prior liens, and the opportunity to sell at any time so that value can be maximized.[12] The preconfirmation sale of assets is often an important part of the business plan to be approved under §1129 and is strictly controlled in that it requires notice to all creditors, a hearing, and there must be a good business reason for the sale.[13]

Section 1146 was modeled upon §267 of the 1938 Bankruptcy Act and §267 was "derived from its direct predecessor, the Bankruptcy Act of 1934, which, in §77(B)(f), used the language, 'to make effective any plan,' as the basis for such exemption."[14] If a preconfirmation sale is among the elements to make a confirmed plan effective, the legislative history suggests that the congressional intent was to promote such a sale by exempting it from transfer tax. This purpose has also been noted widely in the case law, and the consensus tends to be that

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[11] 11 U.S.C.A. § 1146(a) (2012).
[12] Lindsay K. Taft, Comment, *Nothing Natural About it: Still Searching for a Solution to the Chapter 11 Stamp Tax Exemption*, 33 Seattle U.L. Rev. 1349, 1351 (2009-2010).
[13] Brief for Professors Richard Aaron et al. as Amici Curae Supporting Respondent at 23, Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33 (2008) (No. 07-312), 2008 WL 494942.
[14] *Id*. at 9-10.

"Congress's apparent purpose in enacting §1146 was to facilitate reorganizations through giving tax relief."[15] As a practical matter, under the *Piccadilly* interpretation, the exclusion of preconfirmation sales is contrary to this intent by depriving the parties of the largest possible bankruptcy estate from which to pay creditors and to reorganize. Generally, "it is actually more likely (and, sometimes, more wise) for debtors to sell assets prior to confirmation" and by imposing an additional administrative costs on the parties, the calculus of whether to sell the asset changes.[16]

Legislative Proposal to Limit Picadilly and Allow Application of 1146(a) to Preconfirmation Sales

Given certain policy considerations and the original legislative purpose of section 1146(a) of the Bankruptcy Code, Congress should amend section 363(b) of the Bankruptcy Code to correct the Supreme Court's decision in *Piccadilly* and allow assets sales conducted outside of a plan to be free of transfer tax liability. The current rule under *Piccadilly* harms the twin aims of Chapter 11; by allowing local governments to tax assets that would otherwise have been used to more fully pay creditors and assist in the organization's survival, this system tends not to preserve going concerns and decrease the property available for the satisfaction of creditors.[17] The purpose of §1146(a) is to provide a "cheaper and quicker exit" from bankruptcy and "encourage Chapter 11 debtors with tax relief when they are compelled by business realities to sell certain assets."[18] Denying preconfirmation tax relief deprives both creditors and the debtor

[15] City of New York v. Jacoby–Bender, Inc. (*In re* Jacoby-Bender, Inc.), 758 F.2d 840, 841 (2d Cir. 1985).
[16] *In re* GST Telecom, Inc., et al. Debtors., 2002 WL 442233, at *2 (D. Del. March, 20, 2002).
[17] Brief for Professors Richard Aaron et al., *supra* note 13, at 6-8.
[18] Jonathon D. Pressley, Comment, *A New Solution: 11 U.S.C. §1146(a) and the Ordinary Course of Business Distinction*, 25 Emory Bankr. Dev. J. 237, 272 (2008-2009).

the benefit of a larger bankruptcy estate and often forces difficult decisions.[19] Furthermore, as the debtor in *Piccadilly* argued, it makes little sense, given the policy considerations to the contrary, that "a transfer essential to a plan that occurs two minutes before confirmation may be taxed, but the same transfer occurring two seconds after may not."[20]

The Supreme Court's current interpretation of §1146(a) does not comport with the realities of Chapter 11 bankruptcy where in the first months after filling, companies typically attempt to realize as much value as possible from their largest assets or sell their companies as a going concern.[21] The current law forces organizations to decide whether the potential benefits of avoiding the stamp tax outweigh the benefits of a preconfirmation sale. Often, this choice cannot be made freely because funding is needed for the creation and confirmation of a plan for reorganization or liquidation, therefore a sale will often occur and the bankruptcy estate will be reduced by the stamp tax.[22]

Removing the bright-line alone does not sufficiently limit opportunity to enjoy tax benefits without the appropriate relationship to a confirmed reorganization plan. Only approximately 25% of Chapter 11 plans are confirmed and the vast majority are converted to Chapter 7 proceedings or dismissed.[23] This creates two problems: taxing authorities face high administrative costs in collecting after a case is no longer eligible for the exemption because no

[19] Lorenzo Marinuzzi & Jordan A. Wishnew, *Feature, Piccadilly Cafeterias: Congress Should Revisit Supreme Court's Bright Line Test,* 27-6 ABIJ 1 (2008)
[20] Brief for Respondent at 43, Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33 (2008) (No. 07-312) 2008 WL 503589.
[21] Lorenzo Marinuzzi & Jordan A. Wishnew, *supra* note 19.
[22] Craig J. Sperlazza, *The United States Bankruptcy Code Stamp-Tax Exemptoin, §1146(a), Does Not Apply to Transfers Executed Before the Plan is Officially Confirmed Under Chapter 11: Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.,* 11 Duq. Bus. L.J. 79, 88 (2008)
[23] Lindsay K. Taft, *supra* note 12, at 1358.

notice to the taxing authority is currently required; it does not ensure that transfers that are exempt under §1146(a) are sufficiently related to the success of the plan and thus the federal government is unnecessarily interfering with local taxation schemes raising federalism concerns.[24] To combat this, the new law should include provisions requiring that notice be provided of each exemption claimed to ensure the taxing authority can collect efficiently and secondly, a preconfirmation sale must be material under the business plan as an integral step in the program of reorganization.

The notice provision corrects a problem which arose in *NVR Homes, Inv. v. Clerks of the Circuit Courts* where over 5,000 preconfirmation transfers occurred which were claimed exempt from the stamp tax.[25] Without notice, when the tax is determined to be due, by failure to confirm a plan or otherwise, the local governments face very high administrative costs to recover the funds. Each sale requires approval by the bankruptcy court but the state is not party in interest so they are not given notice such that they can object to the transfer. Occasionally funds are escrowed for the purpose of payment of possible transfer taxes but not it is not a uniform practice.[26] Also, additional practical benefits include the ability to get priority over other creditors by claiming their portion as an administrative claim.[27] Thus ensuring that the taxing authorities are properly notified in order to lower the monitoring cost is critical to this revision of the statute.

[24] Thomas E. Plank, *Federalism and Bankruptcy: Deciphering Katz: State Sovereignty in Bankruptcy After Katz*, 15 Am. Bankr. Inst. L. Rev. 59, 92 (2007); Oral Argument at 12, Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33 (2008) (No. 07-312) 2008 WL 791974.
[25] Lindsay K. Taft, *supra* note 12, at 1372.
[26] Oral Argument, *Piccadilly*, 554 U.S. 33 (2008) (No. 07-312).
[27] Lindsay K. Taft, *supra* note 12, at 1373-74.

Next, to give life to the intent to ensure the effectiveness of reorganization plans, the new legislation should require that the transfer be a material part of a plan that will be confirmed.[28] This is similar to the step-transaction doctrine where multiple agreements can be read as one if the parties so intended and the terms, nature and purpose are common to each other or interdependent.[29] Both a plan for sale and a plan for reorganization can be merged into one if the sale is a material element of the debtor's reorganization program where "it is apparent the transactions were entered to accomplish the result of a single plan.'[30] This requirement is doubly enforced because a "good business reason" is required for a sale under §363(b).[31] There is a "good business reason" if the "transfer is necessary to the debtor's program of reorganization," or it would bring the debtor closer to reorganization such as by eliminating "substantial obstacles to reorganization."[32] The combination of these limitations sufficiently encourages successful reorganization while protecting local government from abuses

Piccadilly runs contrary to public policy and creates unnecessarily difficult choices for organizations undergoing Chapter 11 bankruptcy. Reducing the bankruptcy estate to the detriment of creditors and the debtor organization serves to discourage successful reorganization. Congressional action is needed to remedy the prevailing interpretation in order to promote successful reorganization, preservation of going concerns, and maximum payment to creditors. Enacting a statute that removes the bright-line preconfirmation-postconfirmation divide, requires

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[28] Brief for Professors Richard Aaron et al., *supra* note 13, at 6-8.
[29] *Id.* at 13-14.
[30] *Id.* at 13-14.
[31] *Id*. at 7.
[32] *Id.* at 8.

notice to the taxing authority, and requires that the transfer be a material part of the reorganization plan, strikes a reasonable balance between the interests of all parties involved.

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"SHARK TANK"!
SUNDAY, JULY 30, 2017

THE CASE FOR INCREASING CHAPTER 7 TRUSTEE COMPENSATION

By

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Neil C. Gordon is a partner in the Atlanta office of Arnall Golden Gregory LLP. He served for two years as a law clerk in Atlanta for United States District Court Judge Robert L. Vining, Jr. followed by 36 years in private practice, with the last 33 years being exclusively in the areas of bankruptcy, business reorganization, fraud investigations, and creditors' rights. Mr. Gordon represents trustees and receivers throughout the country, including in Delaware litigation that recently settled for approximately $40 million. Mr. Gordon chaired the Bankruptcy Law Section of the Atlanta Bar Association from 1992 to 1993, and has been a panel trustee since 1994, and also serves as a SEC Receiver. Mr. Gordon was first elected to the Board of the National Association of Bankruptcy Trustees in 2000. He has held every office including President (2011-2012) and for eight years chaired its Amicus Committee. Mr. Gordon has authored or co-authored over 70 scholarly articles and book chapters on bankruptcy law related topics and made over 100 seminar presentations throughout the country. He served for three years ending in April 2015 as the Co-Chair of the ABI's Legislation Committee. He is a Lifetime Member of the ABI and the NABT President's Circle, a Master of the Bench in the W. Homer Drake, Jr., Georgia Bankruptcy American Inns of Court, a Full Member of the National Association of Federal Equity Receivers, and a Fellow of the American College of Bankruptcy.

I. Applicable Statutes

11 U.S.C. §330(b)(1)

There shall be paid from the filing fee in a case under chapter 7 of this title $45 to the trustee serving in such case, after such trustee's services are rendered.

11 U.S.C. §330(b)(2)(B) The Judicial Conference of the United States

may prescribe notice of appearance fees and fees charged against distributions in cases under this title;

to pay $15 to trustees serving in cases after such trustees' services are rendered. Beginning 1 year after the date of the enactment of the Bankruptcy Reform Act of 1994, such $15 shall be paid in addition to the amount paid under paragraph (1)

11 U.S.C. §326(a)

In a case under chapter 7 or 11, the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee's services, payable after the trustee renders such services, not to exceed 25 percent of the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims.

28 U.S.C. §1930 (f)(1)

Under the procedures prescribed by the Judicial Conference of the United States, the district court or the bankruptcy court may waive the filing fee in as case under chapter 7 of title 11 for an individual if the court determines that such individual has income less than 150 percent of the income official poverty line (as defined by the Office of Management and Budget, and revised annually in accordance with section 673(2) of the Omnibus Budget Reconciliation Act of 1981) applicable to a family of the size involved and is unable to pay that fee in installments. For purposes of this paragraph, the term "filing fee" means the file fee required by subsection (a), or any other fee prescribed by the Judicial Conference under subsections (b) and (c) that is payable to the clerk upon the commencement of a case under chapter 7.

11 U.S.C. §704(a)

(a) The trustee shall

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521(a)(2)(3) of this title;

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires;

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee;

(10) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c);

(11) if, at the time of the commencement of the case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974) of an employee

benefit plan, continue to perform the obligations required of the administrator; and

(12) use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business that

(A) is in the vicinity of the health care business that is closing;

(B) provides the patient with services that are substantially similar to those provided by the health care business that is in the process of being closed; and

(C) maintains a reasonable quality of care.

II. Historical Perspective

Historically, in a no-asset chapter 7 case, the trustee was paid one-half of the filing fee. When the filing fee was $60, the panel trustee received $30. When the filing fee was increased to $90, the panel trustee was allocated $45. In 1994, the filing fee was increased to $120. At that time, the panel trustee's compensation was increased to $60 as set forth in 11 U.S.C. §§330(b)(1) and (b)(2)(B).

That was the last increase in the no-asset fee for chapter 7 trustees. After many further filing fee increases, the filing fee stands at $335. If the trustee had maintained pace, the panel trustee would now be receiving $167.50. Instead, the trustee receives the same $60 as in 1994, which is less than 18% of the current filing fee. When you take into account that there is no compensation in *in forma pauperis* ("IFP") cases or little to no compensation in installment payment cases that do not fully fund, the trustee is effectively now receiving $51.43 per case, just 15.3% of the filing fee. Requiring trustees to administer IFP cases for no compensation was introduced in the Bankruptcy Abuse Prevention and Consumer Protection Act (Apr. 2005), that went into effect for cases filed after October 16, 2005. 28 U.S.C. §1930 (f)(1) sets forth the criteria for debtors to qualify for a waiver of the filing fee.

Meanwhile, the administrative responsibilities of the trustee have been greatly increased, particularly under BAPCPA. 11 U.S.C. §704(a) sets forth the responsibilities of trustees in every case. Subsections (10) – (12) were added in BAPCPA. Additional responsibilities were also placed on consumer debtor counsel, but at least they do not have to deal with the very time consuming *pro se* cases.

The *Consumer Bankruptcy Fee Study* (the "*Fee Study*") authored by Professor Lois R. Lupica, as reporter and principal investigator, was published approximately 5 ½ years ago on behalf of the American Bankruptcy Institute and the National Conference of Bankruptcy Judges. The entire fee study can be found at www.abiworld.org. Her empirical study reflects that just since the effective date of BAPCPA, debtor counsel fees nationally have increased an average of 48%, not including the fees paid to counsel post-petition (as many are). See *Fee Study* at pp. 8 and 17 and note 41. By comparison, the trustee fee has declined 14.3% because of the IFP cases and failed installment cases. Even petition preparers were determined in the *Fee Study* to be charging on average $184 post-BAPCPA.

III. What does the Trustee do?

As set forth in the *Fee Study*, "in all cases - - including cases in which there are no assets to liquidate and administer - - the Chapter 7 Trustee is accountable for reviewing the debtor's petition and schedules, investigating the debtor's financial affairs, questioning him or her under oath, and submitting reports to the bankruptcy court and the Office of the U.S. Trustee. In addition, BAPCPA imposes a host of new responsibilities on Panel Trustees. They are now required: to collect, track, store and safeguard case documents, such as tax returns: notify appropriate parties of domestic support obligations; review the accuracy of information in forms associated with the means test; and comply with the new requirements for uniform final reports. They are also charged with the responsibility of investigating bankruptcy filings for abuse, criminal activity, and fraud, including mortgage fraud on the part of creditors." *Fee Study* at p. 41.

Thus, trustees are charged with many time consuming and resource draining, responsibilities in every case. Some of these cases might take hours, some weeks, some years, without a successful recovery for the estate. *Fee Study* at p. 42.

IV. Asset Cases

"If the Trustee does liquidate assets, the Trustee will receive, in addition to the $60, a 'trustee commission' based on the sliding scale formula set forth in §326 of the Bankruptcy Code. The commission is based on the value of the assets the trustee brings into the bankruptcy estate." *Fee Study* at p. 41. The hope is that commissions received from asset cases would offset the nominal no-asset fee, such that the Trustee "earns overall, reasonable compensation for his or her service." *Fee Study* at p. 42. However, as noted in the Fee Study, "the system has failed Chapter 7 Panel Trustees." *Id.*

According to the *Fee Study* and the statistics from the Executive Office of the United States Trustee, only a small percentage of cases are administered as asset cases. Of those few asset cases, 95% are in the category of small asset cases, meaning that estates are administered for less than $5,000 of assets. These small asset cases are concentrated in states that have both opted out of the federal exemption scheme, as permitted under §522(b) of the Bankruptcy Code, and adopted a state exemption scheme that provides minimal personal property exemptions and little or no "wild-card" exemption. Trustees in those states sweep up small tax refunds and bank account balances resulting in high numbers of small asset cases. The rest of the country generates virtually no small asset cases because the costs of administering them is too risky given the high personal property exemptions and "wild-card" exemptions. States following the federal exemptions also inherit relatively high personal property and "wild-card" exemptions. Some states, such as Georgia, likewise have both extremely high "wild-card" exemptions and relatively high personal property exemptions. Small asset cases are rarely administered as a result.

Less than two percent of cases are administered as an asset case larger than a small-asset case. This two percent figure generates insufficient revenue to make-up for the insufficient no-asset fee, causing trustees to lose money on their trustee practices. Many trustees believe that the breakpoints for the commission must also be increased. As it stands, many trustees have simply chosen to retire or close down their offices and move to the basements of their homes to cut overhead sufficient to meet the reduced revenue under the present compensation scheme.

V. Proposal:

A. Simply adjusting for inflation, the $60 no-asset fee that went into effect in 1994 would currently be approximately $99.75 (Bureau of Labor Statistics).[1] That does not take into account the numerous additional responsibilities and overhead requirements imposed by BAPCPA. An increase to $120 would be considerably less than the historic 50% of the filing fee, but would pay the trustee up to 35.8% of the present filing fee and make-up for the tremendous resource demands

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of the position. The increased amount should be indexed so there will be no need to wait another 23 years (and counting) for the next increase.

B. The IFP waiver provision of 28 U.S.C. §1930(f) should be amended to require in cases of the waiver that the portion of the filing fee allocated to the trustee's compensation still be paid, whether by lump sum or even if in installments. At $60, three installments of $20 each could be imposed. (Even double that amount is a bargain in exchange for a discharge.) That is a very light burden. If a debtor cannot afford even that, then the debtor is likely judgment proof and has no need to be in a chapter 7 case.

C. Increasing the commission breakpoints would be easier than increasing the commission percentages. The first two breakpoints should be increased from 25% of the first $5,000 and 5% of the next $45,000, to 25% of the first $10,000, and 5% of the next $90,000. This would better compensate the most productive trustees.

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2017 SOUTHEAST BANKRUPTCY WORKSHOP
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V. Proposal:

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- **i.** an increase in the petition filing fee;
- **ii.** an increase in other filing fees;
- **iii.** a reallocation of the existing petition and other filing fees; or
- **iv.** a combination of the foregoing.

B. The IFP waiver provision of 28 U.S.C. §1930(f) should be amended to require in cases of the waiver that the portion of the filing fee allocated to the trustee's compensation still be paid, whether by lump sum or even if in installments. At $60, three installments of $20 each could be imposed. (Even double that amount is a bargain in exchange for a discharge.) That is a very light burden. If a debtor cannot afford even that, then the debtor is likely judgment proof and has no need to be in a chapter 7 case.

C. Increasing the commission breakpoints would be easier than increasing the commission percentages. The first two breakpoints should be increased from 25% of the first $5,000 and 5% of the next $45,000, to 25% of the first $10,000, and 5% of the next $90,000. This would better compensate the most productive trustees.

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Eliminate the Chapter 13 Debt Ceiling

Section 109(e) Current Text

Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than **$394,725** and noncontingent, liquidated, secured debts of less than **$1,184,200** or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than **$394,725** and noncontingent, liquidated, secured debts of less than **$1,184,200** may be a debtor under chapter 13 of this title

Proposed Change

Only an individual with regular income ~~that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than **$394,725** and noncontingent, liquidated, secured debts of less than **$1,184,200**~~ or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, ~~that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than **$394,725** and noncontingent, liquidated, secured debts of less than **$1,184,200**~~ may be a debtor under chapter 13 of this title

The Problems with the Debt Ceiling

- Absolute priority rule wreaks havoc on individual debtors
- Major sources of individual debt are outstripping inflation
- Expense of Chapter 11 impairs ability of individuals to reorganize

Absolute Priority Rule

- Section 1129(b)(2)(B)(ii) requires a nonconsensual Chapter 11 Plan to pay all senior creditors in full before paying a junior creditor
- There is an exception that provides "that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115"
- Every appellate court to consider the exception language has concluded that it does not eliminate the absolute priority rule in individual cases

Absolute Priority Rule

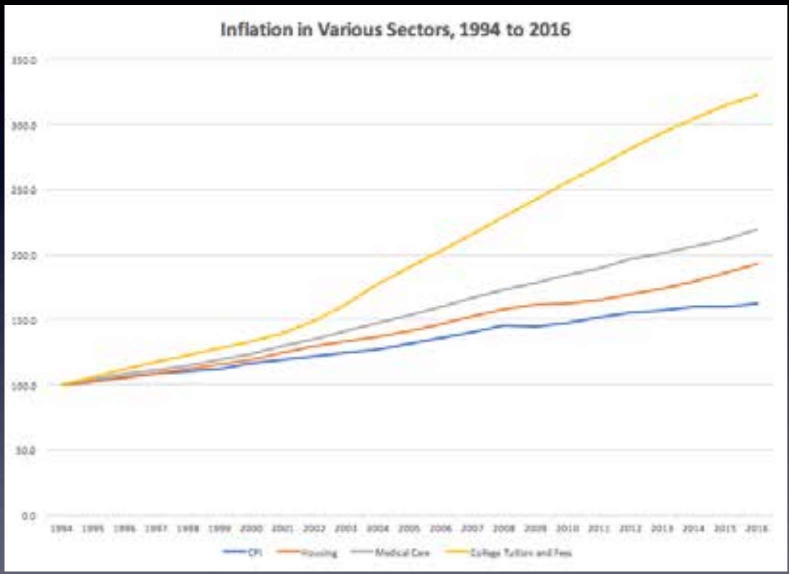
- Eliminating the Chapter 13 debt ceiling would cleanly eliminate this problem
- Absolute priority rule has its roots in the basics of corporate law: debt gets paid before equity
- A careful reading of case law and legislative history reveals that the doctrine was never intended to apply to individuals

Absolute Priority Rule

- Eliminating the debt limits for Chapter 13 would avoid problems with the absolute priority rule—debtors could file a Chapter 13 case instead. Chapter 13 has no absolute priority rule

Major Sources of Debt are outstripping Chapter 13 debt ceilings

- Debt ceilings in Chapter 13 are indexed to inflation by Section 104
- Every three years the ceilings are adjusted on April 1 by the change in the Consumer Price Index for All Urban Consumers (CPI-U)



Inflation Factors 1994 to 2016

Sector	Inflation
CPI-U	62%
Housing	93%
Medical	120%
College Tuition	223%

Chapter 11 Expenses

- Chapter 11 administrative expenses are much higher than Chapter 13 administrative expenses
- In all the Chapter 11 cases filed in the Northern District of Georgia to date in 2017 there were no individual cases filed by counsel without a retainer of $15,000 or higher. Fee requests by counsel all exceeded the retainer
- Fees in Chapter 13 are much lower.

Chapter 11 Expenses

- One consequence is an increase in *pro se* Chapter 11 creditors. These cases have a low probability of success.
- In cases with counsel, the fees come out of the funds otherwise available to creditors.

Chapter 13 already limits abusive filings

- Equal payment requirement in § 1325(a)(5)(B)(iii)(I)
- 5 year limitation on plan length in § 1322(d)(1)(c)
- Immediate payment requirement of § 1326(a)(1)

The Bankruptcy Code Should be Amended to Provide That Creditors' Committees Should be the Exception, Not the Rule, in Undersecured Creditor Cases

The Bankruptcy Code is currently structured to require, other than in small business debtor cases, that "United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." 11 U.S.C. § 1102(a)(1). A creditors' committee ("committee") is designed to protect the interests of the general class of unsecured creditors. Congress, appropriately, provided for the formation of a committee to negotiate on behalf of unsecured creditors and to otherwise "police" the case for them.

A committee is authorized to engage counsel, accountants and other professionals to represent and perform services for the committee. Id., § 1103(a). In addition, Section 1103(c) of the Bankruptcy Code provides that a committee may, among other things, (i) consult with the debtor about the administration of the case, (ii) investigate the acts, conducts, assets and liabilities of the debtor, and (iii) participate in formulating a plan.

Once appointed, a committee has a fiduciary duty to act in the best interests of its constituents as a whole and not the individual members. See In re Kensington Int'l Ltd., 368 F.3d 289, 315 (3rd Cir. 2004). Ostensibly, by the existence of such fiduciary duty, committees will act in a way that seeks to maximize the value available for all unsecured creditors. Moreover, ideally, committees will not waste time or money by, for example, instituting unwarranted litigation or filing baseless objections to relief sought by a debtor.

However, in recent years, a new phenomenon has developed (and has certainly become almost the norm in non-mega chapter 11 cases since the end of the Great Recession) that calls into question the purpose and necessity of a committee. Referred to in this article as the "undersecured creditor case," it is a situation where there are one or more secured creditors with liens on all of the debtor's assets and the value of the debtor (on a reorganized or liquidated basis) is less than the aggregate amount of the secured creditors' claims. In that scenario, the secured creditors are undersecured and there is no value available in the debtor's estate for the benefit of unsecured creditors.

Against this backdrop of slim or no prospects for recovery, the undersecured creditor case has resulted in committees proceeding with "fishing expeditions" and/or actual (or threatened) litigation against the senior secured creditors to attempt to obtain a recovery for its constituents. One perspective on this type of litigation is that, because it is within the powers granted to a committee, there is simply nothing wrong with it. Another perspective is that this type of litigation is just a "shakedown" of the senior secured creditors and the purpose behind appointing a committee is not to force senior creditors to divest themselves of assets and/or liens because of perceived litigation risk when such creditors are the only ones at risk if they lose such litigation.

In situations where unsecured creditors are "out of the money," the question arises whether a committee should be mandated or whether such appointment should only occur after "cause" has been demonstrated to support such appointment. The better reasoned approach is the latter -- the appointment of a committee in an undersecured creditor case should be the exception and not the rule. This is because often the committee, through its professionals, will waste valuable estate resources pursuing claims that have no merit, while trying to justify its formation in the first instance -- often at the expense of the undersecured creditor that is already taking a meaningful hit in the bankruptcy case (because the creditor is not fully secured and relatedly does not have the benefit of post-petition interest, fees, and costs under 506(b) of the Bankruptcy Code).

Accordingly, Section 1102 of the Bankruptcy Code should be amended to reflect this change. Proposed amended language is attached at the end of this article as Exhibit 1.

The proposed amendment to Section 1102 provides that upon “cause,” the bankruptcy court may order that a committee be appointed. Cause, just as many other places in the Bankruptcy Code, is intentionally not defined, but should be determined on a case-by-case basis. Some likely examples of “cause” may include (a) determining, after the case is filed, that there are more than a *de minimis* amount of unencumbered assets available for distribution to unsecured creditors, (b) identifying significant litigation against third parties that could augment the recovery of unsecured creditors, and (c) the debtor requesting assistance concerning it formulating a plan of reorganization that is opposed by the senior secured creditors. Assuredly, there are likely many other examples that creative debtor and unsecured creditor lawyers will develop to argue that “cause” exists and the courts will ultimately determine a set of factors that ought to be considered in any such application.

The amendment to Section 1102 strikes a balance among competing interests in the undersecured secured creditor case. First, it continues to allow a debtor to exercise its rights under chapter 11 of the Bankruptcy Code and seek to reorganize, sell its assets or liquidate. Second, it provides "downside" protection to an undersecured secured creditor from unnecessary costs and litigation resulting from a committee trying to justify its existence. Lastly, it protects unsecured creditors by not creating a complete bar to the formation of committee, but limiting the circumstances under which it may be appointed.

In addition to the limitations on the formation of a committee in an undersecured creditor case, if a court were to appoint such a committee, it should include constraints on the scope of its permitted rights and the costs that should be reimbursable to the committee. Proposed limiting language is also included in Exhibit 1. These limitations will further the goal of balancing the benefits and harms in an undersecured creditor case.

EXHIBIT 1

PROPOSED AMENDMENT TO SECTION 1102 OF THE BANKRUPTCY CODE

Section 1102 of the Bankruptcy Code

(a)

(1) Except as provided in paragraphs (3) and (5), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

(2) On request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee.

(3) On request of a party in interest in a case in which the debtor is a small business debtor and for cause, the court may order that a committee of creditors not be appointed.

(4) On request of a party in interest and after notice and a hearing, the court may order the United States trustee to change the membership of a committee appointed under this subsection, if the court determines that the change is necessary to ensure adequate representation of creditors or equity security holders. The court may order the United States trustee to increase the number of members of a committee to include a creditor that is a small business concern (as described in section 3(a)(1) of the Small Business Act), if the court determines that the creditor holds claims (of the kind represented by the committee) the aggregate amount of which, in comparison to the annual gross revenue of that creditor, is disproportionately large.

(5) In a case in which non-contingent secured claims against the debtor exceed the assets of such debtor, on request of a party in interest, the court, for cause, may order the appointment of a committee of creditors holding unsecured claims.

(b)

(1) A committee of creditors appointed under subsection (a) of this section shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee, or of the members of a committee organized by creditors before the commencement of the case under this chapter, if such committee was fairly chosen and is representative of the different kinds of claims to be represented.

(2) A committee of equity security holders appointed under subsection (a)(2) of this section shall ordinarily consist of the persons, willing to serve, that hold the seven largest amounts of equity securities of the debtor of the kinds represented on such committee.

(3) A committee appointed under subsection (a) shall—
- **(A)** provide access to information for creditors who—
  - **(i)** hold claims of the kind represented by that committee; and
  - **(ii)** are not appointed to the committee;

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(B) solicit and receive comments from the creditors described in subparagraph (A); and

(C) be subject to a court order that compels any additional report or disclosure to be made to the creditors described in subparagraph (A).

Section 1103 of the Bankruptcy Code

(a)

At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.

(b)

An attorney or accountant employed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.

(c) A committee appointed under section 1102 of this title may, subject to the limitations and restrictions set forth in any order appointing a committee under section 1102(a)(5) of this title —

(1) consult with the trustee or debtor in possession concerning the administration of the case;

(2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;

(3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan;

(4) request the appointment of a trustee or examiner under section 1104 of this title; and

(5) perform such other services as are in the interest of those represented.

(d)

As soon as practicable after the appointment of a committee under section 1102 of this title, the trustee shall meet with such committee to transact such business as may be necessary and proper.