Central States
Bankruptcy Workshop

Top Cases/Decisions

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U.S. Bankruptcy Court (N.D. Ill.) | Chicago

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PLENARY SESSION

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INTERESTING CASES AND OTHER THOUGHTS

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Ignoring Actual Knowledge Precludes Buyer's Protections Under § 363(m)

Archer-Daniels-Midland Co., v. Country Visions Coop., No. 21-1400
(7th Cir., April 4, 2022)

I. Facts:

a. In 2007, Appellant Country Visions Cooperative ("CVC") was granted a right of first refusal ("ROFR") on certain real property located in Wisconsin ("Property"). In 2010, the owners of the Property (successors in interest to the dissolved entity that had granted the ROFR) filed for bankruptcy protection. The debtors did not schedule CVC's right in the Property, nor did they notify CVC of their filing for bankruptcy. Subsequently, the debtors sought to and confirmed a plan through which the Property was conveyed to Archer Daniels Midland Company ("ADM") free and clear of all liens claims and encumbrances. Again, CVC was not given any notice of any of the bankruptcy proceedings.

b. Subsequently, ADM sought to sell the Property to a third party. ADM did not provide notice to CVC of the impending sale or otherwise recognize with the ROFR, even though the ROFR still appeared on the Property's title report. Despite this, CVC learned of the impending sale and sued ADM in state court. ADM then returned to the bankruptcy court and in reliance on the good faith provisions of § 363(m), asked the bankruptcy court to enforce its previous order authorizing the sale of the Property to ADM free and clear of all liens, claims and encumbrances.

c. Ultimately, both the bankruptcy court and the district court denied ADM's request. Both courts concluded that ADM could not have acquired the Property in good faith because it had actual and constructive notice of CVC's ROFR at the time of the sale, but failed to give CVC notice of the sale or alert the bankruptcy court to CVC's interest.

II. Ruling:

a. Affirmed.

i. First, the Seventh Circuit noted that it would first answer the statutory question under § 363(m), i.e. whether the buyer had acted in good faith, rather than the constitutional due process question of whether the notice provided to CVC was deficient. If it was determined that ADM had not acted in good faith, then it was not entitled to the protections afforded by § 363(m) and the constitutionality of the constructive notice allegedly provided to CVC becomes irrelevant.

ii. The Seventh Circuit then noted it was certain that the debtors had acted in bad faith when they failed to schedule the ROFR and/or CVC in their schedules of assets and liabilities, and then continued to ignore CVC and

its ROFR throughout the sale process. However, it also noted that for purposes of the analysis before it, it had to focus on whether ADM had proceeded in good faith (rather than the debtors).

iii. The Seventh Circuit concluded that ADM could not have acted in good faith. ADM had actual knowledge of the ROFR, in the form of a title report listing the ROFR, prior to its purchase of the Property from the Debtors. The Seventh Circuit then proceeded to hold that a party who has both actual and constructive notice of an interest in real estate it was about to purchase through a court approved sale, which party fails to advise the court of that interest and to have that interest addressed by the approving court, has not acted in good faith.

III. Thought and Conclusions.

a. Bad Facts Make Good Law.

i. The Seventh Circuit clearly stated it found that both the debtors and ADM lacked good faith because they knowingly ignored CVC's ROFR.

1. The Seventh Circuit pointedly noted that the parties' lack of candor before the bankruptcy court made the bankruptcy court consider whether the sale order should be set aside because of a fraud on the court.

2. The Debtors had already filed multiple documents in the case which required disclosure of the ROFR and CVC's interests. These include schedules and statements, and any motion to use, sell or lease property under § 363.

3. In contrast, ADM's sin was remaining silent despite its having constructive (the ROFR was a public record) and actual (title report) knowledge of the ROFR. And because of that, ADM had could not have acted in good faith and was not entitled to the protections afforded a good faith buyer under § 363(m).

4. For that reason, the Seventh Circuit held ADM must defend the state court litigation brought against it by CVC.

ii. One directional parting shot of note, the Seventh Circuit also reminded the parties that the bankruptcy court did not purport to extinguish the ROFR in 2011 (when it did not know about it) *without compensating CVC* for the extinguishment of its ROFR. The comment was not necessary, but did seem to be a not so subtle reminder that there may be an economic way out of this mess for ADM.

b. Do not be these people.

i. If you are a buyer, the protections § 363(m) afford you are related to the sufficiency of the sale notice provided to creditors and other parties-in-interest.

    1. Constructive notice may be an effective catch all in certain cases. However it is never a replacement for required actual notice to creditors and interest holders of which you have actual notice.

    2. A buyer should not hesitate to ask for as comprehensive of notice as it believes is necessary to protect its purchase. Notice should go to any party whom the buyer believes may claim an interest in the to be purchased property, even if the debtor does not agree with buyer's assessment, and/or even disputes the existence of the interest.

    3. Do not rely on the due diligence of others, especially a debtor. A purchase out of bankruptcy under § 363 is not a magic wand that erases the buyer's need for due diligence.

ii. If you are a debtor or its counsel, aspire to not be called out by your local circuit court of appeals for committing a fraud on the bankruptcy court.

Recent Decisions in the Wake of Taggart v. Lorenzen

I. *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019)

Background

- Bradley Taggart owned an interest in an Oregon company; the company and other owners sued Taggart for breach of the company's operating agreement.
- Taggart filed a chapter 7 case before trial, and received a discharge.
- After entry of the discharge order, state court entered judgment against Taggart in the pre-bankruptcy suit and awarded the plaintiffs an award of attorneys' fees accruing post-petition. Under the 9th Circuit's decision in *In re Ybarra*, 424 F.3d 1018 (2005), discharge order generally discharges postpetition attorneys' fees stemming from pre-petition litigation unless the debtor "returned to the fray" after filing; here, the state court agreed with plaintiffs' argument that Taggart "returned to the fray."
- Taggart went to the Oregon Bankruptcy Court and sought – and received – a civil contempt order against the plaintiffs (on remand; the Bankruptcy Court originally would not hold plaintiffs in contempt). Bankruptcy Court applied a standard akin to "strict liability," where contempt sanctions are permissible, irrespective of the creditor's beliefs, so long as creditor was "aware of the discharge" order and "intended the actions which violate[d]" it. *In re Taggart,* 522 B.R. 627, 632 (Bankr. Ore. 2014).
- On appeal, the 9th Circuit BAP vacated the sanctions and the Ninth Circuit Court of Appeals affirmed the BAP. 9th Circuit so held based on a very different standard than that applied by the Bankruptcy Court; namely, that a "creditor's good faith belief" that a discharge order does not apply to the creditor's claim precludes a contempt finding, "even if the creditor's belief is unreasonable." 888 F.3d 438, 444.

Supreme Court's Ruling

- The standards employed by each of the lower courts were wrong; neither a strict liability approach nor a purely subjective standard is appropriate.
- Supreme Court held that "a court may hold a creditor in civil contempt for violating a discharge order if there is *no fair ground of doubt* as to whether the order barred the creditor's conduct" (essentially, an objective reasonableness standard).
  - Bankruptcy Code does not grant courts unlimited authority to hold creditors in contempt. Rather, sections 524(a)(2) and 105(a), viewed in tandem, incorporate traditional equitable standards for determining when parties may be held in civil contempt for violating an injunction
  - Outside of bankruptcy, Supreme Court has ruled that civil contempt "should not be resorted to where there is [a] *fair ground of doubt* as to the

wrongfulness of the defendant's conduct." *California Artificial Stone Paving Co. v. Molitor*, 113 U.S. 609, 618 (1885) (emphasis added).

- Same principles applied to bankruptcy discharge orders. Standard is *objective*; the party's subjective belief as to compliance will not insulate her from contempt if that belief was objectively unreasonable.
- Ninth Circuit's standard is inconsistent with traditional civil contempt principles, relies too heavily on states of mind, and may have the effect of increasing post-discharge litigation and forcing debtors to constantly defend their discharge.
- Bankruptcy Court's standard is similarly untenable. Taggart's suggestion that a strict liability standard should be employed, and that a creditor would have to get advance determinations from the Bankruptcy Court before attempting to collect a debt, would create confusion and undue burdens on the bankruptcy courts, and interfere with a chief purpose of bankruptcy: "'to secure a prompt and effectual' resolution of bankruptcy cases 'within a limited period.'"
- **Vacated and remanded**.

II. Recent Decisions Analyzing/Applying *Taggart*

A. *Beckhart v. NewRez LLC*, 31 F.4th 274 (4th Cir. 2022)

- 4th Circuit Court of Appeals held the *Taggart* civil contempt standard for violating a discharge order also applies to consideration of civil contempt for a creditor's violation of a confirmed chapter 11 plan
- Debtors confirmed a chapter 11 plan which allowed them to retain possession of a house; plan provided for an initial date for Debtors to resume mortgage payments (though those payments were not specified), and also provided that in event of a default, 10 days' written notice was required before state court remedies could be exercised
- A new servicer took over the Debtors' mortgage account, mistakingly believed the account was past due (because of missed pre-petition payments), and engaged in a 5-year campaign of past due notices, notices of default, and foreclosure proceeding
- Debtors filed emergency motion for contempt in bankruptcy court to stop the foreclosure, alleging that the servicer violated the confirmation order by improperly exercising default remedies. Servicer argued its actions were justified under the confirmation order, that the confirmation order was ambiguous, and that it was entitled to rely on advice of counsel
- Bankruptcy court awarded sanctions, but its order doing so did not seem to consider *Taggart*. District Court reversed under the *Taggart* standard, holding that servicer "ha[d] established a fair ground of doubt with regard to the unclear terms of the confirmation order," and had acted in good faith by relying on outside counsel's advice

- 4th Circuit, while agreeing with the District Court that *Taggart* analysis applied to an alleged violation of a chapter 11 plan confirmation order, held that the District Court erred in, among other things, holding that reliance on advice of counsel "was seemingly dispositive as a defense to civil contempt." Per the 4th Circuit, advice of counsel is not a defense to civil contempt. Accordingly, case was remanded to bankruptcy court to reconsider the contempt motion under the proper standard

B. *Law Offices of Francis J. O'Reilly, Esq. v. Selene Finance, L.P. (In re DiBattista)*, No. 20-4067-bk (2d Cir. May 17, 2022)
   - Dealt with issue of whether a debtor is entitled to recover attorneys' fees incurred in the successful prosecution of an appeal from a bankruptcy court's order holding a creditor in contempt of discharge injunction
   - Here, a chapter 7 debtor obtained a civil contempt award against his mortgage lender, who engaged in "absolutely egregious" conduct by improperly reporting the debtor to credit agencies and bombarding him with collection calls, despite there being no delinquency on the mortgage
   - 2nd Circuit Court of Appeals reversed District Court and Bankruptcy Court orders denying award of appellate fees, in which those courts held that the appeal did not violate the discharge injunction, and that the bankruptcy court lacked authority to award such fees (i.e., the request should have been made to the District Court but was not)
   - 2nd Circuit held that a bankruptcy court has the power to impose contempt sanctions, and that "authority carries with it the ability to award appellate attorneys' fees."
     i. In part, the court relied upon its prior decision in *Weitzman v. Stein*, 98 F.3d 717 (2d Cir. 1996), in which it held that appellate costs were compensable in a contempt proceeding because "none of this [litigation] would have been necessary" if the offending party hadn't violated a court order. So the fact that the appeal itself wasn't in violation of the discharge injunction did not foreclose an award of appellate fees, because those fees were caused by the mortgage company's conduct.
     ii. Court also disagreed with the bankruptcy court's rationale that only the District Court could award appellate fees, adopting *Taggart's* conclusion that the bankruptcy court's contempt power includes authority to "compensate the complainant for losses stemming from the defendant's noncompliance with an injunction," 139 S. Ct. at 1801, even if those losses were incurred in appellate litigation.
     iii. Finally, 2nd Circuit rejected mortgage company's argument that *Weitzman* was distinguishable because it involved a district court sanctions award; court held that – like *Taggart* – sections 524 and 105 "bring with them the old soil that has long governed how courts enforce injunctions," and as

such, the bankruptcy court's contempt sanctions powers derive from long-held authority of the district courts.

- **Vacated and remanded.**

C. *PHH Mortgage Corp. v. Sensenich (In re Gravel)*, 6 F.4th 503 (2d Cir. 2021)

- In this case, the 2nd Circuit held that the *Taggart* standard applies to *all* contempt proceedings in bankruptcy court (not just for violation of the discharge injunction)
- The Bankruptcy Court imposed sanctions totaling $375,000 against a mortgage servicer who was found to be a repeat violator of Bankruptcy Rule 3002.1 in at least three separate chapter 13 cases in Vermont (as well as other cases outside the district). This Rule requires mortgage lenders to file notices of post-petition fees and charges within 180 days of when the charges were incurred, and also contains a provision allowing the bankruptcy court to disallow such charges, and "award other appropriate relief, including reasonable expenses and attorneys' fees" where the lender fails to file the notice
    i. Specifically, the servicer had issued statements containing certain charges (albeit noting these charges were not part of the payment due and that the statement was "not an attempt to collect a debt") despite not having filed a 3002.1 statement. This prompted the chapter 13 trustee to seek contempt sanctions on grounds that the charges violated both Rule 3002.1 and Bankruptcy Court orders determining that the debtors were current on plan payments and that all pre-petition defaults had been cured (the "Current Orders").
    ii. In all such cases, the servicer acknowledged the charges were erroneous and removed the charges from the affected debtors' mortgage statements
- On appeal, the 2nd Circuit reversed the Bankruptcy Court's sanctions award.
    i. First, the court held that the Current Orders were not a clear and unambiguous prohibition on the servicer's conduct, did not constitute an injunction, and therefore was an inadequate basis for contempt sanctions under the *Taggart* standard, which it held should apply to the Current Orders
    ii. Second, the court held that the Bankruptcy Court erred in awarding punitive sanctions under Rule 3002.1 under the authorization to "award other appropriate relief." Interpreting the rule as a whole, the court held that relief that can be imposed thereunder is limited to compensatory damages

D. *Roth v. Nationstar Mortgage, LLC (In re Roth)*, 935 F.3d 1270 (11th Cir. 2019)

- Issue: whether a single, post-discharge informational statement which mortgage holder sent to chapter 13 debtor (which set forth the remaining amounts of the mortgage, but expressly stated that it was not an attempt to collect a discharged debt) warranted an award of sanctions for violation of discharge injunction
- 11th Circuit affirmed decisions of Bankruptcy Court and District Court in holding that it *did not*

- Debtor did not meet burden of showing the informational statement was an unlawful debt collection in violation of section 524; disclaimer language was bold and prominent in the statement, which expressly acknowledged the discharge and stated that any payment was voluntary
- Debtor asked court to employ a "least sophisticated consumer" standard that is employed in cases under the Fair Debt Collection Practices Act. Court declined to do so, holding that such standard has never been incorporated into a section 524 analysis
- But even if the informational statement presented a "close call" under section 524, court would nevertheless find that sanctions are not warranted under *Taggart*, since there is more than a "fair ground of doubt" as to whether the discharge order barred the mortgagor's conduct

E. *Fidelity & Deposit Co. of Maryland v. TRG Venture II, LLC (In re Kimball Hill, Inc.)*, 2022 WL 952727 (N.D. Ill. Mar. 30, 2022)
   - Stemming from the chapter 11 cases of Kimball Hill, Inc. (a homebuilder) and certain affiliates in the U.S. Bankruptcy Court for the Northern District of Illinois, in which a liquidating plan was confirmed in 2009, containing broad releases by claimholders voting to accept the plan of the debtors and other enumerated released parties
   - TRG Venture II, LLC acquired certain properties from a third party that had purchased them from the plan administrator, becoming responsible for obligations under annexation agreements that the debtors had entered into with municipalities
      i. Certain of these municipalities filed suit in state court seeking performance under the annexation agreements from both TRG and Fidelity & Deposit Co. of Maryland ("F&D"), as surety
      ii. F&D then asserted claims against TRG for indemnity and/or unjust enrichment
      iii. TRG, after six years of state court litigation, filed in the Bankruptcy Court a motion to enforce the confirmation order, asserting F&D's state law claims were barred under the plan injunction
      iv. The Bankruptcy Court agreed with TRG, and awarded over $9.5 million in contempt damages to TRG
         1. Bankruptcy Court utilized a two-step analysis: TRG had burden to set forth facts warranting relief; and then F&D had the burden of proving uncertainty in the plan or confirmation order that would give it a fair ground of doubt as to whether its conduct violated the confirmation order
   - On appeal, the District Court addressed whether the Bankruptcy Court properly held F&D in contempt under *Taggart*
      i. F&D contended, among other things, that the Bankruptcy Court erred because there was an objectively reasonable basis to argue that TRG was not a "released party" under the confirmed plan

ii. The District Court rejected these arguments, holding that the confirmed plan was quite clear that creditors voting in favor of the plan (like F&D) agreed to broad releases (including to future purchasers of estate assets), and that F&D's pursuit of state law claims completely undermined the plan's purpose, and if upheld would render the protections to successors and assigns meaningless

iii. The District Court also held that the Bankruptcy Court properly employed an analysis under the *Taggart* standard in reaching its conclusion as to contempt sanctions, and further held that the two-step burden shifting analysis employed by the Bankruptcy Court was appropriate under *Taggart*

F. *Ragone v. Stefanik & Christie, LLC (In re Ragone)*, 2021 WL 1923658 (6th Cir. BAP May 13, 2021)

- In contrast with *Kimball Hill*, the 6th Circuit Bankruptcy Appellate Panel held that the burden of proof on a post-discharge contempt motion falls on the debtor, who must prove that the "creditor committed a sanctionable violation of the discharge inunction by clear and convincing evidence." This same standard was also adopted in several other decision from courts in the 6th Circuit. *In re City of Detroit, Mich.*, 614 B.R. 255 (Bankr. E.D. Mich. 2020); *In re Ostrander*, 2022 WL 999680 (Bankr. N.D. Ohio Apr. 1, 2022).
- The result, however, was similar, with the BAP affirming the Bankruptcy Court's determination that the defendants committed sanctionable violations of the discharge injunction by continuing to pursue garnishment on a discharged debt and failing to turn over improperly garnished funds
- In this particular case, once the creditor learned of the debtor's discharge and had no objectively reasonable basis for concluding that continued collection activities would not violate the discharge injunction, there is no "fair ground of doubt" to support the continuation of such activities and had to immediately return any improperly garnished funds. This did not happen here, and the creditor's continued collection activities were inexcusable because the activities were being pursued by a licensed collection attorney that had access to experienced bankruptcy attorneys, among other things

Post-Petition Retirement Contributions in Chapter 13 Bankruptcy Cases

Saving for retirement is a challenge for many. For those in chapter 13 bankruptcy, however, the question of whether debtors can contribute to their retirement plans during their cases is far from clear. The uncertainty is largely caused by the Bankruptcy Code's "hanging paragraph" in section 541(b)(7)(A), which provides that estate property does not include any of a debtor's wages withheld by an employer for contributions to a 401(k) retirement account, "except that such amount . . . shall not constitute disposable income."[1] This language has resulted in at least four different approaches as to whether a chapter 13 debtor may make post-petition 401(k) contributions.

Background

A bankruptcy estate in chapter 13 includes property owned at the time the debtor files her case, as well as property and income acquired post-petition.[2] A chapter 13 plan may be approved if the debtor dedicates all of her projected disposable income to pay unsecured creditors.[3] Disposable income consists, generally, of a debtor's current monthly income "less amounts reasonably necessary to be expended" for the maintenance and support of the debtor and her dependents.[4] Money not considered disposable income need not be used to pay creditors. The problem, however, is that the hanging paragraph, which arguably excepts 401(k) contributions from disposable income, is found in section 541 of the Code, which addresses property of the estate—not sections 1322 and 1325, which focus on plan requirements for contributions of income.[5]

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[1] 11 U.S.C. § 541(b)(7)(A).
[2] *See generally* 11 U.S.C. §§ 1306, 1322(a)(1), 1327(b).
[3] 11 U.S.C. § 1325(b)(1)(B).
[4] 11 U.S.C. § 1325(b)(2).
[5] Put differently, "in drafting § 541(b)(7)(A), Congress jumped from point A to point C, conflating distinct and arguably unrelated concepts (*i.e.*, property of the estate and disposable income) without explaining the logical connection between the two." Pernell W. McGuire & Aubrey L. Thomas, *401(k) Contributions Under Post-BAPCPA Case Law*, 32-MAR AM. BANKR. INST. J. 18, 19 (2013).

This placement in the Code, combined with the language of the provision, raises numerous questions about how to treat 401(k) contributions in chapter 13. For example, are 401(k) contributions withheld before bankruptcy the only funds that are not considered disposable income? Or are post-petition 401(k) contributions also excluded, allowing chapter 13 debtors to make those contributions throughout their cases? Indeed, how should courts interpret the hanging paragraph's use of "except that"? A phrase like this typically introduces an exception to a rule. The exception in section 541, however, addresses a chapter 13 concept (disposable income), which is separate and distinct from the concept of estate property. When confronted with these questions, courts have taken primarily four different positions.

The Debtor-Friendly *Johnson* Approach

The most permissive interpretation is the *Johnson* approach, which provides that chapter 13 debtors "may fund 401(k) plans in good faith, so long as their contributions do not exceed the limits legally permitted by their 401(k) plans."[6] According to the *Johnson* court, "Congress . . . placed retirement contributions outside the purview of a [c]hapter 13 plan" because section 541(b)(7)(A) "plainly state[s]" that 401(k) contributions "shall not constitute disposable income."[7] Other than the good faith and legality of the proposed contribution, nothing else needs to be considered under this interpretation.[8] Some courts within the Central States have adopted the *Johnson* approach.[9]

The Creditor-Friendly *Prigge* Approach

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[6] *Baxer v. Johnson (In re Johnson*), 346 B.R. 256, 263 (Bankr. S.D. Ga. 2006).
[7] *Id.* (internal quotation omitted); *see also* 11 U.S.C. § 541(b)(7)(A).
[8] *Johnson*, 346 B.R. at 263.
[9] *See, e.g., In re Davis*, No. 17-70784, 2017 WL 4898166, at *5 (Bankr. C.D. Ill. Oct. 30, 2017) (adopting "the majority position set forth in *Johnson*" and concluding that "[p]ostpetition 401(k) contributions are allowable deductions . . . even when those contributions begin at the commencement of the case[,] . . . subject to the good faith requirement for plan confirmation"); *In re Hall*, No. 12 B 43452, 2013 WL 6234613, at *9 (Bankr. N.D. Ill. Oct. 22, 2013) (holding "that both prepetition and postpetition voluntary 401(k) contributions are excluded from disposable income, even if the debtor begins or increases those contributions after the commencement of the bankruptcy case").

On the other end of the spectrum, the court in *In re Prigge* held that voluntary post-petition 401(k) contributions are always disposable income.[10] Examining the placement of the hanging paragraph in the Code, the *Prigge* court concluded that Congress did not intend to exclude from disposable income 401(k) contributions that were made post-petition.[11] The court also interpreted section 541(b)(7)(A) as excluding only 401(k) funds already withheld when the debtor filed chapter 13, not the contributions that the debtor continued to make during the case.[12] The *Prigge* court further reasoned that because the IRS guidelines provide that 401(k) contributions are not necessary expenses in any amount, they should not be excluded from disposable income.[13] Although some courts have adopted the *Prigge* approach,[14] a search of the caselaw reveals that none of those within the Sixth, Seventh, or Eighth Circuits have taken that position.[15]

The CMI Approach

Between the extremes of *Johnson* and *Prigge* are the CMI and Sixth Circuit approaches. Under the CMI (current monthly income) approach, debtors are allowed to deduct from their disposable income the average amount of their 401(k) contributions made during the six months leading up

[10] *See generally* 441 B.R. 667 (Bankr. D. Mont. 2010).
[11] *See id.* at 677 (explaining that "[i]f Congress had intended to exclude voluntary 401(k) contributions from disposable income[,] it could have drafted § 1322(f) to provide for such an exclusion, or provided one elsewhere" within chapter 13).
[12] *See id.* at 677 n.5 (explaining that section 541(b)(7)(A) "seems intended to protect amounts withheld by employers from employees that are in the employer's hands at the time of filing bankruptcy, prior to remission of the funds to the plan" (internal quotation omitted)).
[13] According to Ninth Circuit authority, law by which the *Prigge* court is bound, "Congress provided, by reference to the IRS guidelines, specific guidance as to what qualifies as a necessary expense for . . . purposes of applying" the means test. *Egebjerg v. Anderson (In re Egebjerg*), 574 F.3d 1045, 1052 (9th Cir. 2009); *see also* 11 U.S.C. § 1325(b)(3).
[14] *See Parks v. Drummond (In re Parks)*, 475 B.R. 703, 708–09 (B.A.P. 9th Cir. 2012) (stating that section 541(b)(7)(A) excludes only pre-petition 401(k) contributions and concluding that the statute "does not authorize chapter 13 debtors to exclude voluntary postpetition retirement contributions in any amount for purposes of calculating their disposable income").
[15] In *Seafort v. Burden (In re Seafort)*, the Sixth Circuit stated that "[u]pon careful inspection, we think the view espoused by the *Prigge* . . . court[] is the correct interpretation." 669 F.3d 662, 671 (6th Cir. 2012). The court noted, however, that its position at the time was "not relevant" because the precise issue was not before it. *Id.* at 674 n.7. Eight years later, the Sixth Circuit officially stated its view on section 541(b)(7)(A), one that did not align with *Prigge*. *See Davis v. Helbling (In re Davis)*, 960 F.3d 346, 357 (6th Cir. 2020); *see also infra*.

to the bankruptcy filing.[16] The courts that have reached this conclusion explain that a debtor's "disposable income" is calculated by first looking at "current monthly income," which is defined as the average of a debtor's monthly income in the six months preceding the bankruptcy case.[17] Thus, the CMI courts say, allowing debtors to continue making 401(k) contributions in the same amount they were making, on average, in that same six-month pre-petition lookback period comports with the Code.[18] At least one court within the Central States has adopted the CMI approach.[19]

The Sixth Circuit Approach

Under the final approach—a combination of opinions issued by the Sixth Circuit—a debtor's monthly post-petition 401(k) contributions are excluded from disposable income "so long as those contributions were regularly withheld from the debtor's wages prior to her bankruptcy."[20] After considering all other interpretations, the Sixth Circuit rejected the *Johnson* and *Prigge* approaches,[21] explaining that its interpretation "gives a meaningful effect" to section 541(b)(7)(A)'s language and captures Congress's intent with respect to the hanging paragraph.[22] The Sixth Circuit also prohibits consideration of a debtor's general, years-long history of pre-petition 401(k) contributions in determining how much she can continue withholding.[23] Rather,

[16] *See generally In re Anh-Thu Thi Vu*, Case No. 15-41405-BDL, 2015 WL 6684227 (Bankr. W.D. Wash. June 16, 2015); *In re Bruce*, 484 B.R. 387 (Bankr. W.D. Wash. 2012).
[17] *Bruce*, 484 B.R. at 392. *See also* 11 U.S.C. §§ 101(10A)(A), 1325(b)(2).
[18] *Anh-Thu Thi Vu*, 2015 WL 6684227, at *4.
[19] *See In re Huston*, 635 B.R. 164, 172 (Bankr. N.D. Ill. 2021) (stating that "[a]fter close examination of the competing approaches, this court generally agrees with the analysis set out in *In re Anh-Thu Thi Vu*" and explaining that "the analysis should begin with a calculation based on the average six-month pre-petition income, excluding only average contributions made within that period").
[20] *Davis*, 960 F.3d at 357. This position builds upon the Sixth Circuit's previous holding that "income made available once Debtors' 401(k) loan repayments are fully repaid . . . may not be used to make voluntary contributions" post-petition, as that newly available money had not been used for 401(k) contributions pre-petition. *Seafort*, 669 F.3d at 674.
[21] *See Penfound v. Ruskin (In re Penfound*), 7 F.4th 527, 533 (6th Cir. 2021) (stating that its previous rejections of *Johnson* and *Prigge* "are binding on us").
[22] *Davis*, 960 F.3d at 355.
[23] *Penfound*, 7 F.4th at 534.

the Sixth Circuit explains, a six-month pre-petition period "is the *longest* look-back period" supported by the Code, and the contributions made during that period are all that can be considered.[24] The Sixth Circuit acknowledges that "[u]sually" its approach and "the CMI interpretation will produce identical results" but does not explicitly endorse the latter.[25] Indeed, the Sixth Circuit's approach is less mathematical than CMI's and refers to the six-month lookback period only for guidance, not an average.[26] Some bankruptcy courts within the Seventh and Eighth Circuits have agreed in principle with the Sixth Circuit approach.[27]

Conclusion

The extent to which 401(k) contributions can continue during a chapter 13 case depends on where a debtor files her case. Until the issue is clarified in the statute or addressed by the U.S. Supreme Court, there will likely be no interpretative uniformity. Therefore, the current answer to the question of whether the Code allows a debtor to make 401(k) contributions during her chapter 13 case is "maybe. What's your zip code?"

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[24] *Id.* at 533–34.
[25] *Id.*
[26] *Compare Davis v. Hebling (In re Davis*), 960 F.3d 346 (6th Cir. 2020), *and In re Anh-Thu Thi Vu*, Case No. 15-41405-BDL, 2015 WL 6684227 (Bankr. W.D. Wash. June 16, 2015).
[27] *See In re Read*, 515 B.R. 586, 590 (Bankr. E.D. Wis. 2014) (concluding that "[s]ince the Debtor was not making a voluntary contribution to her retirement plan at the time she filed her case, her post-petition contributions [were] not excluded from the disposable income calculation"); *In re Melander*, 506 B.R. 855, 868 (Bankr. D. Minn. 2014) (allowing a debtor's monthly voluntary retirement contribution post-petition because she "ha[d] been making [them] for the last 14 years" leading up to the petition date); *In re Noll*, No. 10-35209-svk, 2010 WL 5336916, at *2 (Bankr. E.D. Wis. Dec. 21, 2010) (stating that if the debtors "had been making voluntary contributions pre-petition, they would [have been] allowed to continue those contributions").

Divisional Mergers

"*There's a justice system for rich people and powerful corporations – and there's the system for everyone else. ... There's something called the 'Texas Two-Step'. It used to be a dance. But in recent years, it has taken on a new meaning ... It is a form of legal strategy that corporations are using to shield their assets from accountability. It allows wealthy corporations whose products caused harm to avoid paying damages to the victims. Not just that, the 'Texas Two-Step' denies the victims their right to make their case in court. And, it can stretch the process of seeking justice out for years while the victims get sicker and die. Does that sound like justice?... Congress must act to close this loophole for good. I hope Democrats and Republicans can work together on a bipartisan basis to stop this bankruptcy abuse. Bankruptcy is supposed to be a good faith way to accept responsibility, pay one's debts, and receive a second chance – not a 'Texas Two-Step', get-out-of-jail-free card for some of the wealthiest corporations on Earth.***"**

Sen. Richard Durbin
Feb. 15, 2022, Senate Floor

"*Had we known in 1989 that provisions could be dubiously interpreted for entities to avoid known liabilities such as those causing severe and permanent injuries and deaths, it would never have passed with the "Texas two-step"*

Steven Wolens, former Texas lawmaker
Feb. 14, 2022, Financial Times

"*Notwithstanding the barrage of academic and media criticism leveled at the use of the divisional merger provisions under the Texas Business Organizations Code, the Court concludes that there have been no improprieties or failures to comply with the Texas statute's requirements for implementation, and that the interests of present and future talc litigation creditors have not been prejudiced.... [T]he Court finds nothing inherently unlawful or improper with application of the Texas divisional merger scheme in a manner which would facilitate a chapter 11 filing for one of the resulting new entities.*"

***In re LTL Management, LLC*,**
637 B.R. 396, 422, 427 (Bankr. D.N.J. 2022)

I. What is a Divisional or Divisive Merger?

A. The Texas Business Organizations Code defines a merger to include not just two companies merging into one, but one company separating into two or more entities. Tex. Bus. Orgs. Code §1.002(55).

1. A divisional merger proceeds like any other merger, with the filing of a plan of merger, which allocates the property and liabilities among one or more of the surviving corporations. *Id*. at §10.003.

2. Once the divisional merger is completed, the entity that is divided "ceases." *Id*. at §10.008(1).

3. A divisional merger operates "without ... any transfer or assignment having occurred." *Id*. at §10.008(2)(C).

4. The allocation of liabilities in a merger cannot "abridge any right or rights of creditors under existing law." *Id*. at §10.901.

B. Other State Laws:

1. Arizona Entity Restructuring Act §29-2601

2. Delaware Limited Liability Company Act §18-217

3. Kansas Revised Limited Liability Company Act §17-7685

4. Pennsylvania Entity Transactions Law §361

C. DBMP LLC Divisional Merger

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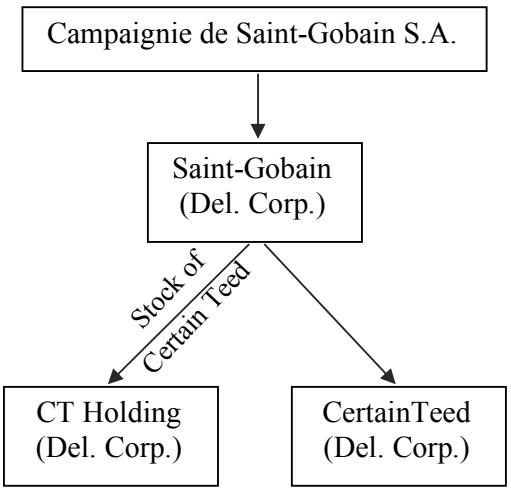
(10/22/19)



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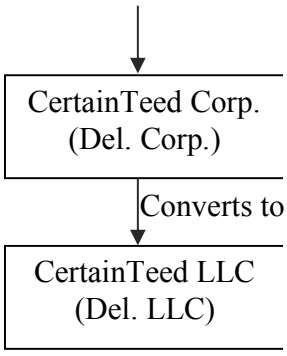
(10/23/19)



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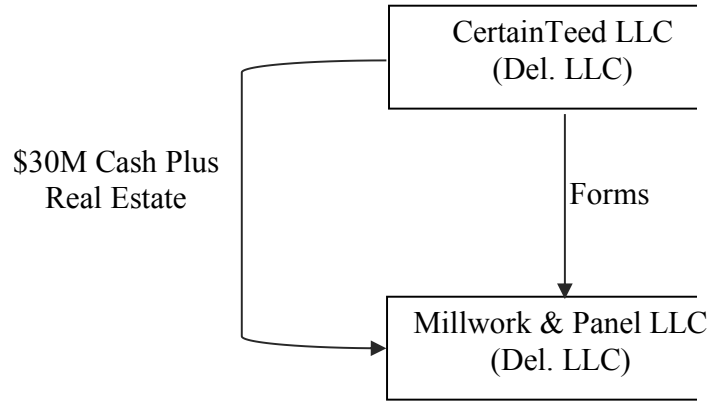

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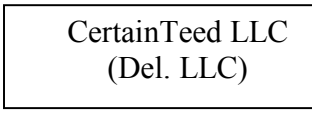

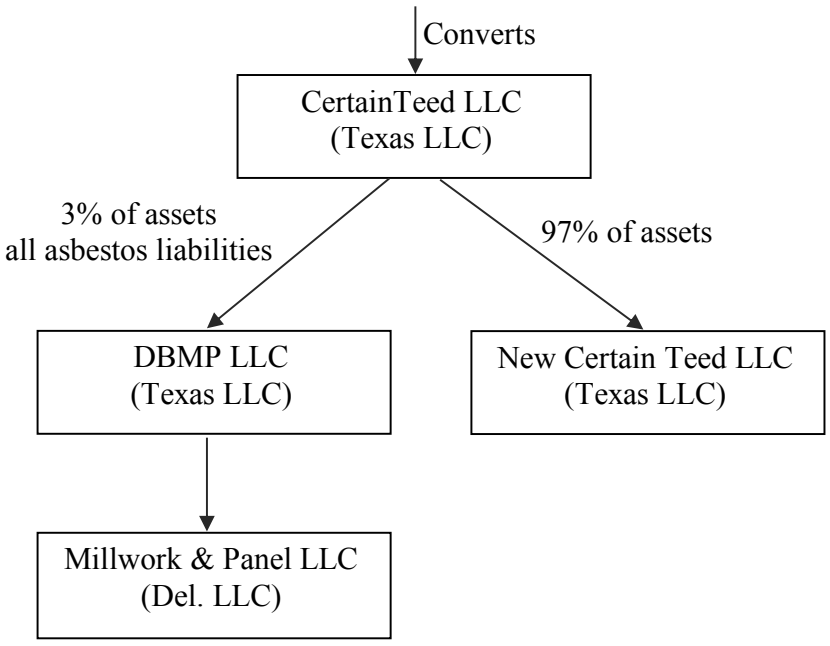

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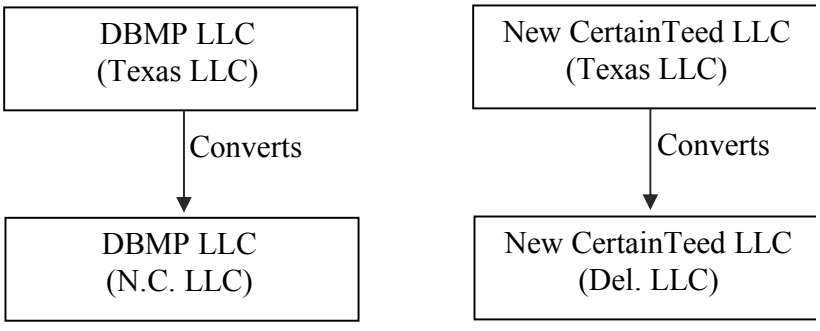
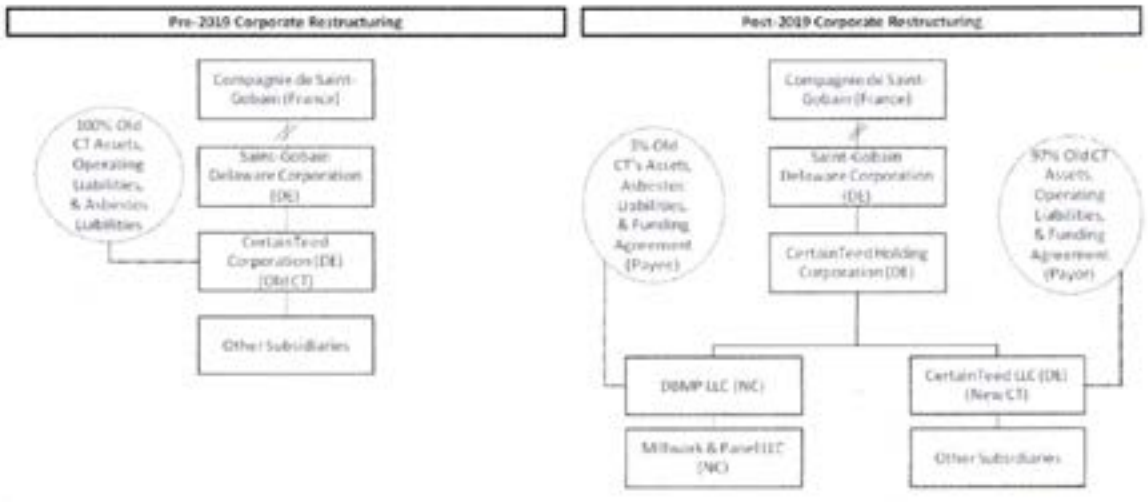
(10/23/19)





STEP #6

As part of the restructuring, the newly formed entities executed a number of intercompany agreements, including:

(1) **Amended and Restated Funding Agreement between DBMP and New CertainTeed dated 10/23/19**.[28] New CertainTeed agreed to provide funding for "Permitted Funding Uses" which includes (i) the costs of administering the chapter 11 case for DBMP, (ii) amounts necessary to fund a §524(g) trust for DBMP, and (iii) DBMP's indemnification obligations to New CertainTeed under the Support Agreement. The obligation to fund is conditioned on DBMP's other assets being insufficient to fund the obligations. As originally drafted, the Funding Agreement placed no restrictions on New CertainTeed's ability to create other financial obligations or engage in other transactions that could lessen or eliminate New CertainTeed's ability to perform.[29]

(2) **Support Agreement between DBMP and New CertainTeed dated 10/23/19.** DBMP agrees to indemnify New CertainTeed from asbestos-related "Losses" and "Proceedings" to which New CertainTeed "may become subject." The Support

[28] On October 22, 2019, the original Funding Agreement was entered into between Old CertainTeed and CertainTeed Holding Co. The Agreement was amended and restated the next day following the divisional merger.

[29] Following the filing of the bankruptcy case, DBMP and New CertainTeed entered into a Second Amended Funding Agreement dated as of September 15, 2021 pursuant to which New CertainTeed is precluded from issuing dividends, forgiving intercompany debt, entering into any agreements that would prohibit funding under the Funding Agreement and eliminates the requirement that DBMP must indemnify New CertainTeed during the pendency of the chapter 11 case to obtain funding. Finally, the Second Amended Funding Agreement requires New CertainTeed to fund the §524(g) trust regardless of whether it supports the proposed plan.

Agreement also provides that the two entities are disregarded for federal income tax purposes with New CertainTeed retaining the Employer Identification Number of Old CertainTeed. DBMP is only required to obtain a new EIN when and if required by law.

(3) **Secondment Agreement between DBMP and Saint-Gobain Corporation dated 10/23/19**. Saint-Gobain Corporation seconds five employees to DBMP.

(4) **Millwork & Panel Agreements with New CertainTeed dated 10/23/19**. These agreements make New CertainTeed the only customer of Millwork & Panel with product sold to New CertainTeed under fixed prices and all of the employees working at the Millwork & Panel plants are seconded from New CertainTeed. In addition, to the extent Millwork & Panel requires financing, it has a financing agreement with a Saint-Gobain entity.

II. Challenges to the DBMP LLC Divisional Merger

A. Fraudulent Transfer Complaint (Adv. 22-0300) (Bankr. W.D.N.C.)

1. **Defendants**: CertainTeed LLC, CertainTeed Holding Corp., and Saint-Gobain Corp.

2. **Allegations**: The complaint seeks to avoid the "Corporate Restructuring" that separated Old CertainTeed's assets from its asbestos liabilities. The complaint alleges that DBMP and the Defendants are alter egos with no corporate separateness. It asserts claims for actual and constructive fraudulent transfer under §548 and the Texas UFTA or the North Carolina or Pennsylvania UVTA. It alleges that the corporate transactions and filing of bankruptcy were intended to "hinder or delay" asbestos creditors and alleges the following badges of fraud: (1) the transfers occurred at the time that Old CertainTeed was subject to substantial liabilities; (2) the corporate restructuring was intentionally concealed both within and outside Defendants' organizations; (3) the corporate restructuring was secretly planned for purposes of avoiding obligations to existing and future creditors; (4) the corporate restructuring benefitted insiders; (5) DBMP was left insolvent, and "utterly beholden" to funding from New CertainTeed; and (6) substantially all of Old CertainTeed's assets were transferred to New CertainTeed.

3. **Defendants' Response**: Motion to Dismiss filed 5/6/22 (Dkt. 38). The motion to dismiss alleges the following grounds for dismissal:

    a. The complaint fails to state a fraudulent transfer claim that belongs to the DBMP estate because it does not allege that DBMP transferred any property or incurred any obligations that are subject to avoidance.

b. The complaint fails to allege any facts about DBMP's "fraudulent" intent because all of the allegations regarding intent involve actions by Old CertainTeed, before DBMP existed, and Old CertainTeed is not the debtor.

c. The Funding Agreement negates any claim that reasonably equivalent value was not exchanged or that there was an intent to avoid payment of asbestos claims.

d. The Funding Agreement coupled with DBMP's ownership of Millwork & Panel makes DBMP solvent.

e. Plaintiff's alter ego allegations fail because (i) they are not connected to a claim that seeks to impose liability on DBMP, (ii) the complaint does not distinguish between the actions of each Defendant; and (iii) the allegations are not sufficient to state a claim.

4. **Issues**:

a. What are the transfers to be avoided by the debtor? If Old CertainTeed no longer exists, can fraudulent transfer/alter ego allegations revive it to merge it into the debtor and then avoid the transfers of assets? What is the impact of the Texas statute's provision that the merger takes effect "without ... any transfer or assignment having occurred?" Texas Bus. Org. Code §10.008(2)(C).

b. What is the impact of the funding agreements? Do they insulate these transactions from attack? Does the post-petition amendments to the funding agreement to close gaps in the agreement matter to the outcome of the complaint?

c. Can you have an intent to hinder or delay creditors if your intent is to file bankruptcy? Should the intent of the Defendants be imputed to DBMP given their control over DBMP?

B. Other Challenges:

1. Substantive Consolidation Complaint (Adv. 21-3023)

a. **Defendants**: DBMP and New CertainTeed.

b. **Allegations**: The complaint alleges that DBMP and New CertainTeed should be substantively consolidated, and that the divisional merger should be void as it was unconscionable. The

complaint alleges that the divisional merger resulted in a structural subordination of the asbestos creditors who have been delayed in payment while other creditors of Old CertainTeed/New CertainTeed are paid in the ordinary course. The complaint alleges that DBMP and New CertainTeed were previously one entity, shared officers and directors, engaged in a series of unfavorable agreements, and that the Funding Agreement had significant problems that made it unlikely New CertainTeed would fund DBMP's liabilities in full. (Note: After this complaint was filed, the Funding Agreement was amended.)

c. **Response**: Defendants moved to dismiss, and the Court granted the motion as to the unconscionability count holding that this is an affirmative defense to enforcement of an agreement and not an independent claim. The motions to dismiss argue that: (i) substantive consolidation of a debtor and non-debtor is not authorized as it amounts to an involuntary bankruptcy filing without satisfying the requirements of 11 U.S.C. §303, (ii) the facts do not support substantive consolidation because creditors do not deal with DBMP and New CertainTeed as one entity and their corporate affairs are not so entangled that they cannot be separated, and (iii) the funding agreement protects creditors.

d. **Issues**: Does traditional substantive consolidation theories fit the facts of a divisional merger?

2. Breach of Fiduciary Duty Complaint (Adv. 22-3001)

a. **Defendants**: Campaignie De Saint-Gobain S.A., Saint-Gobain Corporation, CertainTeed Holding Corporation, CertainTeed LLC, and individual directors and officers of each.

b. **Allegations**:

1. DBMP's individual defendants owed fiduciary duties to DBMP's creditors due to DBMP's insolvency, and they were required to consider the interests of DBMP's asbestos creditors and not act in a manner to benefit Saint-Gobain entities. They failed in the exercise of these duties by (i) entering into the intercompany agreements without engaging in arm's length negotiations, (ii) requiring DBMP to indemnify New CertainTeed through the Support Agreement, and (iii) failing to exercise independent judgment when deciding to file for chapter 11 including by considering alternatives and approving the bankruptcy to gain leverage over the asbestos creditors.

2. The other defendants aided and abetted the individual defendants in the breach of their fiduciary duties.

3. All defendants engaged in a civil conspiracy to commit unlawful acts, including (i) fraudulently separating Old CertainTeed's assets from its asbestos liabilities, (ii) entering into the intercompany agreements; (iii) breaching fiduciary duties, and (iv) "otherwise defrauding" DBMP and its creditors.

c. **Issues**: No responses have been filed yet to the complaint. Is it a breach of fiduciary duty to file chapter 11 and/or to take actions designed to minimize a corporate entity's liability?

Faculty

Hon. Janet S. Baer is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed on March 5, 2012. She also acts on a regular basis as the presiding judge in the Northern District of Illinois for naturalization ceremonies. Previously, Judge Baer was a restructuring lawyer for more than 25 years and was involved in some of the most significant chapter 11 bankruptcy cases in the country. The majority of her practice focused on the representation of large, publicly held debtors in both restructuring and chapter 11 matters, and she also represented companies in commercial litigation matters, including lender liability, fraud, breach of contract and breach of fiduciary duty. Prior to forming her own firm in 2009, Judge Baer was a partner at Kirkland & Ellis LLP, Winston & Strawn and Schwartz, Cooper, Greenberger & Krauss. She is a member of the ABI Board of Directors, the CARE National and Chicago Advisory Boards, and the Chicago IWIRC Network Board, as well as several committees. She also is chair of the NCBJ 2023 Education Committee and a frequent speaker for ABI, the ABA, the Chicago Bar Association, IWIRC and NCBJ, and she regularly acts as the presiding judge for the Northern District of Illinois in naturalization ceremonies. Judge Baer earned her B.A. from the University of Wisconsin - Madison and her J.D. from DePaul College of Law.

Thomas R. Fawkes is a partner at Tucker Ellis in Chicago, where he practices in the areas of bankruptcy, creditors' rights and financial restructuring. He represents official committees, unsecured and secured creditors, debtors, financial institutions, post-confirmation trustees and asset-purchasers in chapter 11 and 7 bankruptcy cases, out-of-court restructurings and liquidation proceedings throughout the U.S. Mr. Fawkes has represented clients in matters including plan confirmations, preference, fraudulent transfer and other bankruptcy litigation, cash collateral and debtor-in-possession financing, § 363 sale transactions, real estate and equipment leasing disputes, and claims reconciliation. He also assists clients in structuring their commercial transactions to mitigate the risk of future bankruptcy and insolvency issues. Mr. Fawkes has been recognized nationally for his professional accomplishments, particularly his representation of creditors' committees in chapter 11 cases, as well as creditors and other parties in notable bankruptcies. He is recognized by *Chambers USA* as one of the leading bankruptcy and restructuring attorneys in Illinois and was named an "Outstanding Young Restructuring Lawyer" by *Turnarounds & Workouts* in 2013. Mr. Fawkes received his B.A. *summa cum laude* in 1999 from Loyola University Chicago and his J.D. *cum laude* in 2022 from Northwestern University School of Law, where he was admitted to the Order of the Coif.

Brian L. Shaw is a member of Cozen O'Connor in Chicago, where he focuses his practice on financial restructuring, bankruptcy, and other in- and out-of-court distressed solutions, along with attendant litigation, representing debtors, creditors and other parties-in-interest in proceedings throughout the country. Over the past three decades, he has guided chapter 11 debtors, chapter 7 and 11 trustees, creditors' and noteholders' committees, assignees, landlords, liquidating trustees, labor organizations, preference and fraudulent conveyance defendants, receivers, and secured and unsecured creditors through all aspects of bankruptcy, insolvency and restructuring. A Fellow of the American College of Bankruptcy, Mr. Shaw has served as ABI's president, chairman and vice president of membership, and previously chaired the Chicago Bar Association's Bankruptcy and Reorganization Section. He has received accolades from *Chambers USA*, *Super Lawyers* (Top 100

in Illinois for 2020), *The Best Lawyers in America*, *Lawdragon* (Top 500 Bankruptcy Lawyers) and *Marquis Who's Who in America*, and he is AV-rated by Martindale-Hubbell. Mr. Shaw chaired ABI's inaugural Professional Development Program and regularly serves on the faculty of ABI's Litigation Skills Symposium. He is admitted to practice in the State of Illinois, as well as the U.S. District Courts for the Northern District of Illinois, Central District of Illinois, Eastern District of Wisconsin, Western District of Michigan and Northern District of Indiana, the U.S. Courts of Appeals for the Third, Seventh and Eighth Circuits, and the U.S. Supreme Court. He is also admitted to the Federal Trial Bar for the Northern District of Illinois. Mr. Shaw received his B.A. from Tufts University and his J.D. *magna cum laude* from the University of Illinois College of Law.

Catherine L. Steege is a partner with Jenner & Block LLP in Chicago and co-chairs the firm's Bankruptcy and Restructuring practice group. She is a Fellow of the American College of Bankruptcy and a member of the National Bankruptcy Conference, and she has been a member of the panel of trustees for the Northern District of Illinois since 1987. In addition to a traditional bankruptcy practice, Ms. Steege has represented numerous parties in complex bankruptcy litigation matters, including her representation of defendants in the *Tribune* fraudulent-conveyance litigation and the *Sentinel Management Group* litigation trustee, the *Magnatrax* litigation trust, the *NKK* litigation trust and the trustees of Emerald Casino Inc. and Consolidated Industries Corp. She has an active appellate practice and argued in the U.S. Supreme Court on behalf of Wellness International Network in *Wellness International Network v. Sharif*. She also represented the petitioner in *Law v. Siegel* and the respondent in *City of Chicago v. Fulton*. In addition, she represented the examiner in the *Lehman Brothers* chapter 11 case and authored the sections of the Lehman Brothers Examiner's Report that considered potential avoidance actions against various financial institutions. Ms. Steege received her J.D. in 1982 from DePaul University.