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Unlike Death and Taxes: A Review of Important Recent Cases and Trends

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A Rose Is a Rose Is a Rose:
Is the Same True for Transfers?

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Wikipedia tells us that Gertrude Stein wrote the sentence "Rose is a rose is a rose is a rose" as part of the 1913 poem "Sacred Emily". "A rose is a rose is a rose" is among her most famous quotations, and is often interpreted as meaning "things are what they are". But can the same be said for transfers of the debtor's property to a bank? When a debtor deposits cash in its bank account, for example, is that deposit an avoidable transfer? In 2017, three different Courts of Appeals opined on this question and failed to give a consistent answer. In two of these decisions, the Courts said that all of the elements of the transfer were present, but there was not really a transfer. The third case by contrast held that there was a transfer. This paper shall review the history and rationale of these cases to try to see if deposits to the debtor's bank accounts are a rose or a thorn.

Several trustees have attempted to avoid all transfers made to a bank by the debtor as fraudulent transfers. To prevail in a fraudulent transfer action, the trustee must show that: first, there was a transfer to the bank; second, the transfer was made with the actual intent to delay, hinder or defraud creditors or was constructively fraudulent; and finally, that the bank was actual transferee or benefited from the transfer. Therefore, the threshold question, as in any avoidance action, is was there a transfer?

The Bankruptcy Act of 1898 in Section 1(30) as amended defined "transfer" as follows:

> "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor[.]

Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *as amended by* Chandler Act, ch. 575, 52 Stat. 840, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

The U.S. Supreme Court looked at this issue in *N.Y. Cty. Nat'l Bank v. Massey*, 192 U.S. 138 (1904). This case involved a deposit by an insolvent debtor into his unrestricted demand account. The bank subsequently set off the cash in the account against an otherwise unsecured loan. The trustee sought to avoid the deposit as a preference. The Bankruptcy Referee and the District Court held that this was a permissible set off under Section 68 of the Act of 1898, but the Court of Appeals for the Second Circuit held that the debtor's deposits were voidable preferences.

The Supreme Court reversed the Court of Appeals and held that:

> A deposit of money to one's credit in a bank does not operate to diminishes the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw a check against it. It is not a transfer of property as a payment, pledge, mortgage, gift or security.

Massey, 192 U.S. at 147.

That seemed to be the state of the law until the passage of the Code of 1978. The Code's definition of "transfer" in 11 U.S.C. § 101(54) provides:

> The term "transfer" means—
> (A) The creation of a lien;
> (B) The retention of title as a security interest;
> (C) The foreclosure of a debtor's equity of redemption; or
> (D) Each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with —
> (i) property; or
> (ii) an interest in property

11 U.S.C. § 101(54).

The House Report explains the Code's definition thus:

> Transfer. It is derived and adapted with stylistic changes from Section 1(30) of the Bankruptcy Act. A transfer is a disposition of an interest in property. The definition of transfer is as broad as possible many of the potentially limiting words in current law are deleted, and the language is simplified. . . . Any transfer of an interest in property is a transfer, including a transfer of possession, custody or control even if there is no transfer of title, because possession, custody, and control are interest in property**. A deposit in a bank account or similar account is a transfer.**

H.R. Rep 95-595, at 314 (1977) (emphasis added).

The Senate Report is almost identical and also emphasizes that a deposit into a checking account is a transfer. *See* S. Rep. 95-989, at 27 (1978).

Despite Congress' apparently clear intent, the Courts have been troubled by this concept. An early seminal case was *Bonded Fin. Servs., Inc. v. Eur. Am. Bank*, 838 F.2d 890 (7th Cir. 1988). *Bonded Financial* involved efforts by the owner of a currency exchange, Michael Ryan, to retire the debts he owed to a bank related to his race horses. Ryan was convicted of fraud and was sent to a gated community operated by the U.S. Department of Justice. On the eve of bankruptcy Ryan directed one of his currency exchanges, Bonded, to transfer

$200,000 to his personal bank account. Subsequently, Ryan wrote a check on that account to retire his personal debt to the bank. The trustee claimed that this was a fraudulent transfer, that the bank was the initial transferee, and that the transfer was made for the bank's ultimate benefit. The note accompanying the check said "deposit this check". It did not say "and pay down my race loan". Had the latter been true, the Court would have had little trouble finding for the trustee.

As a general policy matter, the Court was troubled by the havoc trustees could create by suing banks to recover the debtor's deposits. The Court noted that even in the 1990's hundreds of millions of dollars of deposits were flowing through the country's banking system and to make deposits voidable could cripple the system. To remedy the Court's fears, the Court held that the bank was mere financial intermediary. It received no benefit. Ryan's loan was fully secured and not in arrears, so the bank did not even acquire a valuable right to offset its loan against the funds in Ryan's account. The Court noted that the Bankruptcy code does not define "transferee" and that there is no legislative history on point. However, the Court did not address the Senate or the House reports noted above. If a bank deposit is a transfer, who on earth could be the transferee other than the bank? The Court did find that the bank incredibly had no dominion over the money. However, if this money was not placed in a safety deposit box or in a fiduciary account, the bank could have used the money for any purpose, including a Christmas party for the bank's president. If that is not dominion, what is?

The Court of Appeals for the 10th circuit indicated that it would follow *Bonded* in *Malloy v. Citizens Bank (In re Fist Sec. Mortgage Co.)* 33 F.3d 42 (10th Cir. 1994). The important factual variance was that the account in question was an attorney's trust account. The Court simply applies the *Bonded* dominion and control test and asks whether the bank had the right to put the money to one's own purposes.

This issue remained quiet at the Court of Appeals level until 2017, when three different Courts of Appeal each took a stab at the question. The first decision was *Ivey v. First Citizens Bank & Tr. Co. (In re Whitley)*, 848 F.3d 205 (4th Cir. 2017). This case involved the nefarious affairs of a Ponzi operator, James Edward Whitley. In 2009, like most Ponzi schemes, Whitley's empire collapsed and he was subject to an involuntary petition in bankruptcy. Following Ryan's proud tradition, Whitney was convicted of fraud and also sent to a gated community. In the meantime, the trustee, Charles Ivey, sued the bank to avoid all of the deposits, approximately $1.6 million, Whitley had made into the bank, on the ground that Whitney had made these deposits with the actual intent to delay, hinder and defraud his creditors. The Bankruptcy Court for the Middle District of North Carolina granted summary judgment in favor of the bank. The District Court affirmed on the grounds that the transfer could not be avoided because it did not deplete the estate or remove property from the estate and the funds remained readily available to the debtor's creditors.

The Court of Appeals affirmed, but not for the reasons raised by the parties. The Court, instead, ruled that there was no transfer. Following the Supreme Court in *Massey*, the Court of Appeals for the Fourth Circuit adopted a rule providing that if the debtor could have recovered the deposit upon demand, there was no transfer at all. While the Court conceded that 11 U.S.C. § 101(54) was broader than its Act counterpart, the Court, without looking to the legislative history cited above, held that its own precedents mandated a finding that there was no transfer. The trustee asked the U.S. Supreme Court to grant *certiorari*, but the Supreme Court denied the petition on October 10, 2017. 2017 U.S. Lexis 6235.

Next up, was the decision by the Court of Appeals in *Meoli v. Huntington Nat' l Bank*, 848 F.3d 716 (6th Cir. 2017). Like *Ivey*, this case dealt with a failed Ponzi scheme, by a Baron Watson, but one which involved a lot more money than *Ivey*. Unlike the first two Ponzi operators, Mr. Watson found a more permanent way of procuring a discharge from the debts of a lifetime by committing suicide.

The trustee sued the Huntington National Bank for the return of $72 million in deposits which the trustee claimed were made by Barton and his corporations to the Bank. Besides the transfer issue, the case has a fascinatingly detailed review of the issue of when a bank should have become aware of the scheme and the proper standard for the bank's awareness: actual knowledge, constructive knowledge, willful blindness, or under the totality of the circumstances. The case is well worth the practitioner reading for its treatment that issue alone.

As in *Ivey*, the Court of Appeals in *Meoli* also concluded that there was not any transfer, but again without discussing the legislative history cited above. The Court held that the bank did not have dominion or control over the funds. The Court repeated the test in *Bonded Financial* that the depository bank must have dominion over the money or other assets that is, the right to use the money for its own purposes. The Court distinguished mere possession to ownership. Under this reasoning, the bank cannot be considered an initial transferee if it is merely an agent who has no legal authority to stop the principal, the debtor, from doing what he or she likes with the funds at issue. In support, the Court approved the holding of the Court of Appeals for the Eleventh Circuit in *Menotte v. United States (In re Custom Contracts, LLC)*, 745 F.3d 1342 (11th Cir. 2014), which held that there was no transfer even though [d]epository banks turn profits by employing customers' deposits to earn money at a higher rate than it pays interest to the comers. In other words, depository banks have 'legal rights to put deposited funds to use.'" *Meoli*, 848 F.3d at 726 (quoting *Menotte*, 745 F.3d at 1350). Thus, the Court allowed the trustee to avoid transfer to the bank only to the extent that the bank used the deposits to retire its loan. The excess deposits were not avoidable. Don't reach hastily conclusions.

The final case in 2017 is *Schoenmann v. Bank of the West (In re Tenderloin Health)*, 849 F.3d 1231 (9th Cir. 2017). While this case has very complicated facts, its main issue is whether the hypothetical "greater than" test in preference law should include a hypothetical preference recovery as part of the analysis under § 547(b)(5). In this case, the debtor had deposited $526,402.05 in the bank and the trustee sought to recover $190,595.50 paid to the bank within 90 days of the debtor's petition date. The trustee lost in the Bankruptcy Court and the District Court.

The Court of Appeals reversed, holding that when considering whether the trustee can satisfy the "greater than" test in a preference action, the court may assume that the trustee could have brought a hypothetical avoidance action in the hypothetical chapter 7 case. After the bank in *Schoenmann* lost on the double hypothetical issue, the Bank then followed the crowd and argued that there was no transfer at all. *Schoenmann* was the only case reviewed that cited the legislative history and concluded that new definition of "transfer" in the Code superseded the holding in *Massey*. The Court of Appeals for the Ninth Circuit has even held years earlier that withdrawing money from a bank account and placing the money in the debtor's safe is a transfer. *See Bernard v. Sheaffer (In re Bernard)*, 96 F.3d 1279, 1282 (9th Circuit 1996). Thus, in the Ninth Circuit, at least, a bank deposit is a transfer.

If the dominion and control test is correct then there is many transactions where a transfer does not occur. For example, what if the debtor lent the bank money and evidenced the loan with a demand note. Was there a transfer? What if the debtor gave a piece of machinery to a third party with the understanding that the debtor could have the machinery back on demand? The dominion and control test is a slippery slope.

Whether a naked deposit into a demand account is voidable or not should not rest on an unrealistic results orientated definition of transfer. Rather, it is my opinion that the District Court in *Ivey* got it right. *See Ivey v. First Citizens Bank & Tr. Co.*, 539 B.R. 77 (M.D.N.C. 2015). If there is no injury and the funds were not removed from reach of creditors, the deposit should not be voidable. In any event, even if the deposit were a voidable transfer under these facts, 11 U.S.C. § 548(c) gives the bank a complete defense if the bank gave value, in good faith and without knowledge of the fraud. Is the good faith transferee for value defense not a sufficient ground to prevent trustees from reaping windfalls and disrupting the banking system? Relying on that defense to protect banks, instead of the *Bonded* fiction, would have the added bonus of allowing the courts to view deposits for what they are: transfers. The bottom line is a transfer is a transfer is a transfer and by any other name a transfer.

Ultimately, this issue may go to go to the Supreme Court based upon the circuit split that now exists. Stay tuned.

Debt Collectors and the Bankruptcy Code

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During the 2017 Supreme Court term, the United States Supreme Court issued a decision in *Midland Funding, LLC v. Johnson*, 137 S.Ct. 1407 (2017), wherein the Court found that a claim that was clearly barred by the applicable state law statute of limitations did not violate the Fair Debt Collection Practices Act, 15 U.S.C. §§ 169(2)(e), 169(2)(1) ("FDCPA"), because the debt fell within the Bankruptcy Code's definition of a claim and a right to payment. *Id.* at 1412. The unenforceability of the claim was not based on a false, deceptive, or misleading representation, and filing the claim was not an unfair and unconscionable means to collect or attempt to collect the debt. *Id.* at 1415.

The Court also issued a decision in *Henson v. Santander Consumer USA, Inc.*, 137 S. Ct. 1718 (2017), wherein Justice Gorsuch delivering a unanimous opinion of the Court addressing "who" exactly qualifies as a debt collector under the FDCPA. The question involved the emerging industry of "debt buyers." "Debt buyers" are large entities who purchase debts and collect on those debts, rather than simply providing collection services to the originating lenders. The dispute turns on an oddity of FDCPA which regulates debt collectors, not originators of debt. Congress decided that Federal supervision was appropriate not for originators, but only for third-party collectors who are arguably less likely to have an ongoing relationship with the debtor. This case involves neither of those groups, but rather an entity that (at least for the customers involved here) buys debts originated by others and then collects on that debt for its own benefit.

General Case Facts of Midand Funding, LLC

Midland Funding, LLC ("Midland") had filed a proof of claim in Aleida Johnson's Chapter 13 case (the "Johnson") seeking to avoid credit card debt, however, the claim reflected that the last charge on underlying card was over ten years old. *Midland*, 137 S.Ct. at 1408. Under Alabama law, there was a six (6) years statute of limitations to collect on such claim. *Id.* at 1409. Johnson objected to claim and the Bankruptcy Court for the District of Alabama disallowed the claim. *Id.* (Midland did not respond to the claims objection.)

Johnson then sued Midland in the United States District Court of Alabama claiming that the filing of the proof of claim in the Bankruptcy Case was time barred and was "false," "deceptive," "misleading," "unconscionable," and "unfair" within the meaning of the FDCPA. *Id.* The District Court found that the FDCPA did not apply and dismissed the suit. *Id.* The Eleventh Circuit reversed. *Id.* A petition for certiorari was then filed and granted.

The Supreme Court, in a decision issued by Justice Breyer, held that a claim, which on its face indicates that the limitation period has run does not fall within the scope of any of the five relevant words of the FDCPA. *Id.* at 1412.

The Analysis

The Supreme Court first looked to the Bankruptcy Code's definition of a "claim" which states that a claim is a "right to payment." Section 101 U.S.C. § 101(5)(A). The Court found that state law would then determine whether a person has such a right. *Id*. at 1411; *see also Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Electric, Co.*, 549 U.S. 443, 450-451 (2007). Under Alabama law, a creditor has a right to payment even after the statute of limitations expires. *See Ex Parte Health South Corp.*, 974 So. 2d. 288, 296 (Ala. 2007). Therefore, Midland did indeed have a claim because the statute of limitations is merely a defense to a claim.

However, Johnson argued that the word "claim" meant "enforceable claim". *Midland*, 137 S.Ct. at 1412. The Court found that a review of the plain language of the relevant Bankruptcy Code provisions does not include the word "enforceable." *Id.* In fact, the Court recognized that the unenforceability of a claim is an affirmative defense. *Id.* While Johnson pointed to Section 502(b)(1) of the Bankruptcy Code which states that "if a claim is 'unenforceable' it will be disallowed," the Court determined that the language in this section does not mean in the converse -- that an unenforceable claim is not a claim. *Id.*

Johnson contended that by filing a claim which was stale, Midland had violated the debt collection prohibitions embodied in the FDCPA. *Id.* at 1413. Johnson noted that filing a claim was voluntary and that when Midland chose to do so, presumably hoping to be paid, it was the kind of abusive practice the FDCPA sought to prevent -- using "unfair or unconscionable means to collect or attempt to collect a debt." 15 U.S.C. § 169k(c). Under the FDCPA, the Court found that in order to determine that a statement is misleading, you must consider the "legal sophistication of the audience," which in a Chapter 13, involves a trustee. *Midland*, 137 S.Ct. at 1413 (*quoting Bates v. State Bar of Ariz.*, 433 U.S. 350, 383, n.37 (1977)). The Court found that purpose behind the FDCPA and related state laws is to prevent a creditor from compelling an ordinary debtor into paying an uncollectible claim. *Id.* at 1414. However, in a Chapter 13, with the oversight of the Chapter 13 Trustee, this is less likely to be a concern. The Chapter 13 Trustee can evaluate the validity of claims. *Id.* at 1409.

The Court next considered the argument as to whether Midland's claim was "unfair" or "unconscionable" which presented a closer decision. *Id.* at 1413. Johnson had relied on cases involving civil suits to collect a stale debt. *Id.* However, the Court contrasted those cases with the cases brought in the bankruptcy forum and chose to draw a distinction given the overlay of additional protections afforded in bankruptcy. *Id.* Here, it was unlikely that a debtor could inadvertently repay a stale debt given the involvement of the Chapter 13 trustee because it was unlikely that the Chapter 13 trustee would be misled. *Id.* at 1413-14.

The Court found as unpersuasive Johnson's argument that because a claim that is not otherwise objected to becomes an allowed claim, should serve as support for the argument that the filing of a claim violates the FDCPA. *See* Section 502(a) of the Bankruptcy Code and Rule 3001(f) of the Federal Rules of Bankruptcy Practice. The Court considered these to be merely procedural provisions pursuant to which a claim is allowed. *Id.* at 1412.

At minimum, Johnson sought to have Midland punished for its actions. Johnson, backed by an *amicus brief* from the United States, pointed out that creditors filing stale claims simply hope for a careless trustee. *Id.* at 1414. The Court was not persuaded. *Id.* The Court noted that objecting to claims was still the burden and providence of the trustee. *Id.* The Court was questioned how far such request would lead if determining when to punish -- only to cases where the claim clearly is stale on face? *Id.* What about right to use those claims affirmatively? *Id.* Moreover, given the eventual discharge of the debtor, whereby the claim would be purged from record, the Court did not see the harm.

The Court felt that applying the FDCPA here would upset the "delicate balance" between protecting the debtor and reorganizing obligations. *Id.* at 1415. The Court was concerned that this would lead to the misuse of the bankruptcy courts as a forum to provide remedies that otherwise do not exist. *Id.* For example, possible litigation over a creditor's state of mind at time of filing of a claim in a case could result. It would also require creditors to investigate the merits of affirmative defenses, such as the statute of limitations in the case here, which is typically the debtor's burden to assert and prove. *Id.*

The Court also noted that in promulgating Rule 9011 of the Federal Rules of Bankruptcy Procedure, the Advisory Committee specifically rejected "a proposal that would have required a creditor to certify that there is no valid statute of limitation defense" because that could lead to requiring creditors to make a pre-filing investigation. *Id.* at 1415. However, the Court recognized a split amongst bankruptcy courts in finding that failure to investigate in this instance warranted sanctions. *Id. at* 1407.

Justice Sotomayor, joined by Justice Ginsberg and Kagan dissented.

The dissent pointed out that some creditors have created a business by buying stale debt, filing claims in bankruptcy cases and hoping no one notices, thereby securing a distribution. *Id.* at 1416 (Sotomayor, J., dissenting). The dissent asserted that such business practices were both "unfair" and unconscionable". *Id.* (Sotomayor, J., dissenting).

The FDCPA's prohibitions have helped deter these practices since every state court that has considered the issue of a creditor knowingly filing a stale claim has found the creditor to have violated the FDCPA. *Id.*at 1417 (Sotomayor, J., dissenting); *see Phillips v. Asset Acceptance, LLC,* 736 F. 3d 1076, 1079 (7th Cir. 2013); *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987). The dissent asserts that filing a proof of claim for a time barred claim is no different -- the claim should not be enforced as a matter of public policy. *Midland*, 137 S.Ct. at 1419 (Sotomayor, J., dissenting). If the debtor (who may be unsophisticated) and the trustee (who could be overworked) are not paying attention, then the creditor may benefit. *Id.* at 1421(Sotomayor, J., dissenting). The dissent points out that the majority's belief in the trustees' gatekeeping ability is not supported by fact -- as those "in-the-know" insist that this is simply not the reality. *Id.* (Sotomayor, J., dissenting).

Further, the majority's belief that a debtor may be more sophisticated than the average consumer is also not accurate, nor is the argument that filing the claim actually helps the debtor, so that the debt will be discharged. *Id.* at 1420-21 (Sotomayor, J., dissenting). However, if a debtor does not owe the money, then nothing needs to be discharged. Whereas, by allowing the stale claim to be filed, if the debtor does not know to object, then the debtor ends up paying money to satisfy this claim.

This case should not necessarily be seen as unfriendly to bankruptcy debtors. As the minority endeavored to make clear, the majority's opinion in *Midland* is limited in reach, and further, there may be the potential for Congress to amend the FDCPA or the Bankruptcy Code to clarify the intended interaction of these two federal laws with respect to the practice of filing stale claims. *See id.* at 1421 (Sotomayor, J., dissenting). Moreover, while not an explicit focus of Justice Breyer's opinion, the majority opinion emphasized the need to adopt the broadest available definition of "claim" under the Code, even including facially unenforceable claims.

Some believe that with this decision, the debt collection and the debt buying industries are no longer frustrated by the Courts of Appeals' inconsistent application of these federal statutes. However, in *Midland*, the Court noted that the nation's 6,000 debt collection agencies earned over $13 billion in revenue last year. *Id.* at 1416 (majority opinion). Many debt collectors simply purchase debts from creditors outright, often at a significant discount because of the potential uncollectable nature of the accounts, and keep for themselves revenues on the accounts they collect. *Id.* The Court also noted that debt buyers hold hundreds of billions of dollars in consumer debt, and according to a 2009 Federal Trade Commission study, nine of the leading debt buyers purchased over $140 billion of debt in just a three-year period. Accounts that are stale enough to exceed the limitation period for collections purposes are sold at the steepest discount, since those claims may be unenforceable as a matter of law in a state collection suit. Nevertheless, in her dissenting opinion, Justice Sonia Sotomayor noted that debt buyers may "pursue stale debt" outside of bankruptcy to "entrap debtors into forfeiting their time defenses altogether" who fail to raise state of limitations defenses. *Id.* at 1419 (Sotomayor, J., dissenting).

It is important to note that the Court took no position, however, on whether a debt collector violates the FDCPA by filing a proof of claim in a bankruptcy case for a debt that is not "obviously" time-barred. Nor did the Court take a position on whether filing suit outside of bankruptcy to collect a debt a creditor knows is time-barred violates the FDCPA. The dissent pointed out that to date all of the lower courts that have faced this question have decided that such a lawsuit violates the FDCPA.

The Court was careful to confine its opinion to Chapter 13 bankruptcy proceedings like the one filed by Johnson. One unanswered question is whether the decision is applicable in Chapter 7 cases. While Chapter 7 and Chapter 13 are different in key respects, the claims filing and resolution processes in both chapters are similar, which may promote application of *Midland* to Chapter 7 cases. However, if Chapter 13 debtors do not successfully complete the plan payments then they may end up worse than if they had filed Chapter 7.

<u>General Case Facts of Santander</u>

Ricky Henson ("<u>Henson</u>") contended that CitiFinancial Auto loaned money to him to buy cars, sold the loans to Santander, and when there was a default on the loan, Santander sought to collect in a manner that violated the FDCPA. *Henson v. Santander Consumer USA, Inc.*, 137 S. Ct. 1718 (2017). The question is whether Santander is a debt collector under 15 U.S.C. § 1692a(6). *Id.* at 1720. The parties all agreed that "third party debt collection agents generally qualify as 'debt collectors' under the relevant statutory language, while those who seek only to collect for themselves loans they originated generally do not." *Id.* at 1721. The question then became how are parties who regularly purchase debt from other parties and then seek to collect upon such debt for their own account fall within the ambit of the statute -- "[d]oes the [FDCPA] treat the debt purchaser in that scenario more like the repo man or the loan originator." *Id.*

Ruling

Both the District Court and the Fourth Circuit held that Santander did not qualify as a debt collector because it did not "regularly" work in this industry and seek to collect debts owed by "another" party, rather it only pursued and collected on debts it had purchased. The Fourth Circuit did acknowledge that other courts had ruled differently. *Id.* at 1721; *compare Henson v. Santander Consumer USA, Inc.*, 817 F.3d 131, 133-134, 137-138 (4th Cir. 2016); *Davidson v. Capital One Bank (USA), N.A.*, 797 F.3d 1309, 1309, 1315-1316 (11th. Cir. 2015), *with McKinney v. Caldeway Properties, Inc.*, 548 F. 3d 496, 501 (7th. Cir. 2008); *FTC v. Check Investors, Inc.,* 502 F.3d 159, 173-174 (3rd Cir. 2007).

The Supreme Court found it could not disagree with the Fourth Circuit's decision below. The Court recognized that the FDCPA defines debt collectors to include those who regularly seek to collect debts "owed ….[to] another." *Henson,* 137 S. Ct. at 1721. Thus, the Court felt that this language focused on third party collection agents working for a debt owner, not a debt owner collecting its own debt. *Id.* The Court determined it to be irrelevant whether or not the debt owner was the original owner or had acquired the debt from another entity. *Id.* Essentially, the opinion turns to the core textual argument of the borrowers, who "observe that the word 'owed' is the *past* participle of the verb 'to owe.' *Id.* at 1722. And this, they suggest, means the statute's definition of debt collector captures anyone who regularly seeks to collect debts *previously* 'owed … another.'" *Id.*

Henson argued a grammatical analysis that the word "owed" was a past participle of the verb to "owe" and thus it meant that the statute's definition of debt collector captures anyone who regularly collects a debt previously owed by another. *Id.* Under this reading anyone who buys debt for any purpose at any time would qualify as a debt collector under the FDCPA. The Court found that the use of the past tense was similar to an adjective used to describe the present state of a thing…such as "burnt toast" or a "fallen branch." *Id.* After a bit of an interesting semantic discussion, the Court moved on to review the word "due" noting that this means currently due. *Id.* Thus, the Court rejected Henson's argument because adopting the past tense for one word ("owed") but not the other ("due") made no sense.

In a further attempt to include Santander in the definition of a debt collector, Henson argued that the FDCPA exempts from the definition of debt collector individuals who have obtained particular kinds of debts, such as those not yet in default or those connected to a secured commercial credit transaction and, as such, the word "owed" must mean owed to a previous owner. *Id.* at 1723. Again, the Court rejected this argument finding possessing a debt does not mean there is a prior owner, for example you can obtain use of a piece of property (a hotel room) without taking ownership. *Id.* Moreover, the Court found that just because some persons are excluded from the definition of debt collector (those who acquire debt pre-default) does not mean that the definition must include anyone who regularly acquires debts after default. *Id.* at 1724. Rather, the Court found that in order to qualify you must first attempt to collect a debt owed another -- here, the debt was owed by Santander. *Id.*

Finally, the Court turned pointedly to what it treated as a completely separate question of "policy," for which the Court believes the petitioner is "most eager to pitch battle." *Id.* Henson argued that the FDCPA "excluded loan originators from the Act's demands because it thought they already face sufficient economic and legal incentives to good behavior. But … Congress never had the chance to consider what should be done about those in the business of purchasing defaulted debt. … Had Congress known this new industry would blossom, th[e borrowers] say, it surely would have judged defaulted debt purchasers more like … independent debt collectors." *Id.* In this regard, the Court found that the arguments proffered by Henson were incredibly speculative, and did not hold up within the context of the statute. *Id.* at 1725. The Court chose not to opine and rewrite the statute, finding that "reasonable legislators might contend both ways on the question whether defaulted debt purchasers should be treated more like loan originators than independent debt collection agencies." *Id.* Thus, as this industry grows, so too may the caselaw.

The "Safe Harbor" from Avoidance of Transfers under Section 546(e)

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1. The Safe Harbor of Section 546(e). Section 546(e) is a potentially important provision of the Bankruptcy Code which exempts certain transactions from avoidance by a trustee as fraudulent or preferential transfers. The case law and commentary on the section refers to it as a "safe harbor" from avoidance.

2. To What Transfers Does Section 546(e) Apply? Section 546(e) makes certain transfers unavoidable by a trustee under sections 544, 545, 547, 548(a)(1)(B), and 548(b) if the transfer is a margin or settlement payment "made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency," or that is a transfer "made by or to (or for the benefit of) such a financial party in connection with a "securities contract" (defined broadly in section 741(7) of the Bankruptcy Code), commodity contract, or forward contract. 11 U.S.C. § 546(e). Originally, the section referred only to transactions "by or to" certain parties but a 2006 amendment added the phrase "(or for the benefit of)."

   (a) Cases involving disputes over the applicability of the section have typically arisen in the context of leveraged buyouts.

   (b) However, under the Tenth Circuit's 1991 *Kaiser Steel* decision, section 546(e) may have relatively broad applicability to mergers and sales involving the transfer of securities. *Kaiser Steel Corp. v. Pearl Brewing Co.* (*In re Kaiser Steel Corp.*), 952 F.2d 1230, 1236-38 (10th Cir. 1991). The Second Circuit decision in the *Tribune Company* case and the Seventh Circuit's reasoning in its *Merit Management* also suggest that section 546(e) applies in many in stock transactions (not just leveraged buyouts) if there is a settlement payment or a securities contract and there is a financial intermediary, though the two cases differ on the issue of whether the statute applies if the financial intermediary is acting only as a conduit. *Kirschner v. Large Private Beneficial Owners* (*In re Tribune Co. Fraudulent Conveyance Litigation*), 818 F.3d 98, 112 (2d Cir. 2016), *cert. pending*; *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690, ___ (7th Cir. 2016), *cert granted. sub nom Merit Management Group, LP v. FTI Consulting, Inc.* 137 S.Ct. 2092 (2017). As a result, the circuit split over the "mere conduit" issue that will be resolved by the United States Supreme Court this session could have substantial relevance to many transfers that a trustee or debtor in possession might seek to avoid and that transferees would want to protect against.

3. Purpose of the Safe Harbor. Courts addressing the issue agree that Congress enacted section 546(e) in 1982 to protect financial markets from risks. *See, e.g., Tribune Co. Fraudulent Conveyance Litigation*, 818 F.3d at 119; *Merit Management Group, LP*, 830 F.3d at 692-93. As discussed below, courts have offered alternative descriptions of what risk section 546(e) is protecting against. A majority of the circuits addressing the issue have taken the view that the involvement of a financial intermediary in a covered transaction, whether or not it is a "mere conduit," is key to forwarding the legislative intent in the enactment of section 546(e). The Seventh Circuit, joining the Eleventh Circuit in minority view of the statute, explained why parties should not be shielded from avoidance actions in these transactions when the financial intermediary only acts as a mere conduit, took a decidedly different view.

4. Does Section 546(e)'s Safe Harbor from Avoidance Apply Only to Trustees? Under the express language of the statute, section 546(e) applies only to avoidance of transfers by trustees (although that, of course, includes debtors in possession). A Second Circuit decision

that includes more than the "mere conduit" issue addressed by the Seventh Circuit's *Merit Management* decision discussed below held that individual creditors are preempted from bringing fraudulent transfer actions under state law that a trustee could bring in a bankruptcy case. *Tribune Co. Fraudulent Conveyance Litigation*, 818 F.3d at 111-15. It is not yet clear whether the Supreme Court will grant *cert.* in the *Tribune Company* issue, nor is it clear that there is a circuit split on this issue.

5. The Split in the Circuits. Currently, there is a sharp split in the circuit courts of appeal on the mere conduit issue.

(a) Circuits Holding that Section 546(e) Applies even if the Financial Intermediary only Acts as a "Mere Conduit." Four circuits, the Second, Third, Sixth, and Eighth Circuits hold that, even though a financial intermediary acted only as a "mere conduit" in the type of transaction identified by section 546(e), the transfer may not be avoided under section 546(e). *Tribune Co. Fraudulent Conveyance Litigation*, 818 F.3d at 112; *Official Committee of Unsecured Creditors v. American United Life Insurance Co.* (*In re Quebecor World (USA) Inc.*), 719 F.3d 94, 98-100 (2d Cir. 2013); *Enron Creditors Recovery Corp. v. ALFA, S.A.B. DE CV, ING* VP *Balanced Portfolio, Inc.*, 651 F.3d 329, 338-39 (2d Cir. 2010); *Brandt v. B.A Capital Co., LP* (*In re Plassein Int'l Corp.*), 590 F.3d 252, 257-58 (3d Cir. 2009); *Resorts Int'l. Fin. Inc. v. Resorts Int'l., Inc.* (*In re Resorts Int'l., Inc.*), 171 F.3d 505, 516 (3d Cir. 1999); *QSI Holdings, Inc. v. Alford* (*In re QSI Holdings, Inc.*), 571 F.3d 545, 549-50 (6th Cir. 2009); *Contemporary Ind. Corp. v. Frost*, 564 F.3d 981, 986-87 (8th Cir. 2009). The Tenth Circuit's early decision in *Kaiser Steel* suggests the same outcome, though it does not explicitly rule on the mere conduit issue. *Kaiser Steel Corp.*, 952 F.2d 1230, 1236-38. The Seventh Circuit includes the Tenth Circuit as among the courts which have taken the majority view. *Merit Management*, 830 F.3d at 697.

(b) Circuits Holding that Section 546(e) Does Not Apply if the Financial Intermediary Acts as a "Mere Conduit." Two circuits, the Seventh and the Eleventh, have taken the position that when a financial intermediary such as a "financial institution" is involved in a relevant transaction only as a "mere conduit" the exemption from avoidance under section 546(e) does not apply. As the Seventh Circuit stated, when the financial intermediary acts only as a party "through" whom a transfer was made, not as a party "by or to" whom the transfer was made, the trustee may pursue parties who received the actual value of the transfer. *Merit Management*, 830 F.3d at 692-93; *Munford v. Valuation Research Corp.* (*In re Munford*), 98 F.3d 604, 610 (11^{th} Cir. 1996). The Seventh Circuit denied rehearing on the decision, which Bill Rochelle believes was at least in part because of the "powerful bench" the Seventh Circuit assigned to the case, including Chief Judge Diane P. Wood (who wrote the opinion), influential Judge Richard A. Posner, and Judge Ilana Rovner. Rochelle, "Circuit Splits on Invoking Safe Harbor Whenever a Bank Serves as Conduit," at www.abi.org/newsroom/daily-wire/supreme-court-to-decide-whether-using-a-'mere-conduit'-invokes-the-546e-'safe- (accessed October 2017).

6. Positions of the Courts. The easier part of the current split in the circuits, which prompted the United States Supreme Court to grant *certiorari* in an appeal from the Seventh Circuit's *Merit Management* decision is whether section 546(e) applies when the only involvement of an enumerated financial intermediary in a transaction is acting as a "mere conduit." This is the only issue on appeal to the Supreme Court in the *Merit Management* case

and the issue should be resolved by the Court in this decision. If the Supreme Court grants cert in the *Tribune Co. Fraudulent Conveyance Litigation* appeal, the issues will include whether section 546(e) impliedly preempts state law on fraudulent transfer in bankruptcy cases and applies to creditors bringing fraudulent transfers in such cases. The circuit splits in the wider issues are more complicated.

(a) Second Circuit Line of Cases. Although five separate circuits follow this line of cases, the Second Circuit has taken the lead since 2011 in developing the analysis. In this line of cases, the courts dismiss adversary proceedings for avoidance of fraudulent and preferential transfers if the transfer involves a margin or settlement payment by or to or for the benefit of one of the enumerated financial intermediaries or if the transfer made by or to or for the benefit of such a financial intermediary was in connection with a securities or other identified contracts, even if the financial intermediary acted only as a "mere conduit" in the transaction.

There are two bases for this. First, under the language of the statute, the payments are made "to" the financial intermediary, even though it does not have a beneficial interest in the payment and is simply acting as a conduit to parties who do have a beneficial interest. *Quebecor World*, 719 F.3d at 99. The other basis for this ruling is found in policy and Congressional intent: creating a safe harbor from the potential "systemic risk" permitting such avoiding actions to go forward could pose to the "financial markets." In *Enron*, for example, the Second Circuit noted that "[if a firm is required to repay amounts received in settled securities transactions, it could have insufficient capital or liquidity to meet its current securities trading obligations, placing other market participants and the securities markets themselves at risk," (*Enron Creditors*

Recovery, 651 F.3d at 334) and focused on the "substantial . . . negative effect on the financial markets" a large number of avoiding actions could have, which could implicate the "systemic risks that motivated Congress's enactment of the safe harbor." *Enron Creditors Recovery Corp.*, 651 F.3d at 338-39. The later decision, *Quebecor*, ruled that, even if *Enron* "left any ambiguity" on applying section 546(e)'s safe harbor to transfers involving financial intermediaries as mere conduits, the Second Circuit would follow the decisions from the Third, Sixth, and Eighth Circuits in support of this position. *Quebecor World*, 719 F.3d at 99. The Second Circuit did not include the Tenth Circuit because its decision, while referring to "mere conduits," did not involve this specific issue.

The most recent decision of the Second Circuit, issued in the Tribune Company cases, forcefully sums up the policy issue as follows:

> Section 546(e) was intended to protect from avoidance proceedings payments by and to financial intermediaries in the settlement of securities transactions or the execution of securities contracts. The method of settlement through intermediaries is essential to securities markets. Payments by and to such intermediaries provide certainty as to each transaction's consummation, speed to allow parties to adjust the transaction to market conditions, finality with regard to investors' stakes in firms, and thus stability to financial markets. . . . Unwinding settled securities transactions by claims such as appellants' would seriously undermine – a substantial understatement – market in which certainty, speed, finality, and stability are necessary to attract capital.

Tribune Co. Fraudulent Conveyance Litigation, 818 F.3d at 119.

(b) <u>Seventh Circuit Line of Cases</u>. Although the Seventh Circuit identified the Eleventh Circuit as following the same reasoning, the Eleventh Circuit's decision is from 1996 and is much less well developed. The real exponent of section 546(e) not applying when the only involvement by a financial intermediary is as a mere conduit is the Seventh Circuit in its *Merit Management* opinion. The Seventh Circuit found that the threat to financial markets was overblown in the context where a financial institution acts only as a conduit and is not threatened by the threatened avoidance and that the concept of transfers made by or to or for the benefit of a financial intermediary acting merely as a conduit was not what Congress had in mind. The court addressed the *Seligson* case reportedly led Congress to which section 546(c)

> The history of section 546(e) also supports the position we take here, and illustrates why our holding will not give rise to problems in the financial-services markets. Congress first enacted the safe harbor in response to a New York federal district court decision: *Seligson v. New York* Produce *Exchange*, 394 F.Supp. 125 (S.D.N.Y. 1975). In *Seligson*, the trustee of a commodity broker's bankruptcy sued the New York Produce Exchange . . . to recover payments the broker made to the Association in connection with cottonseed oil futures, which declined in value drastically. . . . The court denied summary judgment, finding a triable issue of fact on the questions of whether the Association was a "transferee" within the meaning of the Bankruptcy Code's avoidability provisions, ... Congress responded in 1982 by creating the safe harbor, which enabled financial institutions that were recipients of transfers of the kind that took place in *Seligson* to invoke the safe harbor from avoidance. . . . Nothing it did, however, indicated that the safe harbor applied to those institutions in their capacity as intermediaries.

Merit Management, 830 F.3d at 692-93.

7. Report on the Arguments before the Supreme Court. Oral argument in the *Merit Management* case was held on November 6, 2017. [report any impressions from this]

Life After Jevic: How will the Supreme Court's decision affect chapter 11 practice?

Southwest Bankruptcy Conference

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LIFE AFTER JEVIC: HOW WILL THE SUPREME COURT'S DECISION AFFECT CHAPTER 11 PRACTICE?

BY JEFFREY N. POMERANTZ[1]

"Once again, the Supreme Court screws up our bankruptcy world". That is how one commentator[2] has characterized the recent decision in *Czyzewski v. Jevic Holding Corp.,* 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017).

Whether one agrees or disagrees with this description of *Jevic*, the decision indisputably raises more questions than it answers. Its application to structured dismissals with different fact patterns and its potential impact on numerous other, more common, aspects of a case—from first day motions to asset sales—will only unfold over time through decisions, published and unpublished, by courts across the country.

The Case

The United States Supreme Court issued the *Jevic* decision on March 22, 2017, effectively reversing decisions of the bankruptcy court, the district court and the Third Circuit Court of Appeals. At its core, *Jevic* holds that a court cannot approve a structured dismissal[3] which provides for distributions different from the standard priority scheme in a chapter 11 or chapter 7 case without the consent of affected parties.

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[2] In re Jevic: Once Again the Supreme Court Screws up our Bankruptcy World—And Justice Thomas is Wise in his Dissent, Donald L. Swanson, Mediatbankry (March 30, 2017), https://mediatbankry.com/2017/03/30/. The reference to previous times the Supreme Court "screwed up" the bankruptcy system is primarily to *Stern v. Marshall*, 564 U.S. 462 (2011).

[3] "Structured dismissals" are mechanisms to conclude a chapter 11 case which provide for distributions and address other issues without a plan or a conversion to chapter 7. They are most commonly used following a sale of assets which leaves the chapter 11 estate with insufficient assets to distribute to general unsecured creditors.

Factual Background

Jevic Transportation, Inc. ("Jevic"), a New Jersey trucking company, was acquired by Sun Capital Partners ("Sun") in 2006 through a leveraged buyout financed by the CIT Group ("CIT"). Within less than two years, Jevic ceased operations, terminated its employees and commenced a case under chapter 11 of the Bankruptcy Code, owing $53 million to senior secured creditors Sun and CIT and in excess of $20 million to the taxing authorities and general unsecured creditors.

Two lawsuits were filed in the bankruptcy case. First, ex-employee truck drivers filed suit alleging violations of state and federal Worker Adjustment and Retraining Notification ("WARN") Acts. The Bankruptcy Court granted judgment in favor of the truck drivers in the amount of $12.4 million, $8.3 million of which constituted a priority wage claim under Bankruptcy Code §507(a)(4).

Second, the Official Committee of Unsecured Creditors appointed in the Jevic chapter 11 filed a fraudulent conveyance action on behalf of the bankruptcy estate against Sun and CIT, alleging that they had "'hastened Jevic's bankruptcy by saddling it with debts that it couldn't service'". The Committee and Sun and CIT reached agreement for the following structured dismissal of Jevic's chapter 11 case: (1) the fraudulent conveyance action would be dismissed with prejudice; (2) CIT would deposit $2 million in a segregated account earmarked to pay the Committee's legal fees and administrative expenses; (3) Sun would assign its lien on the debtor's remaining $1.7 million of cash to a trust; (4) thereby permitting the trust to use the funds to pay taxes and administrative expenses, with the remainder to be distributed pro rata among general unsecured creditors; and (5) Jevic's bankruptcy case would be dismissed. *Jevic,* 137 S. Ct. at

981. However, no funds were permitted to be paid to the WARN plaintiffs on account of their judgement, including on account of their wage claims which held priority over general unsecured creditors. Sun insisted on this provision in order to deprive the ex-employees of funds to bankroll further litigation against Sun.[4] *Id.*

The Lower Court Decisions

While acknowledging the proposed settlement's divergence from the Code's priority scheme, the bankruptcy court approved the settlement, including the structured dismissal embedded therein, in recognition of the "dire circumstances" present in the case, finding that neither priority nor general unsecured creditors would receive any recovery absent approval of the settlement. *See id*. at 981-82. The district court and the Third Circuit both affirmed, with the Third Circuit holding that Congress had only "'codified the absolute priority rule . . . in the specific context of plan confirmation'" and that in "'rare instances'" such as these, structured dismissals which did not adhere to the Bankruptcy Code's priority scheme could be approved. *Id.* at 9.

The Supreme Court Decision

The Supreme Court first considered and dismissed the argument that the WARN claimants did not have standing. Noting that even a small financial interest is sufficient to establish standing, the Court found that if the present settlement was not approved a different settlement which provided a recovery to the WARN claimants remained a "reasonable

[4] Separate from the WARN claims filed against the *Jevic* estate, the WARN plaintiffs also asserted state court claims against Sun on the grounds that Sun was a statutory employer. Sun was not willing to allow the WARN plaintiffs to receive part of the distribution being made through the bankruptcy estate while at the same time retaining their rights to pursue the WARN claims against Sun in state court. Because Sun and the WARN plaintiffs could not reach a global resolution, the settlement contemplated distributions skipping over the priority WARN claims. Subsequently, Sun prevailed in the state court action with the WARN plaintiffs.

possibility" and that appellants might be able to find an attorney to pursue the fraudulent conveyance action on a contingency basis. *Id*. at 982-83.

Addressing the merits, the Supreme Court turned to the core issue of the case: can a bankruptcy court approve a structured dismissal providing for distributions that deviate from the ordinary priority rules of the Bankruptcy Code without the consent of the affected party. The Court's "simple answer to this complicated question" was "'no'". *Id.* at 983. The Court noted that the Code's distribution priority scheme was "fundamental," and that something more than "simple statutory silence"-- an "affirmative indication of intent"-- would be expected if Congress intended to permit dismissals which allow for a major departure from the scheme. *Id.* at 984.

The Court then addressed respondent's contention that Code §349(b), which authorizes a bankruptcy judge to dismiss a case "for cause," permits courts to approve a dismissal which does not comport with the standard priority distribution scheme. The Court concluded that this provision, "read in context", merely granted courts the "flexibility to 'make the appropriate orders to protect rights acquired in reliance on the bankruptcy case'". *Id.* at 984 (citation to legislative history omitted). As nothing in the Code authorizes a court to make "end-of-case" distributions of estate assets that violate the chapter 11 and chapter 7 priority schemes, that do not restore the *status quo ante* as is normally required in a dismissal and that do not protect "reliance interests acquired in the bankruptcy", the Court held that "the word 'cause' is too weak a reed upon which to rest so weighty a power." *Id.* at 984-85.

The Supreme Court's basic ruling appears to be unequivocal, though limited:

> A distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies.

Id. at 978.

However, in what one bankruptcy court has termed "dicta" (*see* discussion of *In re Fryar*, below) *Jevic* also contrasts the structured dismissal before the Court with certain permissible wage and critical vendor payments, and even lender "roll-ups" which allow lenders who provide postpetition financing to be paid first on their prepetition claims, all of which have been approved by courts:

> We recognize that *Iridium* is not the only case in which a court has approved interim distributions that violate ordinary priority rules. But in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve. Courts, for example have approved "first-day" wage orders that allow payment of employees' prepetition wages, "critical vendor" orders that allow payment of essential suppliers' prepetition invoices, and "roll-ups" that allow lenders who continue financing the debtor to be paid first on their prepetition claims [citations omitted]. In doing so, these courts have usually found that the distributions at issue would "enable a successful reorganization and make even the disfavored creditors better off." *In re Kmart Corp,* 359 F.3d 866, 872 (CA7 2004)…. By way of contrast…[the structured dismissal] does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmed plan; it does not help to restore the *status quo ante*; and it does not protect reliance interest.

Id. at 985-86.

<u>The Dissent</u>

Justice Thomas, joined by Justice Alito, dissented in favor of dismissing the writ granted by the Court, because the majority "answer[ed] a novel and important issue of bankruptcy law…without the benefit of any reasoned opinions on the dispositive issue from the court of appeals…and with briefing on that issue from only one of the parties." *Id*. at 987. Justice Thomas was upset at what he thought was a bait and switch by the appellant. The Supreme Court granted certiorari to decide "whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme." With respect to that issue there was a clear circuit split.

However, in the briefing to the Supreme Court the appellants reframed the question to be "whether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme." With respect to that issue there was no circuit split. Justice Thomas noted that the field of structured dismissals was "rapidly developing" and that the Court would benefit from further lower court opinions on the topic before taking up the issue. Justice Thomas objected to the Court permitting the appellant to change the question presented to the Court, especially since respondents appropriately "declined to brief the question that the majority" decided. *Id*. at 988. Accordingly, the Court was prematurely deciding a "novel and important issue" with insufficient input regarding the issues involved.

<u>Decisions Subsequent to *Jevic*</u>

Three opinions have cited the "priority" portion[5] of *Jevic* in reaching decisions. Notably, none of them relates to structured dismissals, demonstrating that *Jevic*'s application will likely extend to many other issues which arise in a case.

In *In re Pioneer Health Services*, 2017 Bankr. LEXIS 939 (Bankr. S.D. Miss., Apr. 4, 2017), a Mississippi bankruptcy court cited *Jevic* in determining that increased scrutiny was required in assessing a request to pay prepetition amounts owing to alleged critical vendors. Noting that the Supreme Court distinguished critical vendor motions from structured dismissals, the bankruptcy court quoted *Jevic*'s contrast of the structured dismissal before the Supreme Court with other, permissible, deviations from standard distribution priorities, but understanding *Jevic* to require "increased scrutiny" of even these permissible deviations. *Pioneer*, 2017 Bankr. LEXIS 939 at *14-15.

[5] Several other cases have cited *Jevic* for its holding regarding standing.

"Mindful of the increased scrutiny required by *Oxford Management, CoServ,* and *Kmart*, and, apparently, by *Jevic*", the court found that the debtor hospital had failed to establish that payments to three emergency room doctors qualified as critical vendor payments because the debtor had presented no evidence that the doctors were irreplaceable or that they would leave if prepetition amounts owing to them were not paid. *Id*. at *15-17. The bankruptcy court further noted that if the debtor could establish that the doctors were leaving because the debtor would not pay them prepetition amounts owing, the debtor could threaten the doctors with an action for violating the automatic stay for failure to perform under their employment agreements. *Id*.[6]

In *In re Hansen*, 2017 Bankr. LEXIS 1120 (Bankr. D. N.H., Apr. 25, 2017), the chapter 7 trustee brought a motion to sell certain patent assets which involved the settlement of litigation and which the court deemed to be a compromise of controversy. The trustee accepted an offer which compromised litigation and provided funds for payment in full of all prepetition claims, but left no surplus for the debtor. *Hansen*, 2017 Bankr. LEXIS 1120 at *4. The objections to the sale-settlement argued that the trustee should instead have opted for a different offer which contemplated pursuing, rather than settling, pending litigation, because success in the litigation could result in a surplus for the debtor.

In overruling the objections to the settlement, the court cited *Jevic* for the unremarkable proposition that the Code gives priority to payment of creditors over payment of debtors. *Id.* at *32. The court described *Jevic* as holding that a bankruptcy court may not approve structured dismissals which "do not follow the Bankruptcy Code's ordinary priority rules without the affected creditors' consent". *Id*. at fn. 17.

[6] If this logic is accepted, it might prohibit debtors from including anyone working pursuant to an employment agreement in a first day motion, though this factor is only one among several mentioned by the *Pioneer Health* decision.

Finally, in *In re Fryar*, 2017 Bankr. LEXIS 1123, 64 Bankr. Ct. Dec. 8 (Bankr. E.D. Tenn., Apr. 25, 2017), a motion seeking approval of the sale of real property which included a compromise of controversy was denied where (1) the settlement distribution scheme did not follow ordinary Code priorities, (2) three creditors and the Office of the United States Trustee objected, which required the court to consider whether significant Code-related objectives existed to justify deviation from ordinary Code priorities, and (3) the debtor failed to establish sufficient Code-related objectives.

In simplification of a complicated fact pattern, the following are the relevant facts: Pinnacle Bank was an undersecured creditor. Part of the unsecured portion of its claim was being paid concurrently with the sale under the settlement, when other unsecured claims, and even a priority claim, was not. The court found that even though a sound business purpose exists for the sale of the property, because the "sale also involve[s] a settlement and a payment of one unsecured creditor ahead of other prior parties and other unsecured creditors, the court must also review the standards for approval of a settlement" and determine whether the compromise is "fair and equitable". *Fryar*, 2017 Bankr. LEXIS 1123 at *8-10.

The bankruptcy court reviewed case law in the area, noting that the Fifth Circuit holds that a settlement cannot be used to circumvent the Code priority scheme but that the Second Circuit is more flexible, allowing "a settlement reordering distribution from some assets [where] necessary to allow the estate to pursue its most significant assets and where the nature and extent of the estate and the priorities were not fully resolved." *Id*. at *11.

Turning to *Jevic* and its holding regarding structured dismissals, the bankruptcy court noted that courts sometimes allow distributions other than in accordance with the priority scheme under a chapter 11 plan or in a chapter 7 case, as in the case of certain first day orders regarding wages and critical vendors, but only where the distributions would assist in a reorganization and make even dissenting creditors better off. As the court noted, Pinnacle jumping ahead "might be acceptable if all of the creditors were consenting; however, three creditors and the U.S. Trustee have objected, so the court must consider whether there are Code-related objectives being served that are so significant that deviation is justified." *Id*. at *14. But the debtor failed to demonstrate promotion of significant Code-related objectives. Thus, even though the failure to approve the compromise may result in unsecured creditors ultimately receiving nothing, the court held that it is "their decision to make if they want to see if they can find a better deal". *Id*. at *16.

The court directly based its ruling on *Jevic*:

> In light of the Supreme Court's recent ruling in *Jevic*, parties who seek approval of settlements that provide for a distribution in a manner contrary to the Code's priority scheme should be prepared to prove that the settlement is not only "fair and equitable" based on the factors to be considered by the Sixth Circuit, *Bauer*, 859 F.2d at 441, but also that any deviation from the priority scheme for a portion of the assets is justified because it serves a significant Code-related objective. The proposed settlement should state that objective, such as enabling a successful reorganization or permitting a business debtor to reorganize and restructure its debt in order to revive the business and maximize the value of the estate. The proposed settlement should state how it furthers that objective and should demonstrate that it makes even the disfavored creditors better off.

Id. at *16-17.

<u>The Third Circuit's *LifeCare* Decision</u>

At about the same time that the Third Circuit was deciding *Jevic* it also decided *In re LCI Holdings Co*., 802 F. 3d 547 (3d Cir. 2015) ("*LifeCare").* In *LifeCare*, the Third Circuit affirmed an order of United States District Court for the District of Delaware, granting a 363 motion for the sale of the debtor's property which included the payment of claims outside the standard Code distribution scheme. The stalking horse (and winning) bid was made by the (under)secured creditor, which credit bid 89% of the amount of its debt and deposited funds into an escrow to pay legal and accounting fees of the Committee. The Committee objected to the sale because the proceeds were insufficient to provide a recovery to unsecured creditors or even to pay all administrative expenses. The United Sates objected because it would be owed $24 million of capital gains taxes as an administrative claim if the sale were to be consummated, but all cash from the sale was to be used solely to pay other administrative expenses (fees of the Committee's professionals) with which its claim had equal priority. Eventually the Committee withdrew its objection when the secured creditor agreed to escrow monies to fund a partial return to general unsecured creditors. Not surprisingly, the United States now objected to payment of not only other, *pari passu*, administrative claimants to its exclusion, but also to lower-in-the-priority-scheme general unsecured creditors.

The bankruptcy court overruled the government's objection and approved the sale, finding that the credit bid was the best and only bona fide bid, and that the alternative to the sale was a liquidation of assets which could endanger patients and would provide no recovery whatsoever to any creditor including the government. *LifeCare,* 802 F. 3d at 551. Moreover, the court found that because the escrowed funds came directly from the secured creditor/purchaser and never passed through the estate, such funds were not sales proceeds and thus not property of the estate. *Id*. Accordingly, the Code distribution priorities did not apply to them.

In affirming, the Third Circuit rejected the government's argument that the Committee itself had conceded that its settlement with the purchaser "'allocate[d] proceeds from the sale'" and therefore implicated property of the estate, declining to "elevate form over substance and give legal significance to the Committee's description of the settlement funds". *Id*. at 556. Further, the originally-escrowed funds to pay professional fees were likewise not property of the estate even though the Asset Purchase Agreement referred to them as "consideration" for the debtor's assets and part of the purchase price. Because the purchaser was buying, among other assets, all of the debtor's cash and thus the excess over professional fees would be returned to the buyer, these funds could not be termed property of the estate. *Id*. Rather, these were funds to assure a smooth transfer of assets and to resolve objections to the sale rather than as partial consideration for the debtor's assets. *Id*. at 557.

The United States did not appeal the *LifeCare* decision. As discussed below, it is unclear whether *LifeCare* remains good law after *Jevic*.

<u>Beyond *Jevic*</u>

The holding in *Jevic* directly addresses a structured dismissal to which parties objected. The narrow circumstances of *Jevic*, however, should not obscure the more fundamental and commonly-occurring circumstances to which it may—or may not—be applied, as well as several other issues.

(1) <u>Issue</u>: Is *Jevic*'s holding limited to structured dismissals, or do its principles and analysis apply to any potential distribution made during the course of a chapter 11 case which does not comport with the absolute priority rule (or to distributions in a chapter 7 case contrary to the distribution priorities set forth in the Code)? For example, does it apply to a proposed settlement which includes a distribution of proceeds or to first day motions seeking to pay certain prepetition obligations?

<u>Analysis</u>: *Jevic* will likely have broad application. It explicitly contrasts structured dismissals with first-day motions and the like by identifying the former's deficiencies (*e.g.,* doesn't preserve the debtor as a going concern, doesn't promote reorganization). The bankruptcy courts in two subsequent cases (discussed above) clearly apply *Jevic* beyond

structured dismissals. In *Pioneer Health Services,* the court explicitly cites the *Jevic* list of deficiencies in evaluating (and denying) a critical vendor motion, noting that *Jevic* "apparently" requires increased scrutiny of such motions. And in *Fryar*, the court cited *Jevic* in refusing to approve a settlement which involved a distribution of proceeds which deviated from the standard Code priority scheme. Although neither is binding precedent, the decisions may augur the approach likely to be taken by many, if not most, courts post-*Jevic*. Whether, and to what extent, courts require a more robust evidentiary showing to support first day motions seeking to pay prepetition claims (ala *Kmart*) remains to be seen.

(2) Issue: If *Jevic* applies beyond structured dismissals (which almost always, by their nature, have most of the deficiencies identified in *Jevic*), can a court approve a deviation from the standard distribution scheme if "Code-related objectives" are achieved even if the affected creditor objects?

Analysis: On the one hand, *Jevic* appears to state a bright-line holding: a deviation from standard Code distribution priorities can only be approved with the consent of the affected creditor. Perhaps this bright line applies to other situations as well. On the other hand, *Jevic* contrasts its circumstances with those of potential first day orders, reciting its laundry list of deficiencies which go well beyond the fact that the affected creditor has not consented. As noted above, post-*Jevic* cases *Pioneer Health* and *Fryar* apply *Jevic*'s more nuanced analysis. Indeed, *Fryar* explicitly analyzed whether Code-related objectives were being achieved only once it noted that creditors had objected. *Fryar*, 2017 Bankr. LEXIS 1123 at *14. However, *Fryar* also noted that the Supreme Court's listing of deficiencies under the facts of *Jevic* was dicta to *Jevic*'s fundamental, narrow holding applicable to structured dismissals. *Id*. at *12-13. The context of *Jevic* made it difficult to argue that the settlement was achieving Code-related objectives—the company had shut its doors pre-bankruptcy and all that was happening through the settlement was a resolution of estate owned fraudulent conveyance actions. But the more typical context of a class-skipping structured dismissal involves a creditors committee giving up its rights to object to a sale or DIP financing in exchange for a fund earmarked to its constituency. In those cases, the elimination of potential sale or DIP litigation often paves the way for a going concern sale without the attendant costs and risks of litigation. Since the Code promotes value maximization one could argue that such a fact pattern is distinguishable and that *Jevic* does not apply. Whether courts will take that view remains to be seen.

(3) Issue: As noted by the Supreme Court, affected parties objected to the structured dismissal in *Jevic*. Presumably if all affected parties consent, a deviation from distribution priorities would be permitted. *Cf. Fryar*, 2017 Bankr. LEXIS at *13 (analysis of whether Code-related objectives have been met undertaken after noting that parties have objected, though states only that the plan "*might* be acceptable if all of the creditors were consenting." (emphasis added)). Does the lack of an objection after notice and opportunity to object constitute consent?

Analysis: *Jevic* sheds no light on the issue; the affected parties affirmatively objected. In *Fryar*, the bankruptcy court noted that creditors were not consenting, that three creditors and the UST objected. This *may* imply that had no objections been filed, consent would have been inferred. *Pioneer Health* did not address the issue of consent at all.

Even if consent can be inferred through failure to object, first day motions are of course heard on an emergency basis following limited notice. Perhaps debtors, where possible, should bring critical vendor and similar motions on regular notice sent to all creditors.

(4) Issue: Can a priority skipping payment be authorized over an objection if there is evidence of "significant Code-related objectives" even if the payment will not benefit the

affected party? For example, if unsecured creditors would be paid in full on a liquidation, can a critical vendor motion be granted over an objection by such a creditor, who has nothing to gain but whose recovery in full is put at risk by an authorization based on Code objectives of reorganization and preserving the debtor as a going concern?

Analysis: In rejecting the class-skipping payments in *Jevic* the Court reasoned that the structured dismissal pursuant to which they were proposed to be made "does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmable plan; it does not help to restore the *status quo ante*; and it does not protect reliance interests." *Jevic*, 137 S. Ct. at 985-86. That language would imply that if the class-skipping payments further fewer than all —or perhaps even any one— of those Code-related objectives then the payments can be approved even if the payments do not benefit the objecting party. However, the bankruptcy court in *Fryar* appears to go further than the Court in *Jevic*, stating that a settlement which deviates from Code distribution priorities should state how it is serving code related objectives "and should demonstrate that it makes even the disfavored creditors better off." *Fryar*, 2017 Bankr. LEXIS 1123 at *16-17 (and at *13, quoting *In re Kmart Corp*., 359 F. 3d 866, 872 (7th Cir. 2004) discussing justifications for critical vendor motions). *Fryar*, of course, is one bankruptcy court's opinion. Although inconclusive, *Jevic*'s laundry list implies, at a minimum, that not all of the listed elements must be met.

(5) Issue: Are there creative ways to structure a dismissal which do not run afoul of *Jevic*? Does the methodology and do the principles enunciated in *LifeCare* survive *Jevic*, *i.e.,* do the *Jevic* requirements apply to funds which are not property of the estate? Recently, the United States Bankruptcy Court for the District of Delaware approved a credit bid sale to a junior lender under Section 363 which sale included an assumption of $750,000 of prepetition general

unsecured claims on a pro rata basis in *United Road Towing Company, et al*., case no 17-10249 (LSS). Although the buyer was also paying known administrative and priority claims, would the assumption of liabilities construct work even if certain priority or administrative claims were not satisfied?

Analysis: The issue of whether *LifeCare* survives *Jevic* was hotly contested in *Constellation Enterprises, LLC, et al*., case no. 16-11213 (CSS) pending in the Delaware bankruptcy court (*see,* primarily, docket nos. 944-948, 955 & 956). Among the arguments put forth that *LifeCare* did not survive *Jevic* were the following: (1) The assets at issue in *Jevic* were also not estate property: $2 million was contributed by secured creditor CIT (clearly not property of the estate) and a lien on $1.7 million was "contributed" by secured creditor Sun. (2) If the assets being used are so divorced from the estate that *Jevic* does not apply, then the court does not have subject matter jurisdiction over such assets and can neither approve nor disapprove their use.

The Committee replied that no portion of *Jevic* addresses or overrules *LifeCare*. $1.7 million of the funds being used in *Jevic* were estate funds even though they were subject to a lien. And despite that the CIT $2 million was not property of the estate, *Jevic* refused to hold that the use of *any* estate assets which are to be distributed outside the standard distribution scheme is improper. In fact, *Jevic* acknowledged the permissible use of such funds in certain first day and settlement motions. Further, the alleged jurisdictional Catch-22 is merely a red herring, as the settlement resolves numerous disputes in the case regarding, for example, previous objections to DIP financing orders.

In declining to approve the settlement in *Constellation*, Judge Sontchi, for the most part, avoided this issue, finding that though the property in question was currently owned by the purchaser of the estate's assets, the property had once been property of the estate and the parties always contemplated that it would be transferred back. Accordingly, the property in question was considered property of the estate, *LifeCare* was thus inapplicable and the settlement would be disallowed under *Jevic*. Judge Sontchi acknowledged that the Supreme Court in *Jevic* wasn't focused on the issue of property vs. non-property of the estate. Since he concluded that *Constellation* dealt with estate property he was able to sidestep the issue. Accordingly, it is unclear how the Court would have ruled had the property involved been unequivocally non-estate property. Nevertheless Judge Sontchi did reason that "if [*LifeCare]* hasn't been overturned by *Jevic* altogether, and I'm not ruling that it has been, I think it probably has been significantly narrowed…". Transcript of May 16, 2017 hearing in *Constellation*, at 247-48. Elsewhere, however, Judge Sontchi noted that if faced with a true *LifeCare* scenario where unequivocally only non-estate property was being used, "I think I'd be constrained to follow or enforce [it]". *Id*. at 250.

In a post-*Jevic* world, can the partial assumption of liabilities in *United Road Towing Company* be utilized in a circumstance where higher priority creditors are not being paid in full? If *LifeCare* survives *Jevic*, a sale including *United Road Towing*'s partial assumption of liabilities likely does as well. In the parlance of the *LifeCare* decision, non-estate property is being used to "smooth" the transfer of assets by resolving objections to the sale, rather than to purchase assets.

One can argue that *United Road Towing*'s assumption is even more removed from use of estate assets than the funding of a creditor trust in *LifeCare* with non-property of the estate. No assets whatsoever—estate or non-estate owned—are being transferred. Moreover, it is common practice for a purchaser of assets to selectively assume liabilities. Just as a purchaser is allowed to select which liabilities to assume based on its future business necessities, so too a purchaser should be permitted to select liabilities to assume based on the business necessity of garnering support for the proposed sale transaction.

However, if the purpose of an *United Road Towing*esque partial assumption of liabilities is clearly to bypass the standard Code priority scheme, the issue may still come down to whether *LifeCare* survives or not. A court may either determine that the approach is permitted because estate assets are not being used in violation of Code distribution priorities, or will instead view the structure as form over substance, focusing on the fact that funds paid (as in *LifeCare*) or to be paid (as in *United Road Towing*) are monies the purchaser is willing to pay for the debtor's assets, which monies are being used to pay the debtor's liabilities.

JUDICIAL ESTOPPEL

Hon. William T. Thurman
United States Bankruptcy Judge

I- What is Judicial Estoppel?

a. *Doctrine:* An affirmative defense that can be raised by a party to preclude a litigant from asserting a position that is inconsistent with one asserted in the same or prior proceeding.
    i. *Affirmative defense can be waived if not raised.*
b. *Policy:* the policy is to protect the integrity of court proceedings by not allowing litigants to shift positions to suit the needs of the litigant at a particular point in time.
    i. "[W]here a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him." *New Hampshire v. Maine*, 532 U.S.742 (2001) **(Ginsburg),** quoting from *Davis v. Wakelee*, 156 U.S. 680, 689 (1895) **(Brown).**

II- How does Judicial Estoppel arise in the Bankruptcy Context?

a. The defense has typically been applied when a plaintiff pursues a lawsuit in one court and files for bankruptcy without disclosing the claim as an asset that may be used to pay her creditors.
b. Courts apply the judicial estoppel defense in such circumstances to prevent plaintiffs from obtaining a windfall by concealing the asset from the bankruptcy court while simultaneously asserting the same claim in a different court.
c. Companies facing consumer litigation have successfully employed this defense by reviewing sworn bankruptcy schedules to see if the plaintiffs failed to disclose claims asserted in pending lawsuits.
d. Courts generally cite three elements in barring the pursuit of a claim on the basis of judicial estoppel:
    i. First, the party against whom estoppel is asserted must have argued a contrary position in a prior case.
        1. In bankruptcy, this element is satisfied when the debtor pursues a cause of action which she has failed to disclose on her bankruptcy schedules.
    ii. Second, the court before whom the contrary position was argued must have accepted the position.

1. This element is typically satisfied in bankruptcy when the debtor receives a discharge; it is assumed that the bankruptcy Court would not have granted the discharge if it was known that the debtor's schedules were inaccurate. *Guay v. Burack*, 677 F.3d 10, 18 (1st Cir. 2012). **(Lipez)**

iii. Third, the assertion of the contrary position either conferred an "unfair advantage" on the party asserting the contrary position, or imposed an "unfair detriment" on the opposition. "ABI Consumer Bankruptcy Committee News", Volume 9, Number 3 (August 2011).

1. This element is typically satisfied by the presumption that the debtor sought to keep the recovery from the hands of creditors. *Moses v. Howard University Hospital*, 606 F.3d 789, 799 (D.C. Cir. 2010). **(Edwards)**

III- <u>*Slater v. U.S. Steel Corp*. and the application of Judicial Estoppel in Bankruptcy</u>

a. In *Slater v. United States Steel Corp.,* No. 12-15548, 2017 WL 4110047 (11th Cir. Sept. 18, 2017) **(Pryor)**, the 11th Circuit clarified and modified its rule on when a failure of the debtor to schedule a cause of action on the bankruptcy schedules results in requiring the court handling that cause of action to dismiss such action.

History: Slater sued U.S. Steel for sex and race discrimination, as well as retaliation for her complaints of discrimination. The district court denied in part U.S. Steel's motion for summary judgment, but Slater did not have an opportunity to present her claims to a jury. About a month after the summary judgment order, Slater filed for Chapter 7 bankruptcy relief, and failed to disclose the discrimination cause of action, answering 'none' on both the list of assets regarding contingent and unliquidated claims and on the statement of financial affairs regarding pending suits or administrative proceedings within the last year. The trustee filed a report of no distribution, and 30 days later the estate was presumed fully administered (Red. R. Bankr. Proc. 5009(a)).

The next day the, U.S. Steel again moved for summary judgment in the district court asserting judicial estoppel. The following business day after U.S. Steel filed its motion in district court, the Debtor amended her schedule of assets and statement of financial affairs to disclose the cause of action. She testified that she had misunderstood the question on the statement of financial affairs to refer to only suits against her. The Chapter 7 trustee requested and was granted a request to employ the counsel representing the debtor in the discrimination suit. Meanwhile, the Debtor converted to a Chapter 13 and confirmed a plan, but defaulted under the plan and the case was dismissed.

Relying on prior Eleventh Circuit case law, the district court granted U.S. Steel's motion for summary judgment. In an *en banc* decision, however, the Eleventh Circuit not only turned over the district court's decision, it overruled prior precedent.

The Eleventh Circuit reaffirmed that courts may apply judicial estoppel only when the employer can establish two things:

- First, the plaintiff took a position under oath in the bankruptcy proceeding that was inconsistent with the plaintiff's pursuit of the lawsuit; and
- Second, the plaintiff intended to make a mockery of the judicial system.

Prior Eleventh Circuit decisions, *Barger v. City of Cartersville* and *Burnes v. Pemco Aeroplex*, endorsed a rule that intent to "make a mockery of the judicial system" was established through the plaintiff's nondisclosure, even if the plaintiff later corrected the bankruptcy disclosure. *Barger v. City of Cartersville,* 348 F.3d 1289 (11th Cir. 2003); *Burnes v. Pemco Aeroplex, Inc.,* 291 F.3d 1282 (11th Cir. 2002) **(Hunt)**. In *Slater*, the court reconsidered the precedent set in *Barger* and *Burnes* through *en banc* review, eventually overruling those decisions. Accordingly, courts in the Eleventh Circuit may no longer infer a plaintiff's intent to "make a mockery" of the judicial system without consideration of the plaintiff's circumstances as they pertain to the nondisclosure of a lawsuit in the bankruptcy schedules. Factors that the court in the Eleventh Circuit may now consider include:

- The Plaintiff's level of sophistication;
- The Plaintiff's explanation for the omission;
- Bankruptcy court orders or motions concerning the nondisclosure;
- The Plaintiff's attempt to correct the disclosures, and;
- Whether the trustee or creditors were aware of the civil lawsuit or claims before the Plaintiff amended the schedules

Within the opinion, the court in *Slater* acknowledged that their decision would establish a new precedent on judicial estoppel that would bring them in line with the Sixth, Seventh, and Ninth Circuits, but that the other circuits (the Fifth and Tenth) still recognize that the nondisclosure itself is enough to satisfy the intent prong of the judicial estoppel defense. While this additional consideration will make it harder for defendants to win their case, as they can no longer simply point to the plaintiff's sworn bankruptcy schedules to prove intent, the court in *Slater* clarified that judicial estoppel remains an accessible defense.

The Eleventh's Circuit's new requirement to consider the "surrounding circumstances" does not entirely eradicate the judicial estoppel defense. In a concurring opinion, Chief Judge Carnes notes that courts are "not required to accept the testimony of the plaintiff that her misstatements . . . were not made with intent to mislead, even if that testimony is uncontradicted." (*Slater*) If a bankrupt plaintiff denies any intent to mislead the court or creditors by not disclosing a cause of action, the court has the "authority and responsibility to find the facts and not blindly accept [such] testimony."

IV- Judicial Estoppel in the 10th Circuit

- The doctrine of judicial estoppel is based upon protecting the integrity of the judicial system by prohibiting parties from deliberately changing positions according to the exigencies of the moment. *Mathews v. Denver Newspaper Agency LLP*, 649 F.3d 1199 (10th Cir. 2011). **(Murphy)**
- A party that adopts an inconsistent position that is accepted by the bankruptcy court that gives the party an unfair advantage if not estopped, is subject to judicial estoppel and will not be permitted to pursue their inconsistent position in district court. *Queen v. TA Operating, LLC*, 734 F.3d 1081 (10th Cir. 2013). **(Ebel)**
- If a bankruptcy debtor fails to disclose an asset, and that failure to disclose is not inadvertent, the debtor will be judicially estopped from claiming entitlement to the asset. The bankruptcy code imposes a duty upon a debtor to disclose all assets, including contingent and unliquidated claims. That duty encompasses disclosure of all legal claims and causes of action, pending or potential, which a debtor might have. A debtor's assertion that he simply did not know better and his attorney "blew it" is insufficient to withstand application of the doctrine of judicial estoppel. *Eastman v. Union Pacific R.Co.*, 493 F.3d 1151 (10th Cir. 2007). **(Baldock)**
- Where a party assumes a certain position in a legal proceeding, and succeeds in maintaining the position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him. *New Hampshire v. Maine*, 532 U.S. 742, 121 S.Ct. 1808 (2001) is followed. *Johnson v Lindon City*, 405 F.3d 1065 (10th Cir. 2005). **(Kelly)**
- Three factors that courts consider in deciding whether to apply judicial estoppel doctrine are: (1) whether party's later position is clearly inconsistent with earlier position; (2) whether party has succeeded in persuading court to accept the earlier position, so as to create perception that either the first or second court was misled; and (3) whether the party seeking to assert inconsistent position would derive an unfair advantage or impose an unfair detriment on opposing party if he were not estopped. *In re Riazuddin*, 363 B.R. 177 (10th Cir.BAP 2007). **(Brown)**

V- Who is impacted by the application of the Judicial Estoppel Doctrine in the bankruptcy context?

a. *The estate:* the Trustee could be prevented from administering an asset for creditors and the creditors lose out on a potential recovery.
b. *Debtor:* Loses his or her day in court

c. *Defendant:* Defendant is asserting judicial estoppel; potential windfall to wrongdoer
d. *Court:* Is the administration of justice served?

VI- Considerations for the 10th Circuit's current approach to judicial estoppel

The National Consumer Bankruptcy Rights Center ("NCBRC") filed an amicus brief in the Eleventh Circuit on behalf of National Association of Consumer Bankruptcy Attorneys ("NACBA") members to address the that circuit's approach to judicial estoppel. *Slater v. U.S. Steel*, No. 12-15568 (filed October 24, 2016). The amicus brief raises additional concerns that the Tenth Circuit may want to examine in its own approach to judicial estoppel, including:

- In cases such as *Slater* (prior to the en banc decision), a better approach than invoking judicial estoppel might be to challenge the debtor's standing. For example, in a Chapter 7, unless the asset is abandoned, the trustee is the party with standing; in a Chapter 13, the debtor's standing to pursue the claim would continue with any recovery benefitting the estate.
- Actual fraud on the part of a debtor could be more appropriately dealt with by other provisions in the bankruptcy Code and Rules (rather than by judicial estoppel), including: denial of a discharge, sanctions within the bankruptcy proceeding, and criminal charges for particularly egregious behavior.