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When a Business Owner Files Chapter 7

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CONCURRENT SESSION

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V. SUBSTANTIVE CONSOLIDATION:

"NEITHER AUTHORIZED NOR PROHIBITED" BY THE BANKRUPTCY CODE

With its "historical roots" derived "from the bankruptcy court's general equity powers as expressed in 105 of the Bankruptcy Code" the granting of substantive consolidation of debtors with other debtors or debtors with non-debtors has evolved differently in each Circuit with various tests/considerations resulting. What seems to be most determinative of whether consolidation is allowed or not, is "fairness" to creditors in what results from this equitable action. Most courts agree that "Bankruptcy courts may substantively consolidate two or more related entities and thereby pool their assets…treating separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities."

Below is a compilation of the various test adopted by Circuits across the country, if there is one, and some examples of how courts have managed this very tough balancing act for the benefit of all parties involved in the cases and how they have addressed some ancillary issues arising in conjunction with substantive consolidation.

***Logistics Information Sys. Inc. v. Braunstein (In re Logistics Information Sys. Inc.)*, 432 B.R. 1, 81 Fed. R. Evid. Serv. 1042 (D. Mass. 2010)**

Sperbeck founded Logistics and was the principal owner and President. Logistics designed and licensed transportation management software, which allowed shippers to monitor and manage the transportation of their goods by private carriers. Two of its popular software products were "MaxPayload" and "Audit-Logic." In August 1999, Logistics sued one of its customers, "APBLS" and APBLS counter sued and in December 2001, ultimately obtained a default judgment against Logistics for $1.5 million. In September 2000, Sperbeck created Arclogix to conduct business substantially similar to Logistics'. Arclogix utilized software that was also similar to Logistics' except that it was webbased and had improved functionality. Arclogix started active operations in January 2001; Logistics ceased operations at about the same time. Between December 2000 and August 2001, Logistics paid Sperbeck approx.. $254,000 for loan repayments which Sperbeck put into Arclogix. Arclogix purchased certain assets of Logistics, essentially office equipment, for about $30,000. Logistics then paid that money to Sperbeck. On February 3, 2003, faced with a $1.5 million judgment and having transferred all its assets, Logistics filed a Chapter 7 bankruptcy petition. "Arclogix was like Logistics in almost every way." [i.e. same employees, same phone number, balance sheets were nearly identical (AR's were the same amounts as were the computer software assets)]. The Trustee brought a fraudulent transfer action against Arclogix and to substantively consolidate Logistics and Arclogix.

The court explained that "(s)ubstantive consolidation involving a nondebtor was at least tacitly approved by the Supreme Court in a 1941 case. In *Sampsell v. Imperial Paper and Color Corp.,* 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941), the Court affirmed a lower court order substantively consolidating a debtor corporation with a nondebtor corporation of which the debtor was the primary shareholder. The bankruptcy referee had concluded that the non-debtor corporation was 'nothing but a sham and a cloak? devised by [the debtor] for the purpose of

preserving and conserving his assets ... and that the corporation was formed for the purpose of hindering, delaying and defrauding his creditors.''

The court went on to explain that in its circuit, "bankruptcy courts (had) approved the application of substantive consolidation to non-debtors, often in cases in which the non-debtor is a subsidiary or alter ego of the debtor. *See, e.g., Gray v. O'Neill Props. Group, L.P. (In re Dehon, Inc.),* No. 02-41045, 2004 WL 2181669, at *3 (Bankr.D.Mass. Sept. 24, 2004) ("Large corporations, such as the Debtor, often use multi-tiered corporate structures, and substantive consolidation has been used to reach the assets and liabilities of a non-debtor subsidiary corporation."); *Murphy v. Stop & Go Shops, Inc. (In re Stop & Go of Am., Inc.),* 49 B.R. 743, 745 (Bankr.D.Mass.1985).

The bankruptcy court considered two different standards, in making its decision. The first test was a two-factor test:

1. Consolidation is permitted only if it is first established that the related debtors' assets and liabilities are so intertwined that it would be impossible, or financially prohibitive, to disentangle their affairs. The trustee may request consolidation to conserve for creditors the monies which otherwise would be expended in prolonged efforts to disentangle the related debtors' affairs; and
2. Balance the potential benefits of consolidation against any potential harm to interested parties.

The second test was a twelve-factor test:

"(1) common ownership; (2) pervasive control; (3) confused intermingling of business activity, assets, or management; (4) thin capitalization; (5) nonobservance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at the time of the litigated transaction; (9) siphoning away of corporate assets by the dominant shareholders; (10) nonfunctioning of officers and directors; (11) use of the corporation for transactions of the dominant shareholders; and (12) use of the corporation in promoting fraud."

Here, the district court affirmed the bankruptcy's court's decision to substantively consolidate the parties.

***In re Owens Corning*, 419 F.3d 195 (3rd Cir. 2005)**

After a 13-day evidentiary hearing, the District Court concluded that substantive consolidation was appropriate in anticipation of a Ch 11 plan. Credit Suisse First Boston ("CSFB") the agent for a syndicate of banks (collectively, the "Banks") that extended in 1997 a $2 billion unsecured loan to Owens Corning, a Delaware corporation ("OCD"), and certain of its subsidiaries, appealed. OCD was facing asbestos litigation claims and its credit was enhanced in part by guarantees made by other OCD subsidiaries. The Circuit court acknowledged the importance and reasonableness of substantive consolidation in the Circuit "to rectify the seldom-seen situations that call for this last-resort remedy" but it was imperative to use it carefully and sparingly, to avoid "a ploy to deprive one group of creditors of their rights while providing a windfall to other creditors."

"Substantive consolidation, a construct of federal common law, emanates from equity. It 'treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor.' *Genesis Health Ventures, Inc. v. Stapleton* (*In re Genesis Health Ventures, Inc.*), 402 F.3d 416, 423 (3d Cir.2005). Consolidation restructures (and thus revalues) rights of creditors and for certain creditors this may result in significantly less recovery."

"Rather than endorsing any prefixed factors, in *Nesbit* we 'adopt[ed] an intentionally open-ended, equitable inquiry. . . to determine when substantively to consolidate two entities." The 3rd Circuit test is as follows:

"In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity,19 or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors… Proponents of substantive consolidation have the burden of showing one or the other rationale for consolidation. The second rationale needs no explanation. The first, however, is more nuanced. A *prima facie* case for it typically exists when, based on the parties' prepetition dealings, a proponent proves corporate disregard creating contractual expectations of creditors21 that they were dealing with debtors as one indistinguishable entity. Proponents who are creditors must also show that, in their prepetition course of dealing, they actually and reasonably relied on debtors' supposed unity. Creditor opponents of consolidation can nonetheless defeat a *prima facie* showing under the first rationale if they can prove they are adversely affected and actually relied on debtors' separate existence."

Here, there was "no prepetition disregard of corporate separateness" OR "no hopeless commingling exists post-petition" AND other considerations were weighed: 1) trying to fix unfairness with special priorities given to various creditors does not comply with the Code; and 2) substantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve advantage over one group in the plan negotiation process.

***In re Amco Ins.*, 444 F.3d 690 (5th Cir. 2006)**

"The significance of this bankruptcy case relates to the *nunc pro tunc* substantive consolidation of the assets and liabilities of a corporation in bankruptcy and its sole shareholder, not in bankruptcy (until afterwards)." Here, the Circuit Court vacated the district court's order and remanded.

"Rehmat A. Peerbhai, an entrepreneur in the automobile industry, owned and managed AIG, a holding company in the automobile insurance business, prior to 1992. On April 21, 1992, Peerbhai incorporated a new company, AIA, which sells automobile insurance. A parent subsidiary relationship was formed between AIG, as parent, and AIA, as subsidiary, with Peerbhai acting as the sole owner of both companies." AIG, AIA, and Peerbhai all filed their own

bankruptcies. Prior to the bankruptcies, Peerbhai and AIG borrowed $2.4M from Wells Fargo, and AIG borrowed another $1.2M separately, with Peerbhai guarantying the AIG debt as well, all in approximately September 2000. By December 2001, the loans agreements with Wells Fargo were breached and by February 2002, AIG and AIA filed for Chapter 7.

In March 2002, Wells Fargo obtained relief from stay to pursue Peerbhai in state court, then reached an agreement with Peerbahi by April, to obtain a consensual lien against him homestead, in which he agreed he owed Wells Fargo more than $3,300,000.00.

In July 2002, the Trustee of the AIA filed a motion to substantively consolidate Peerbhai (not in bankruptcy) with AIA as a single debtor, and asked the court to do so *nun pro tunc* back to the date of the filing of AIA. Wells Fargo objected, rightfully so, after spending time and resources after the RFS was granted. Peerbhai filed a Ch 11, in response, which ultimately was converted to Ch 7. The Trustee argued that:

"Peerbhai and AIA were not separate legal entities, and that the finances of AIA and AIG were commingled by Peerbhai so that substantively consolidating all of Peerbhai's personal assets with the assets of AIA and AIG was the only way to ensure equitable distribution of the assets to the creditors of AIA and AIG."

The court found that Peerbhai made "no meaningful distinction between his funds and those of AIA" while AIA was a going concern, that "AIA's creditors dealt with Peerbhai and AIA as a single economic unit and did not rely on their separate identities in extending credit," that Peerbhai and AIA "did not observe the corporate formalities required by Texas law, and that Peerbhai treated AIA as an alter ego of himself, using the AIA corporate status to commit fraud against his and AIA's creditors."

Factors the court relied on, in granting substantive consolidation, here, were as follows:

1. Substantive consolidation would benefit all creditors, and not unfairly prejudice any creditor, because the financial affairs of AIA and Peerbhai were so entangled that the assets of each could not be segregated;
2. Substantive consolidation would avoid the harm of AIA's creditors receiving virtually nothing in a bankruptcy that was caused primarily by Peerbhai looting AIA;
3. Wells Fargo would not be unfairly harmed by substantive consolidation because of Wells Fargo's knowledge and the circumstances surrounding the execution of the Limited Forbearance Agreement, and further that any prejudice Wells Fargo may suffer from substantive consolidation is not unfair, and is substantially outweighed by the benefits to other creditors;
4. The fact that AIA and Peerbhai were essentially a single financial entity could not have been ignored by Wells Fargo or any other reasonably diligent party extending credit to Peerbhai; and
5. Substantive consolidation should be effective *nunc pro tunc* to the petition date of February 4, 2002, because at all relevant times, Peerbhai

The district court affirmed and the 5th Circuit reversed, holding that nun pro tunc application of the substantive consolidation was improper, unfairly would affect Wells Fargo who took action that the Trustee "consented" to, the Trustee should have acted sooner. The Circuit did not reach the question of whether the bankruptcy court had the right to grant substantive consolidation or what standard should be applied. Both issues were left for another day.

***Spradlin v. Beads & Steeds Inns, LLC (In re Howland)* (6th Cir. 2017)**

"This court has not adopted a test for evaluating a substantive consolidation claim…." but, here, the parties applied the 3rd Circuit's test. There appears to be no case in the 6th Circuit deciding that a specific test should be applied to cases in this Circuit.

***Huntington Nat'l Bank v. Richardson (In re Cyberco Holdings, Inc.),* 734 F.3d 432 (6th Cir. 2013)**

The BAP determined that the denials of a motion to substantively consolidate were not final appealable orders. The Sixth Circuit affirmed.

***In re Giller*, 962 F.2d 796 (8th Cir. 1992)**

Giller, the sole/majority shareholder of six separate corporations, filed a Chapter 11. The Trustee moved to consolidate the six corporations with the Giller's estate, which would avoid the need to bring multiple avoidance action and preserve resources for creditors. Only one creditor objected and the Circuit upheld the bankruptcy court.

The Court held the "(f)actors to consider when deciding whether substantive consolidation is appropriate include:

1. The necessity of consolidation due to the interrelationship among the debtors;
2. Whether the benefits of consolidation outweigh the harm to creditors; and
3. Prejudice resulting from not consolidating the debtors

***Official Comm. of Unsecured Creditors v. Archdiocese of Saint Paul and Minneapolis (In re Archdiocese of Saint Paul and Minneapolis),* 888 F.3d 944 (8th Cir. 2018)**

"The Committee, which represented more that 400 clergy sexual abuse claimants, appealed the district court's decision affirming the bankruptcy court's denial of the Committee's motion for substantive consolidation of debtor, the Archdiocese, and over 200 affiliated non-profit non-debtors ("Targeted Entities"). The Eighth Circuit held that the Targeted Entities were entitled to the protections under 11 U.S.C. 303(a), and could not be involuntarily substantively

consolidated with the Archdiocese. In this case, the Committee failed to plausibly allege sufficient facts to negate the non-profit non-debtor status of the Targeted Entities."

The Court "recognize(d) the bankruptcy court's authority to substantively consolidate debtor entities" under the *Giller* test which required the bankruptcy court to find:

1. That there was an "abuse of the corporate form;" and
2. The existence of "transfers among the debtors that could 'give rise to fraudulent conveyance and preference causes of action.'

"Given the facts in *Giller*, we found the equitable remedy of substantial consolidation to be the 'only hope' of recovery for the unsecured creditors." However, because 303(a) does not allow non-profits to be involuntary debtors, the District Court was affirmed here.

***In Re Raejean Bonham, dba World Plus*, 229 F.3d 750 (9th Cir. 2000)**

The 9th Circuit reversed the decision of the district court, remanding with instructions to affirm the bankruptcy court's order substantively consolidating two non-debtor corporations, World Plus, Inc. ("WPI") and Atlantic Pacific Funding Corporation ("APFC"), with the bankruptcy estate of Chapter 7 debtor, Raejean Bonham, nunc pro tunc as of the filing date of the involuntary Chapter 7 petition of Bonham.

This case involved a failed ponzi scheme operated by Bonham where funds were borrowed from hundreds of investors through WPI and APFC but used by Bonham personally and commingled among the three with no regard for where they originated. Bonham was the sole shareholder of WPI and APFC. By the time Bohnam's involuntary petition was filed, neither Bonham or either of the corporations had any assets so Bonham's Chapter 7 Trustee filed 600 adversary actions against Bonham's investors, who in turn, challenged the Trustee's standing to avoid transfers by WPI and APFC. The Trustee responded by filing a motion to substantively consolidate the three together. The bankruptcy court granted the motion and held that using a motion to consolidate was appropriate and WPI and APFC were "simply vehicles Bonham used to perpetrate the fraud."

Investors appealed to the district court which dismissed the appeal, holding that the consolidation order was not an appealable order. The investors next had to appeal to the Circuit who reversed and held that the consolidation order was appealable and affirmed the bankruptcy court's order consolidating the non-debtors with Bonham.

The Court discussed the "two broad themes" to consider in substantive consolidation motions:

1. Whether there is a disregard of corporate formalities AND commingling of assets by various entities; and
2. Balancing the benefits that substantive consolidation would bring after the harms that it would cause.

The Court then discussed the **D.C. Circuit test**[1] which was "a three-part burden-shifting test" as follows:

1. The proponent of substantive consolidation must first show that:
    a. "there is a substantial identity between the entities to be consolidated; and
    b. Consolidation is necessary to avoid some harm or to realize some benefit."
2. Once the above prime facie showing is made, "a presumption arises 'that creditors have not relied solely on the credit of one of the entities involved" shifting the burden to an objecting creditor to show that:
    a. It has relied on the separate credit of one of the entities to be consolidated; and
    b. It will be prejudiced by substantive consolidation."
3. If the objecting creditor makes the required showing above- "the court may order consolidation only if it determines that the benefits of consolidation 'heavily' outweigh the harm."

The Court then discussed the **Second Circuit test for substantive consolidation**[2], which required only a showing one of two factors:

1. "Whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending creditor; or
2. Whether the affairs of the debtor are so entangled that consolidation will benefit all creditors."

The first factor justifies substantive consolidation because lenders "structure their loans according their expectations regarding the borrower and do not anticipate either having the assets of a more sound company…or the creditors of a less sound debtor to compete…".

The second factor justifies substantive consolidation "only where 'the time and expense necessary even to attempt to unscramble them is so substantial as to threaten the realization of any net assets for all the creditors' or where no accurate identification and allocation of assets is possible."

Here, the Court adopted the 2nd Circuit test and found that under either factor, the bankruptcy court properly granted substantive consolidation of Bonham, WPI and APFC.

***Clark's Crystal Springs Ranch, LLC v. Gugino (In re Clark)* (9th Cir. 2017)**

In this case, the Court considered whether "the bankruptcy court err by entering a judgment to substantively consolidate the estate of Debtor with the LLC and its member Trust?" after the Supreme Court's decision in *Law v. Siegel*, 134 S. Ct. 1188 (2014).

Here, the Court found that *Law v Siegel*, did not do away with bankruptcy courts' right to order substantive consolidation. It reasoned that *Law v Siegel* may have held that "a bankruptcy court may not contravene specific statutory provisions" of the Bankruptcy Code, but ordering

[1] *In re Auto-Train Corp., Inc.,* 810 F.2d 270 (D.C. Cir. 1987).
[2] *In re Augie/Restivo Baking Co., Ltd.,* 860 F.2d 515 (2nd Cir. 1988).

"substantive consolidation…does not contravene specific provisions of the Bankruptcy Code. While the Code does not explicitly authorize substantive consolidation, neither does the Code forbid it. That there are other ways to bring non-debtors into a bankruptcy case also does not render substantive consolidation in conflict with express provisions of the Code. Bankruptcy courts retain equitable power to grant substantive consolidation notwithstanding Congress's amendment of the Code without codifying that power."

***Branch Banking & Tr. Co. v. Shapiro (In re R&S St. Rose Lenders, LLC)* (9th Cir. 2019)**

The Court held that the bankruptcy court did not err in denying substantive consolidation under the framework set forth in *In re Bonham*, and held that "substantive consolidation should be used 'sparingly and in keeping with [its] equitable nature."

Here, the bankruptcy court "*considered* all creditors" but ultimately focused on the "expectations" of the largest "value" creditor, rather than the largest "number" of creditors, to determine that the largest creditor, BB&T's predecessor, Colonial Bank, NA, dealt with the entities as "separate economic units" in extending credit.

***Allen v. Old Nat'l Bank of Wash. (In re Allen)*, 896 F.2d 416 (9th Cir.1990)**

The Court held that a Motion for Substantive Consolidation is an immediately appealable order because of the irreparable harm that can be done to parties involved.

***In re Pearlman*, 23 Fla. L. Weekly Fed. B 209, 55 Bankr.Ct.Dec. 275, 66 Collier Bankr.Cas.2d 1522, 462 B.R. 849 (Bankr. M.D. Fla. 2012)**

The Court considered whether to substantively consolidate eleven debtors (the "Debtors") with other Pearlman-related entities not in bankruptcy—the "Non–Debtors" when defendants of the Debtors' trustee's fraudulent conveyance proceedings, "arguing that the Debtors and Non–Debtors together consist of 'one intertwined enterprise,' and that substantive consolidation will reduce time and administrative costs associated with untangling their individual assets and liabilities."

In deciding not to allow substantive consolidation of the Debtor's with the Non-Debtors, the court held that "under § 105(a) of the Bankruptcy Code because (substantive consolidation) is not an act that is 'necessary or appropriate' to carry out any legitimate bankruptcy purpose," any such motion should fail.

The court reasoned that "parties have other tools, albeit accompanied by stringent and befitting proof requirements, to force a non-debtor entity into bankruptcy. Parties can file involuntary bankruptcy petitions if they can plead and meet all the requirements of § 303 of the Bankruptcy Code. Alternatively, they can rely on state law and the attendant legal theories of

alter ego and piercing the corporate veil. But, they cannot get the shortcut of relying on § 105 to substantively consolidate non-debtors."

VI. ADDITIONAL CASES ON RESTRICTED AND CONTINUING GUARANTOR LIABILITY AND THE CHAPTER 7 DISCHARGE

Dulles Elec. & Supply Corp. v. Shaffer (In re Shaffer), 585 B.R. 224 (Bankr. W.D. Va. 2018)

The Court held "as a matter of law that the debts to Dulles Electric that arose after the individual guarantors filed chapter 7 were not discharged in the individual guarantors' bankruptcy cases."

Here, the debtors did not list the vendor/Dulles Electric, the debt that the vendor sought to be excluded from the debtors' discharge was a debt incurred by their business, postpetition, which the Court found to be a continuing guaranty, "which means that the individuals guaranteed an unlimited series of transactions, each of which is a new debt" rather than a restricted guaranty. "The liability on the continuing guaranty…did not arise until (Debtor's non-filing corporation) made a purchase, which is an independent transaction and a new debt. The Court reasoned that if the debtors wanted to discharge the guaranteed debt at issue here, they should have "revoked" or "terminated" the guaranty with the vendor.

Orlandi v. Leavitt Family Ltd. P'ship (In re Orlandi), 612 B.R. 372 (B.A.P. 6th Cir. 2020)

The BAP considered whether the "bankruptcy court had jurisdiction to determine whether the debtor's personal guaranty of the original lease between the parties was reinstated under a renewed post-petition extension of the lease."

The Panel agreed with a "line of cases holding that a pre-petition personal guaranty is a contingent debt that is discharged in bankruptcy." The Court reasoned that "'debt' and 'claim' are defined in the Code as broadly as possible 'to enable the debtor to deal with all legal obligations in a bankruptcy case.'" And "(t)hese broad definitions are consistent with '[t]he principal purpose of the Bankruptcy Code [ ] to grant a 'fresh start' to the 'honest but unfortunate debtor.'"

In this case, the debtor listed the personal guaranty in his petition and received a discharge which seems to be a largely considered factor by most courts grappling with whether a guaranty debt like that in this case is discharged or not.

Reinhart FoodServ. v. Schlundt (E.D. Wis. 2022)

This appeal concerned "the application of (the discharge) to liabilities arising after the bankruptcy but based on the debtor's pre-bankruptcy promise to guarantee the obligations of a third party. " Here, the debtor did not list the vendor as a creditor in the bankruptcy. However,

"the bankruptcy court concluded it was bound by the Seventh Circuit's decision in *Saint Catherine Hospital of Indiana, LLC v. Indiana Family and Social Services Administration*, 800 F.3d 312 (7th Cir. 2015) to hold the debts in this case were discharged even though it is undisputed that the transactions that gave rise to the debts did not occur until four years after the debtor filed his joint bankruptcy petition."

***In re Getzoff, 180 B.R. 572* (B.A.P. 9th Cir. 1995)**

The bankruptcy court held that "a guaranty executed postpetition was invalid under Section 524 of the Bankruptcy Code because it was based on a discharged debt." The creditor appealed from the summary judgment entered against it and the BAP affirmed.

***Umpqua Bank v. Burke (In re Burke)* (B.A.P. 9th Cir. 2019)**

"In 2017, Ms. Burke/("Debtor") sold her home. But, as a result of error, Umpqua/("Creditor") submitted a demand into escrow that was approximately $250,000 too low." When the sale closed, Creditor got a smaller payment than it should have, and Debtor "received a substantially enhanced payment"—at Creditor's expense.

The BAP held that because "the demand bound Umpqua as a matter of California law, Umpqua's trust deed was reconveyed. And because of (Debtor's) bankruptcy discharge, it (could not) sue (Debtor) on the guaranty." The only issue before the BPA was whether Debtor's "2009 bankruptcy discharge bars Umpqua from bringing an unjust enrichment action." The bankruptcy court concluded that any claims by Umpqua against Debtor were discharged; the BAP reversed.

Thought the Court acknowledged that "the Bankruptcy Code broadly defines 'claim' and may allow for discharge of litigation claims even if not yet ripe for adjudication" at the time of the bankruptcy;" and "Umpqua's guaranty claim was discharged, it retained an *in rem* claim that survived discharge and allowed recovery from proceeds (from the Debtor's home securing its debt), but its erroneous demand into escrow extinguished its ability to obtain recovery on account of its *in rem* rights." However, because a "California unjust enrichment claim does not arise under a contract" and it is a common law cause of action, Creditor's claim "arose postpetition because it was not fairly contemplated on a prepetition basis." One of panelists dissented.

***Thompson Tractor Co. v. Schleicher (In re Schleicher)* (Bankr. N.D. Ala. 2018)**

The Debtor filed a Chapter 7 on October 10, 2016, and received a discharge. The guaranty between Debtor and Creditor was executed pre-petition, but the credit advances were made to the principal obligor/("Debtor's corporation"/"Dixie") post-petition. Debtor listed a debt to Creditor of approximately $138,000 and no issue arose as to this debt being discharged. However, after filing, Dixie, through Debtor, sought approximately $86,000 of more credit from

Creditor which it extended. Debtor argued "Dixie's post-petition debts were contingent and unliquidated claims under the Guaranty, and thus subject to discharge." The Court disagreed and held that the post-petition debts were "not claims at all—not contingent, unliquidated, or any other kind of claim." The court further held "there was nothing contingent or unliquidated" about the post-petition debts that did not exist at the time of filing, especially where the creditor had "no obligation to extend further credit and the borrower has no obligation to request and accept further extensions of credit." Instead, the Court found the Debtor's guaranty to be a continuing guaranty that had to be specifically revoked to discharge any liability arising from post-petition credit that the Debtor sought from the Creditor for the Debtor's non-filing corporation.

VII. OTHER MISCELLANSOUS ISSUES TO CONSIDER WHEN REPRESENTING INDIVIDUALS WITH BUSINESSES

***In re Long*, BAP No. MT-08-1165-DMoPa (B.A.P. 9th Cir. (B.A.P. 9th Cir. 2009)**

"Beginning sometime in 2003, Mr. Long/"Debtor" became AboutMontana's/(the "Corp's) controlling shareholder." The Corp created a "Business Plan" and borrowed $100,000 from MW Bank/"Creditor" in 2004 to implement same which was secured against all of its assets. The Business Plan failed and Montana Sky bought the Corp's assets for approximately $141,000 in 2005. Debtor did not tell Creditor of the sale and did not pay over any of the sale proceeds to the Creditor pursuant to its lien rights. Debtor testified in the bankruptcy:

1. The Corp continued on in existence and tried to different business models, however, it was clear from the evidence that it did not generate any income after the sale; and
2. The Corp used the funds from the sale to service its debts until the Corp ultimately closed, however, it was clear from the evidence that Debtor used the majority of the funds for his personal use.

Debtor filed for bankruptcy in 2007 after Creditor obtained a judgment against Corp and Creditor was in the process of pursuing Debtor on his personal guaranty.

Creditor filed an adversary against Debtor pursuant to § 523(a)(4) and (a)(6) as well as § 727(a)(3) and (a)(4)(A). The bankruptcy court's concluded that Creditor did not meet its burden of proof to prevail on any its claims. The BAP agreed with the bankruptcy court as to its ruling on § 523(a)(4) and § 727(a)(3) and (a)(4)(A) claims. However, the BAP reversed as to § 523(a)(4). The reasoned that Debtor's "fruitless efforts to start a new business were not the same as a good faith effort to keep his business going within the meaning of *Transamerica Comm'l Fin. Corp. v. Littleton (In re Littleton)*, 942 F.2d 551 (9th Cir. 1991), when he sold the principal assets of his corporation, failed to disclose the sale and remit the sale proceeds to the creditor with a security interest in those assets, and appropriated a substantial portion of those sale proceeds for his personal use." Therefore, the BAP reversed the bankruptcy court's judgment in favor of Debtor on the § 523(a)(6) cause of action.

This case serves as a very good example that it is important to "look under the hood" of an individual debtor's case and circumstances (including their closed business' books and records), before filing, to determine if there are going to be issues pursuant to 523 and 727, based on actions they took as the principal in control of business' assets and liabilities, that can be rectified/addressed before filing their individual bankruptcy.

In re Boyajian, 564 F.3d 1088 (9th Cir. 2009)

Individual debtors (sisters/"Debtors") each filed their own Chapter 7 bankruptcy, after they entered into leases with Epic Leases/("Epic") on behalf of their corporation, "Blue Diamond." The Debtors, as the principals of Blue Diamond provided financial statements for Blue Diamond to Epic and each guaranteed the debt, and after Blue Diamond ultimately failed. The debt owing to Epic was assigned multiple times to various companies and ultimately ended up with New Falls/"Creditor" just before Debtors filed their bankruptcies. Creditor filed an adversary against the Debtors pursuant to 523(a)(2)(B).

"The bankruptcy court determined as a matter of law that in order for an assignee creditor to prevail in an exception to discharge adversary proceeding brought pursuant to § 523(a)(2)(B), the assignee creditor must have reasonably relied on the materially false financial statement provided by the debtor." The BAP reversed and the 9th Circuit affirmed the BAP.

Again, this case is an example of why it is imperative to obtain documents and information relating to a debtor's open **and** closed business to determine if there are nondischargeability issues underlying in actions the debtor took in their capacity as a business owner, and further, that "debt buyers" still hold the same rights the original creditor held when giving the initial credit…at least in the 9th and 6th Circuits.

Also, see attached ABI Article regarding "Secret Creditor" issues arising in "business cases.

AN EXAMPLE OF "OUTSIDE OF THE BOX" ANSWERS TO BUSINESS DEBTS ARISING FROM THE RESULTS OF THE PANDEMIC:

***Melendez v. City of N.Y.*, 16 F.4th 992 (2nd Cir. 2021)**

After the COVID-19 pandemic, the New York City Council passed the "Personal Liability Provisions in Commercial Leases" law, commonly referred to as the "Guaranty Law," which took effect on May 26, 2020. *See* N.Y.C. Admin. Code § 22-1005. The Guaranty Law permanently rendered, unenforceable, "personal liability guaranties on certain commercial leases for any rent obligations arising during a specified pandemic period." The Guaranty Law pertained to "leases held by commercial tenants who were required to cease or limit operations under Executive Orders…As to those leases, the law applies retroactively to rent arrears dating from March 7, 2020, as well as prospectively through June 30, 2021, without regard to the financial circumstances of the tenant, the guarantor, or the landlord. In sum, for rent arrears arising during that almost sixteen-month period, the Guaranty Law does not simply defer a

landlord's ability to enforce a personal guaranty" as did many cities and state and counties legislate, "it forever extinguishes" the liability.

"Plaintiffs appealed the dismissal of their Contracts Clause challenge to the Guaranty Law, arguing that the district court misapplied that constitutional protection in concluding that they failed to state a plausible claim."

The Court discussed why there are lots of . However, it held that when it viewed "all factual allegations and draw all reasonable inference in favor of plaintiffs," it agreed that the Plaintiffs' claims could not be dismissed as a matter of law under Rule 12(b)(6). The Court reasoned that in "granting dismissal, the district court applied a three-part balancing test derived from the Supreme Court's recent Contracts Clause jurisprudence:

"At the first step, the district court concluded that the challenged law did substantially impair plaintiffs' commercial leases. Nevertheless, at the second step, it concluded that the impairment served a significant and legitimate public purpose and, at the third step, that the challenged law was appropriate and reasonable to advance that purpose." The appellate court held that it was bound by the same precedent, but we did "not reach the same conclusion at the last step."

Instead, the Court, here, held that the "Plaintiffs state(d) a plausible Contracts Clause challenge to (the Guaranty Law)." Reviewing that claim by reference to "balancing principles identified in the Supreme Court's most recent Contracts Clause jurisprudence, this Court conclude(d) that:

a. the challenged Guaranty Law significantly impairs personal guaranty agreements;
b. the record thus far demonstrate(d) a plausible significant public purpose for the impairment; **but**
c. the same record raise(d) at least five serious concerns about that law being a reasonable and appropriate means to pursue the professed public purpose, and, thus, that determination cannot now be made in favor of defendants as a matter of law.

This case teaches us, as bankruptcy practitioners, that drastic times often require drastic measures and that there may be laws outside the confines of the Bankruptcy Code that may assist our clients with debt issues they are facing.

"When a Business Owner Files Chapter 7"
April 22, 2023 at 8:30 a.m.

I. DEFINING PROPERTY OF THE ESTATE

A. The Code's Definition of "Property of the Estate"

Section 541(a) defines "property of the estate" as "all legal or equitable interest of the debtor in property as of the commencement of the case." Section 541(c)(1) further provides:

> Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement transfer instrument, or applicable nonbankruptcy law—
>
> (A) that restricts or conditions transfer of such interest by the debtor; or
>
> (B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

B. Section 541 Preempts State Law Termination of Membership Interests

Courts have consistently held that 11 U.S.C. § 541(c) preempts any provision in state law or within specific operating agreements that purports to terminate a member's interest in a business entity upon bankruptcy or that otherwise restricts the transfer of a debtor's interest to the trustee.

> *In re All Year Holdings Ltd.,* 2022 WL 17584254, at *17 (S.D.N.Y. Dec. 12, 2022) (Chapter 11) (finding that "Section 541(c) squarely precludes" termination of membership interest due to bankruptcy filing)
>
> *In re William H. Thomas, Jr.*, 2020 WL 2569993, at *9 (Bankr. W.D. Tenn. May 8, 2020) (Chapter 11) ("[U]pon the filing of the Debtor's bankruptcy petition, his membership interest in [the LLC] became property of his bankruptcy estate notwithstanding the attempt by [Tennessee state law] to prevent that result.")
>
> *In re Minton*, 2017 WL 354319, at *6 (Bankr. C.D. Ill. Jan. 24, 2017) ("Under [541], a debtor's interest in an LLC becomes property of the estate even though some provision of the operating agreement or nonbankruptcy law would otherwise prevent the transfer.")
>
> *In re Prebul*, 2012 WL 5997927, at *10-11 (E.D. Tenn. Nov. 30, 2012) (finding that applicable NY state law "was rendered inapplicable here because it would modify or terminate" the debtor's interest in an LLC, and that section 541 "renders inapplicable termination or modification of an interest solely due to a debtor's bankruptcy.")

In re Klingerman, 388 B.R. 677 (Bankr. E.D. N.C. 2008) (Chapter 11) ("Section 541(c) provides that all of the debtor's interest passes to the estate notwithstanding applicable nonbankruptcy law that effects a modification or termination of the debtor's interest upon the commencement of a bankruptcy case.")

But see Northwest Wholesale, Inc. V. PAC Organic Fruit, LLC, 357 F.3d 650 (Wash. 2015) (Supreme Court of Washington holding that the Bankruptcy Code did not preempt state law, and that bankruptcy filing would restrict trustee's interest to that of an assignee)

C. Trustee's Rights to Non-Economic Interests in Business Entity

Similarly, courts have generally recognized that the trustee acquires the non-economic rights and interests (e.g., voting rights, dissolution rights, etc.) associated with debtor's membership interest in a business entity. Notably, this is true regardless of whether or not the operating or partnership agreement governing the entity is determined to be executory in nature.

In re William H. Thomas, Jr., 2020 WL 2569993, at *9 (Bankr. W.D. Tenn. May 8, 2020) (collecting cases) (Chapter 11) ("The Debtor's membership interest included both financial rights and governance rights. Upon the appointment of the Trustee, the right to exercise the governance rights for the benefit of the estate passed to the Trustee.")

In re Altman, 2018 WL 3133164, at *5 (B.A.P. 9th Cir. June 26, 2018) (Chapter 11) (collecting cases and recognizing that "membership in a limited liability company may confer both economic and non-economic rights and that both fall within the § 541(a)'s definition of estate property")

In re First Prot., Inc., 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010) ("We conclude that all of the Debtors' contractual rights and interest in [the LLC] became property of the estate under § 541(a) by operation of law when they filed their petition.")

In re Antonelli, 4 F.3d 984 (4th Cir.1993) (Chapter 7 converted to Chapter 11) ("When bankruptcy proceedings commenced, Antonelli's general partnership interests became the property of the Debtor's bankruptcy estate. Both the economic interest in the partnerships and the right to participation in the management of the partnerships' affairs vested in the estate.")

In re Tarkanian, 562 B.R. 424, 455 (Bankr. D. Nev. 2014) ("If the member files a Chapter 7 petition, both the member's economic and non-economic interests become property of the bankruptcy estate, and the bankruptcy trustee may exercise the management rights, if any, that the debtor has in the limited liability company.")

In re Lee, 524 B.R. 798, 804 (Bankr. S.D. Ind. 2014), *aff'd sub nom. Lee Grp. Holding Co., LLC v. Walro*, 2015 WL 4724944 (S.D. Ind. Aug. 10, 2015) ("Based on these authorities,

Indiana law and the clear terms of the Operating Agreement, the Court concludes that Debtor's voting rights in the Lee Group were property of the estate as of the Petition Date.")

In re Jundanian, 2012 WL 1098544, at *6 (Bankr. D. Md. Mar. 30, 2012) (Chapter 11) ("The Court concludes that the Voting and Management Rights became property of the estate upon the filing of the petition.")

In re Warner, 480 B.R. 641, 653 (Bankr. N.D.W. Va. 2012) ("The court finds that these and similar voting rights—non-economic contractual rights—are property of the Debtor's estate under § 541(a)(1).")

In re Liber, 2012 WL 1835164, at *2 (Bankr. N.D. Ohio May 18, 2012) ("[I]n a Chapter 7 case, where a debtor owns an interest in a business entity, the trustee is entitled to administer that interest—as well as any rights derived from that interest—in the stead of the debtor.")

But see In re Marchese, 2018 WL 3472823, at *16 (Bankr. E.D. Pa. July 16, 2018) ("It is not settled whether a bankruptcy trustee can succeed to the managerial rights of an individual debtor who is an LLC member.")

D. Trustee Does Not Acquire Interest in Underlying Assets of Business Entity

Although there is a consensus that the bankruptcy estate acquires the economic rights of the membership interest, the business entity's underlying assets nonetheless remain with the entity.

In re Chatha, 2022 WL 4101292, at *5 (Bankr. E.D. Cal. Sept. 6, 2022) (distinguishing between trustee's ownership interest in LLC and assets of LLC)

In re Johnson, 2021 WL 5496731, at *4 (Bankr. E.D. Va. Nov. 22, 2021) (refusing to compel sale of LLC property pursuant to 363(h) because debtors "did not have a direct interest" in the property but rather "membership interests in [the LLC], which were owned by them individually")

In re Hess, 618 B.R. 13, 17 (Bankr. D.N.M. 2020) (residential property owned by LLC not included in property of the estate)

In re McCauley, 549 B.R. 400, 410 (Bankr. D. Utah 2016) ("Under Utah law, a member of an LLC has no interest in specific property of the company.")

Manson v. Friedberg, 2013 WL 2896971, at *3 (S.D.N.Y. June 13, 2013) ("Whatever legal or equitable interest an individual has in an LLC is personal property within the meaning of the bankruptcy estate under § 541. But property of the LLC is not property of individual members and members of an LLC have no interest in the specific property of the LLC.")

In re Rodio, 257 B.R. 699 (Bankr. D. Conn. 2001) (Chapter 13) (holding that property of LLC in which Debtor is a member is not property of Debtor's estate)

II. SALE OF DEBTOR'S MEMBERSHIP INTEREST

A. Trustee's Sale of Equity in Single-Member Business Entity

If the debtor possesses complete ownership in a business entity, and there are no other members, the courts generally recognize that a trustee succeeds to all of the debtor's rights, including control of the business entity, as well as the right to sell the entity's assets.

> *In re Morreale,* 595 B.R. 409, 417 (10th Cir. BAP 2019), *aff'd*, 959 F.3d 1002 (10th Cir. 2020) (explaining that where Chapter 7 trustee succeeded to interest in LLC, the trustee also obtains the right to "control and manage the LLC and its assets")
>
> *In re Blair Oil Invs., LLC*, 588 B.R. 579, 595 (Bankr. D. Colo. 2018) ("[A] Chapter 7 debtor's membership interests in a Chapter 11 limited liability company pass to the Chapter 7 bankruptcy estate. At that point, a Chapter 7 trustee, acting as the sole member of a Chapter 11 limited liability company, may control all governance of a Chapter 11 limited liability company.")
>
> *In re Cleveland*, 519 B.R. 304, 306 (D. Nev. 2014) ("[W]here a debtor has a membership interest in a single-member LLC . . . the Chapter 7 trustee succeeds to all of the debtor's rights, including the right to control that entity, and a trustee need not take any further action to comply with state law before exercising such control.")
>
> *In re Wallace*, 2013 WL 1681780, at *3 (Bankr. D. Idaho Apr. 17, 2013) ("[W]hen debtor is the sole member of an LLC, all of the debtor's rights in the LLCs become property of the estate, including both economic and management rights.")
>
> *In re B & M Land & Livestock, LLC*, 498 B.R. 262, 267 (Bankr. D. Nev. 2013) ("This Court concludes that, where a debtor has a membership interest in a single-member LLC and files a petition for bankruptcy under Chapter 7, the Chapter 7 trustee's rights automatically include the right to manage that entity.")
>
> *In re Albright*, 291 B.R. 538, 540 (Bankr. D. Colorado, 2003) ("Because there are no other members in the LLC, no written unanimous approval of the transfer was necessary. Consequently, the Debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the Trustee obtained all her rights, including the right to control the management of the LLC.")
>
> *In re First Prot., Inc*., 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010) (finding trustee "stepped into Debtors' shoes, succeeding to all of their rights, including the right to control [LLC].")

B. Effect of the Automatic Stay on Single-Member and Multi-Member Business Entities

As a general matter, the courts will not allow other members of a business entity to terminate or interfere with the debtor's post-petition membership or voting rights in the business entity.

Because the debtor's membership in the business entity is part of the estate, any governance or membership changes that affect that interest may violate the automatic stay. Similarly, certain courts have held that the automatic stay extends to a business entity of which the debtor is the sole member.

> *In re Bello,* 612 B.R. 389, 391 (Bankr. E.D. Mich. 2020) (Chapter 11) (collecting cases) ("[W]hen a bankruptcy debtor owns a 100%, or the majority, interest in a corporation, it is a violation of the automatic stay for a creditor to file a motion seeking the appointment of a receiver of the corporation in a non-bankruptcy case.")
>
> *In re Qarni*, 2019 WL 6817106, at *3-5 (Bankr. E.D. Cal. Dec. 11, 2019) (Chapter 13) (holding that creditor's filing of a lawsuit against corporation for appointment of receiver violated automatic stay where debtor was sole shareholder and possessed contractual right, based on corporate bylaws, to control the activities of the corporation as receivership would alter debtor's right to control)
>
> *In re Altman,* 2018 WL 3133164, at *6 (B.A.P. 9th Cir. June 26, 2018) (Chapter 11) ("[U]nder the Operating Agreement, [debtor] had the prepetition contractual right to manage [LLC]. The bankruptcy court correctly found that this non-economic contractual right to manage [the LLC] was property of [the debtor's] estate under § 541(a)(1) and therefore protected by the automatic stay.")
>
> *In re McCabe*, 345 B.R. 1, 7 (D. Mass. 2006) (holding that non-debtor member's post-petition amendments to LLC agreement reallocating debtor's membership interest violated automatic stay)
>
> *Matter of Daugherty Const., Inc*., 188 B.R. 607, 615 (Bankr. D. Neb. 1995) (Chapter 11) (finding "pospetition acts of other LLC members seeking to terminate or modify the debtor's interests," including by voting to continue LLC business, removing LLC manager, and by adding new members, all violated automatic stay)
>
> *See also In re Jorgensen,* 2011 WL 6000871, at *5 (Bankr. D. Wyo. Nov. 30, 2011) (holding that collateral securing promissory note was an asset of multi-member LLC and creditor suit for default did not violate automatic stay)
>
> *But see In re McCormick*, 381 B.R. 594, 602 (Bankr. S.D.N.Y. 2008) (Chapter 13) (refusing to expand automatic stay to wholly-owned LLC through which debtor carried out general contracting business (chapter 13 case))

C. Validity of Restrictions on Trustee's Membership Interests

In contrast to section 541's preemption of state law and operating agreements purporting to limit the property of the estate, a business entity's operating agreement (and applicable state law) may validly restrict the trustee's ability to sell the estate's interest in the business entity once the trustee succeeds to that interest.

Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1663 (2019) (holding that with respect to contract rights "Section 365 reflects a general bankruptcy rule: The estate cannot possess anything more than the debtor itself did outside bankruptcy")

In re Kramer, 2022 WL 17176411, at *8 (B.A.P. 10th Cir. Nov. 23, 2022) (upholding operating agreement's transfer restrictions on LLC interests and enforcing restrictions with respect to Trustee's proposed sale of capital interests)

In re Chatha, 2022 WL 4101292, at *10 (Bankr. E.D. Cal. Sept. 6, 2022) (concluding that under Texas law and restrictions in the operating agreements the court could "not authorize the chapter 7 trustee to use his 100% interest in [the LLC], and his status as the Manager and sole member of [the LL], to transfer the Hotel to the bankruptcy estate for the purpose of selling the Hotel under 11 U.S.C. § 363")

In re Ogletree, 2020 WL 6557434, at *4 (B.A.P. 9th Cir. Nov. 4, 2020) (Chapter 13) ("[T]he rights to which the trustee succeeds are defined and limited by the LLC's operating agreement.")

In re Minton, 2017 WL 354319, at *6 (Bankr. C.D. Ill. Jan. 24, 2017) ("Section 541(c)(1) [] does not provide authority for the Trustee to sell the estate's interest in [the LLC] free of the constraints of the Operating Agreement . . . [S]ale restrictions in LLC operating agreements are generally enforced in bankruptcy where they do not significantly impair a trustee's ability to obtain the fair market value of the estate's interest in the LLC.")

In re Garbinski, 465 B.R. 423, 426 (Bankr. W.D. Pa. 2012) (noting that an operating agreement "might contain provisions that would prevent the trustee from transferring an interest in the entity")

In re Liber, 2012 WL 1835164, at *3 (Bankr. N.D. Ohio May 18, 2012) (finding pension fund possessed superior claim to sales proceeds and noting that "Trustee, while stepping into the Debtor's shoes insofar as it concerns the Debtor's membership interest in [LLC], takes that interest subject to any applicable legal limitations imposed on that interest.")

In re Crossman, 259 B.R. 301, 307 (Bankr. N.D. Ill. 2001) (finding that trustee could not sell or assign debtor's right to future payments under settlement agreement)

See also In re IT Grp., Inc., Co., 302 B.R. 483 (D. Del. 2003) (right of first refusal under LLC operating agreement held enforceable (chapter 11 case))

III. TRUSTEE'S LIQUIDATION OF A BUSINESS ENTITY

A. Trustee's Liquidation of One-Member Business Entity

As with a trustee's right to sell a membership interest, where a debtor is the sole member of a business entity, the courts recognize that a trustee succeeds to all of the debtor's rights, including the right to wind down or dissolve the business entity.

> *In re Johnson*, 2021 WL 5496731, at *6 (Bankr. E.D. Va. Nov. 22, 2021) (refusing to dismiss trustee's claim for dissolution and noting that "the Trustee is not without rights" both "economic and non-economic")
>
> *In re Dzierzawski*, 528 B.R. 397, 410 (Bankr. E.D. Mich. 2015) (collecting cases) (noting as "correct" the parties' assumption that trustee could exercise debtor's 100% management rights in order to make distributions, sell assets, or "cause the LLC to dissolve, wind down, and thereby liquidate under Michigan law")
>
> *In re Klingerman*, 388 B.R. 677, 679 (Bankr. E.D.N.C. 2008) (Chapter 11) ("[Debtor's rights and interest in the LLC, economic and non-economic, became property of the estate upon the filing of his petition. As a member of the LLC, the estate has standing to ask for dissolution of ExecuCorp.")
>
> *In re Albright*, 291 B.R. 538, 539 (Bankr. D. Colo. 2003) (finding trustee could use 100% interest as manager and sole member of debtor's entity to sell entity's property and distribute net proceeds or distribute entity's property to the estate and liquidate the property)

B. Trustee's Liquidation of Multi-Member Business Entity

Where the debtor is one of several members in a business entity, the trustee's ability to liquidate the entity may be dependent on other factors, including specific corporate governance rights, whether the operating agreement is deemed an executory contract and, if so, whether it was assumed or rejected.

> *Sullivan v. Mathew*, 2015 WL 1509794, at *8 (N.D. Ill. Mar. 30, 2015) ("By failing to assume the partnership agreement, Sullivan rejected the contract and cannot now enforce it. The relief [the trustee] seeks in his complaint—dissolution pursuant to the partnership agreement, judicial supervision of winding up, and an accounting to ensure that the partnership was properly dissolved and wound-up—are based on the management rights included in the agreement that he rejected.")
>
> *In re Ogletree*, 2020 WL 6557434, at *4 (B.A.P. 9th Cir. Nov. 4, 2020) (Chapter 13) ("A chapter 7 trustee would step into [the debtor's] shoes and assume only the rights she had under the operating agreement. Because [the creditor] failed to present the court with the LLC's operating agreement, there was no factual basis for her argument that a chapter 7 trustee . . . could have liquidated the [LLC property]"

In re Tsiaoushis, 383 B.R. 616, 618 (Bankr. E.D. Va. 2007), *aff'd*, 2007 WL 2156162 (E.D. Va. July 19, 2007) (Chapter 11) (finding that because operating agreement was not an executory contract, § 365 was "not applicable" and provisions providing for dissolution of LLC and liquidation of company property were "fully enforceable")

In re Garbinski, 465 B.R. 423, 427 (Bankr. W.D. Pa. 2012 (recognizing that in the absence of operating agreements the trustee could "exercise rights as a partner/member seeking to obtain a judicial dissolution and winding up of the entities by invoking state law remedies involving dissolution or liquidation of LLC or limited partnership entities")

IV. OPERATING AGREEMENTS AS EXECUTORY CONTRACTS

A. Courts Apply the Countryman Test to Operating Agreements

Generally, courts will evaluate an operating agreement using the *Countryman* standard *i.e.* whether both parties to the contract have unperformed obligations that would constitute a material breach if not performed. To make this determination, the courts will carefully review the agreement's text and analyze the particular circumstances.

Operating Agreement Deemed Executory Contract

In re Woodfield, 602 B.R. 747, 760–61 (Bankr. D. Or. 2019) (Chapter 11) ("Given the particular facts of this case, I hold that a breach of any of the ongoing obligations in the Operating Agreements would be material, thus making the agreements executory contracts for purposes of § 365.")

In re Allentown Ambassadors, Inc., 361 B.R. 422, 444 (Bankr. E.D. Pa. 2007) (Chapter 11) ("I conclude that the Operating Agreement is an executory contract. I find that the members of the NAB, LLC had ongoing, material, unperformed obligations to one another and the LLC as of the commencement of this bankruptcy case. These obligations included: (1) the duty to manage the [LLC] and (2) the duty to make additional cash contributions if needed by the LLC.")

Matter of Daugherty Const., Inc., 188 B.R. 607, 611 (Bankr. D. Neb. 1995) (Chapter 11) ("[T]he LLC Articles of Organization and the Operating Agreement among the LLC members (together the "LLC Articles and Agreements") constitute, on the facts of this case, executory contracts which the debtor may attempt to assume under section 365….")

In re Ichiban, Inc., 2014 WL 2937088, at *4 (Bankr. E.D. Va. June 30, 2014) ("The operating agreement is an executory contract and the right of first refusal, if it did not expire earlier, was rejected by the trustee's failure to assume it on July 2, 2006.")

In re DeLuca, 194 B.R. 65, 77 (Bankr. E.D. Va.1996) (Chapter 11) (LLC operating agreement was an executory contract where the "object of the agreement—the

development of the Parc City Center project—has not yet been accomplished and the parties have on-going duties and responsibilities")

Operating Agreement Not an Executory Contract

In re Duncan, 2023 WL 2229349, at *7 (Bankr. D. Idaho Feb. 24, 2023) ("None of these rights [first refusal and tax gross up], however, are performance obligations that transform the Agreement into an executory contract under the Countryman definition and the existing case law.")

In re All Year Holdings Ltd., 645 B.R. 10, 36 n.23 (Bankr. S.D.N.Y. 2022), *aff'd*, 2022 WL 17584254 (S.D.N.Y. Dec. 12, 2022) (Chapter 11) ("With only one member to the LLC Agreement here, the contract is not executory.")

In re Yow, 590 B.R. 696, 701 (Bankr. E.D.N.C. 2018) (operating agreements not executory where only ongoing responsibility was to conduct and attend annual meeting and agreements did not "otherwise obligate the members to perform any managerial duties" nor did they "delineate or specify any required action or outstanding material obligations")

In re Minton, 2017 WL 354319, at *5 (Bankr. C.D. Ill. Jan. 24, 2017) ("The Debtor was not in a managerial role in BMA Ventures, and whatever other obligations he may have had are not material. The Operating Agreement is therefore not an executory contract that could be assumed or rejected pursuant to § 365.")

In re Cap. Acquisitions & Mgmt. Corp., 341 B.R. 632, 636–37 (Bankr. N.D. Ill. 2006) (Chapter 11) ("Having reviewed the specific operating agreement at issue in this case, and finding neither current obligations nor any role, let alone an important one, for CAMCO in the management of the LLC, the court concludes that the Operating Agreement is not an executory contract and cannot be assumed, assigned or rejected.")

In re Ehmann, 319 B.R. 200, 205 (Bankr. D. Ariz. 2005) ("In the absence of any obligation on the part of the member, it is difficult to see where an executory contract lies.")

In re Richardson Miles Hanckel, III, 2015 WL 7251714, at *5 (D.S.C. Mar. 10, 2015) ("Like the Bankruptcy Court, this Court finds that the Operating Agreement is not an executory contract.")

In re Garrison-Ashburn, L.C., 253 B.R. 700, 708 (Bankr. E.D. Va. 2000) (Chapter 11) ("In this case, the Operating Agreement merely provides the structure for the management of the company. It imposes no additional duties or responsibilities on the members.")

In re Knowles, 2013 WL 152434, at *3 (Bankr. M.D. Fla. Jan. 15, 2013) ("The Court, after reviewing the Operating Agreement and considering the undisputed evidence as to the Debtors' limited roles in the management of the LLC and the actual operations of the LLC, easily finds the agreement is not executory.")

In re Warner, 480 B.R. 641, 652 (Bankr. N.D.W. Va. 2012) (operating agreement of LLC was not executory because "there are no material unperformed and continuing obligations owed by the Debtor")

In re Denman, 513 B.R. 720, 725 (Bankr. W.D. Tenn. 2014) (Chapter 13) ("Based on the foregoing, the court finds here that Tennessee LLC operating agreements are not per se executory contracts governed by § 365 of the Bankruptcy Code because of their unique elements and features under state law that are inconsistent with contract law.").

In re Hanckel, 512 B.R. 539, 548 (Bankr. D.S.C. 2014) (concluding that the operating agreement is not an executory contract.")

In re Smith, 185 B.R. 285, 293 n.10 (Bankr. S.D. Ill. 1995) (collecting cases)

B. Effect of Executory Contract Determination on a Trustee's Non-Economic Rights

Courts have analyzed the impact of whether or not an operating agreement is executory on governance rights in various ways.

In re Yow, 590 B.R. 696, 706 (Bankr. E.D.N.C. 2018) (finding operating agreements were non-executory and permitting sale of "bare economic interests" while noting that trustee had "not requested authority to sell or otherwise convey the non-economic interests.")

In re Minton, 2017 WL 354319, at *3 (Bankr. C.D. Ill. Jan. 24, 2017) (distinguishing between management and property rights for purposes of rejecting an operating agreement)

Sullivan v. Mathew, 2015 WL 1509794, at *8 (N.D. Ill. Mar. 30, 2015) ("[Trustee] rejected the contract and cannot now enforce it. The relief [the trustee] seeks in his complaint [corporate dissolution] . . . [is] based on the management rights included in the agreement that he rejected.")

In re Garbinski, 465 B.R. 423, 426 (Bankr. W.D. Pa. 2012) ("[I]f an operating agreement is found to be an executory contract, Section 365(c) permits a non-debtor party to enforce specific transfer restrictions contained in it against the trustee. For instance, the agreement might contain provisions that would prevent the trustee from transferring an interest in the entity." Further, the Court recognized that in the absence of operating agreements the trustee could "exercise rights as a partner/member seeking to obtain a judicial dissolution and winding up of the entities by invoking state law remedies involving dissolution or liquidation of LLC or limited partnership entities.")

In re Ehmann, 319 B.R. 200, 206 (Bankr. D. Ariz. 2005) ("Because there are no obligations imposed on members that bear on the rights the Trustee seeks to assert here, the Trustee's rights are not controlled by the law of executory contracts and Bankruptcy Code § 365. Consequently the Trustee's rights are controlled by the more general provision governing property of the estate, which is Bankruptcy Code § 541.")

In re Tsiaoushis, 383 B.R. 616, 618 (Bankr. E.D. Va. 2007), *aff'd*, 2007 WL 2156162 (E.D. Va. July 19, 2007) (Chapter 11) (finding that because operating agreement was not an executory contract, § 365 was "not applicable" and provisions providing for dissolution of LLC and liquidation of company property were "fully enforceable")

In re DeVries, 2014 WL 4294540, at *13–14 (Bankr. N.D. Tex. Aug. 27, 2014) (finding operating agreement was an executory contract rejected by the trustee and that trustee was therefore entitled to economic rights but not management rights in LLC)

V. SUBSTANTIVE CONSOLIDATION: "NEITHER AUTHORIZED NOR PROHIBITED" BY THE BANKRUPTCY CODE

With its "historical roots" derived "from the bankruptcy court's general equity powers as expressed in 105 of the Bankruptcy Code" the granting of substantive consolidation of debtors with other debtors or debtors with non-debtors has evolved differently in each Circuit with various tests/considerations resulting. What seems to be most determinative of whether consolidation is allowed or not, is "fairness" to creditors in what results from this equitable action. Most courts agree that "Bankruptcy courts may substantively consolidate two or more related entities and thereby pool their assets…treating separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities."

Below is a compilation of the various test adopted by Circuits across the country, if there is one, and some examples of how courts have managed this very tough balancing act for the benefit of all parties involved in the cases as well as how they have addressed some ancillary issues arising in conjunction with substantive consolidation.

***Logistics Information Sys. Inc. v. Braunstein (In re Logistics Information Sys. Inc.),* 432 B.R. 1, 81 Fed. R. Evid. Serv. 1042 (D. Mass. 2010)**

Sperbeck founded Logistics and was the principal owner and President. Logistics designed and licensed transportation management software, which allowed shippers to monitor and manage the transportation of their goods by private carriers. Two of its popular software products were "MaxPayload" and "Audit-Logic." In August 1999, Logistics sued one of its customers, "APBLS." APBLS counter sued and in December 2001 and ultimately obtained a default judgment against Logistics for $1.5 million. In September 2000, Sperbeck created Arclogix to conduct business substantially similar to Logistics'. Arclogix utilized software that was also similar to Logistics' except that it was web-based and had improved functionality. Arclogix started active operations in January 2001; Logistics ceased operations at about the same time. Between December 2000 and August 2001, Logistics paid Sperbeck approx.. $254,000 for loan repayments which Sperbeck put into Arclogix. Arclogix purchased certain assets of Logistics, essentially office equipment, for about $30,000, paying that money to Sperbeck. On February 3, 2003, faced with a $1.5 million judgment and having transferred all its assets, Logistics filed a Chapter 7 bankruptcy petition. "Arclogix was like Logistics in almost every way." [i.e. same employees, same phone number, balance sheets were nearly identical (AR's

were the same amounts as were the computer software assets)]. The Trustee brought a fraudulent transfer action against Arclogix and to substantively consolidate Logistics and Arclogix.

The court explained that "(s)ubstantive consolidation involving a nondebtor was at least tacitly approved by the Supreme Court in a 1941 case. In *Sampsell v. Imperial Paper and Color Corp.,* 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941), the Court affirmed a lower court order substantively consolidating a debtor corporation with a nondebtor corporation of which the debtor was the primary shareholder. The bankruptcy referee had concluded that the non-debtor corporation was 'nothing but a sham and a cloak? devised by [the debtor] for the purpose of preserving and conserving his assets ... and that the corporation was formed for the purpose of hindering, delaying and defrauding his creditors.''

The court went on to explain that in its circuit, "bankruptcy courts (had) approved the application of substantive consolidation to non-debtors, often in cases in which the non-debtor is a subsidiary or alter ego of the debtor. *See, e.g., Gray v. O'Neill Props. Group, L.P. (In re Dehon, Inc.),* No. 02-41045, 2004 WL 2181669, at *3 (Bankr.D.Mass. Sept. 24, 2004) ("Large corporations, such as the Debtor, often use multi-tiered corporate structures, and substantive consolidation has been used to reach the assets and liabilities of a non-debtor subsidiary corporation."); *Murphy v. Stop & Go Shops, Inc. (In re Stop & Go of Am., Inc.),* 49 B.R. 743, 745 (Bankr.D.Mass.1985).

The bankruptcy court considered two different standards in making its decision. The first test was a two-factor test:

1. Consolidation is permitted only if it is first established that the related debtors' assets and liabilities are so intertwined that it would be impossible, or financially prohibitive, to disentangle their affairs. The trustee may request consolidation to conserve for creditors the monies which otherwise would be expended in prolonged efforts to disentangle the related debtors' affairs; and
2. Balance the potential benefits of consolidation against any potential harm to interested parties.

The second test was a twelve-factor test:

"(1) common ownership; (2) pervasive control; (3) confused intermingling of business activity, assets, or management; (4) thin capitalization; (5) nonobservance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at the time of the litigated transaction; (9) siphoning away of corporate assets by the dominant shareholders; (10) nonfunctioning of officers and directors; (11) use of the corporation for transactions of the dominant shareholders; and (12) use of the corporation in promoting fraud."

Here, the district court affirmed the bankruptcy's court's decision to substantively consolidate the parties.

***In re Owens Corning*, 419 F.3d 195 (3rd Cir. 2005)**

After a 13-day evidentiary hearing, the District Court concluded that substantive consolidation was appropriate in anticipation of a Ch 11 plan. Credit Suisse First Boston ("CSFB") the agent for a syndicate of banks (collectively, the "Banks") that extended, in 1997, a $2 billion unsecured loan to Owens Corning, a Delaware corporation ("OCD"), and certain of its subsidiaries, appealed. OCD was facing asbestos litigation claims and its credit was enhanced in part by guarantees made by other OCD subsidiaries. The Circuit court acknowledged the importance and reasonableness of substantive consolidation in the Circuit "to rectify the seldom-seen situations that call for this last-resort remedy" but it was imperative to use it carefully and sparingly, to avoid "a ploy to deprive one group of creditors of their rights while providing a windfall to other creditors."

"Substantive consolidation, a construct of federal common law, emanates from equity. It 'treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor.' *Genesis Health Ventures, Inc. v. Stapleton* (*In re Genesis Health Ventures, Inc.*), 402 F.3d 416, 423 (3d Cir.2005). Consolidation restructures (and thus revalues) rights of creditors and for certain creditors this may result in significantly less recovery."

"Rather than endorsing any prefixed factors, in *Nesbit* (the court) 'adopt[ed] an intentionally open-ended, equitable inquiry. . . to determine when substantively to consolidate two entities." The 3rd Circuit test is as follows:

"In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity,19 or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors… Proponents of substantive consolidation have the burden of showing one or the other rationale for consolidation. The second rationale needs no explanation. The first, however, is more nuanced. A *prima facie* case for it typically exists when, based on the parties' prepetition dealings, a proponent proves corporate disregard creating contractual expectations of creditors that they were dealing with debtors as one indistinguishable entity. Proponents who are creditors must also show that, in their prepetition course of dealing, they actually and reasonably relied on debtors' supposed unity. Creditor opponents of consolidation can nonetheless defeat a *prima facie* showing under the first rationale if they can prove they are adversely affected and actually relied on debtors' separate existence."

Here, there was "no prepetition disregard of corporate separateness" OR "no hopeless commingling exist(ed) post-petition" AND other considerations were weighed: 1) trying to fix unfairness with special priorities given to various creditors does not comply with the Code; and 2) substantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve advantage over one group in the plan negotiation process.

***In re Amco Ins.*, 444 F.3d 690 (5th Cir. 2006)**

"The significance of this bankruptcy case relates to the *nunc pro tunc* substantive consolidation of the assets and liabilities of a corporation in bankruptcy and its sole shareholder, not in bankruptcy (until afterwards)." Here, the Circuit Court vacated the district court's order and remanded.

"Rehmat A. Peerbhai, an entrepreneur in the automobile industry, owned and managed AIG, a holding company in the automobile insurance business, prior to 1992. On April 21, 1992, Peerbhai incorporated a new company, AIA, which sells automobile insurance. A parent subsidiary relationship was formed between AIG, as parent, and AIA, as subsidiary, with Peerbhai acting as the sole owner of both companies." AIG, AIA, and Peerbhai all filed their own bankruptcies. Prior to the bankruptcies, Peerbhai and AIG borrowed $2.4M from Wells Fargo, and AIG borrowed another $1.2M separately, with Peerbhai guarantying the AIG debt as well, all in approximately September 2000. By December 2001, the loans agreements with Wells Fargo were breached and by February 2002, AIG and AIA filed for Chapter 7.

In March 2002, Wells Fargo obtained relief from stay to pursue Peerbhai in state court, then reached an agreement with Peerbahi by April, to obtain a consensual lien against his homestead, in which he agreed he owed Wells Fargo more than $3,300,000.00.

In July 2002, the Trustee of AIA filed a motion to substantively consolidate Peerbhai (not in bankruptcy) with AIA as a single debtor, and asked the court to do so *nun pro tunc* back to the date of the filing of AIA's case. Wells Fargo objected, rightfully so, after spending time and resources after the RFS was granted. Peerbhai filed a Ch 11, in response, which ultimately was converted to Ch 7. The Trustee argued that:

"Peerbhai and AIA were not separate legal entities, and that the finances of AIA and AIG were commingled by Peerbhai so that substantively consolidating all of Peerbhai's personal assets with the assets of AIA and AIG was the only way to ensure equitable distribution of the assets to the creditors of AIA and AIG."

The court found that Peerbhai made "no meaningful distinction between his funds and those of AIA" while AIA was a going concern, that "AIA's creditors dealt with Peerbhai and AIA as a single economic unit and did not rely on their separate identities in extending credit," that Peerbhai and AIA "did not observe the corporate formalities required by Texas law, and that Peerbhai treated AIA as an alter ego of himself, using the AIA corporate status to commit fraud against his and AIA's creditors."

Factors the court relied on, in granting substantive consolidation, here, were as follows:

1. Substantive consolidation would benefit all creditors, and not unfairly prejudice any creditor, because the financial affairs of AIA and Peerbhai were so entangled that the assets of each could not be segregated;
2. Substantive consolidation would avoid the harm of AIA's creditors receiving virtually nothing in a bankruptcy that was caused primarily by Peerbhai looting AIA;

3. Wells Fargo would not be unfairly harmed by substantive consolidation because of Wells Fargo's knowledge and the circumstances surrounding the execution of the Limited Forbearance Agreement, and further that any prejudice Wells Fargo may suffer from substantive consolidation is not unfair, and is substantially outweighed by the benefits to other creditors;
4. The fact that AIA and Peerbhai were essentially a single financial entity could not have been ignored by Wells Fargo or any other reasonably diligent party extending credit to Peerbhai; and
5. Substantive consolidation should be effective *nunc pro tunc* to the petition date of February 4, 2002, because at all relevant times, Peerbhai

The district court affirmed and the 5th Circuit reversed, holding that nun pro tunc application of the substantive consolidation was improper, unfairly would affect Wells Fargo who took action that the Trustee "consented" to, and the Trustee should have acted sooner. The Circuit did not reach the question of whether the bankruptcy court had the right to grant substantive consolidation or what standard should be applied. Both issues were left for another day.

***Spradlin v. Beads & Steeds Inns, LLC (In re Howland)* (6th Cir. 2017)**

"This court has not adopted a test for evaluating a substantive consolidation claim…." but, here, the parties applied the 3rd Circuit's test. There appears to be no case in the 6th Circuit deciding that a specific test should be applied to cases in this Circuit.

***Huntington Nat'l Bank v. Richardson (In re Cyberco Holdings, Inc.)*, 734 F.3d 432 (6th Cir. 2013)**

The BAP determined that the denials of a motion to substantively consolidate were not final appealable orders. The Sixth Circuit affirmed.

***In re Giller*, 962 F.2d 796 (8th Cir. 1992)**

Giller, the sole/majority shareholder of six separate corporations, filed a Chapter 11. The Trustee moved to consolidate the six corporations with the Giller's estate, which would avoid the need to bring multiple avoidance action and preserve resources for creditors. Only one creditor objected and the Circuit upheld the bankruptcy court.

The Court held the "(f)actors to consider when deciding whether substantive consolidation is appropriate include:

1. The necessity of consolidation due to the interrelationship among the debtors;
2. Whether the benefits of consolidation outweigh the harm to creditors; and
3. Prejudice resulting from not consolidating the debtors

***Official Comm. of Unsecured Creditors v. Archdiocese of Saint Paul and Minneapolis (In re Archdiocese of Saint Paul and Minneapolis)*, 888 F.3d 944 (8th Cir. 2018)**

"The Committee, which represented more than 400 clergy sexual abuse claimants, appealed the district court's decision affirming the bankruptcy court's denial of the Committee's motion for substantive consolidation of debtor, the Archdiocese, and over 200 affiliated non-profit non-debtors ("Targeted Entities"). The Eighth Circuit held that the Targeted Entities were entitled to the protections under 11 U.S.C. 303(a), and could not be involuntarily substantively consolidated with the Archdiocese. In this case, the Committee failed to plausibly allege sufficient facts to negate the non-profit non-debtor status of the Targeted Entities."

The Court "recognize(d) the bankruptcy court's authority to substantively consolidate debtor entities" under the *Giller* test which required the bankruptcy court to find:

1. That there was an "abuse of the corporate form;" and
2. The existence of "transfers among the debtors that could 'give rise to fraudulent conveyance and preference causes of action.'

"Given the facts in *Giller*, we found the equitable remedy of substantial consolidation to be the 'only hope' of recovery for the unsecured creditors." However, because 303(a) does not allow non-profits to be involuntary debtors, so here, the District Court was affirmed.

***In Re Raejean Bonham, dba World Plus*, 229 F.3d 750 (9th Cir. 2000)**

The 9th Circuit reversed the decision of the district court, remanding with instructions to affirm the bankruptcy court's order substantively consolidating two non-debtor corporations, World Plus, Inc. ("WPI") and Atlantic Pacific Funding Corporation ("APFC"), with the bankruptcy estate of Chapter 7 debtor, Raejean Bonham, nunc pro tunc as of the filing date of the involuntary Chapter 7 petition of Bonham.

This case involved a failed ponzi scheme operated by Bonham where funds were borrowed from hundreds of investors through WPI and APFC but used by Bonham personally and commingled among the three with no regard for where they originated. Bonham was the sole shareholder of WPI and APFC. By the time Bohnam's involuntary petition was filed, neither Bonham or either of the corporations had any assets so Bonham's Chapter 7 Trustee filed 600 adversary actions against Bonham's investors, who in turn, challenged the Trustee's standing to avoid transfers by WPI and APFC. The Trustee responded by filing a motion to substantively consolidate the three together. The bankruptcy court granted the motion and held that using a motion to consolidate was appropriate and WPI and APFC were "simply vehicles Bonham used to perpetrate the fraud."

Investors appealed to the district court which dismissed the appeal, holding that the consolidation order was not an appealable order. The investors next had to appeal to the Circuit

who reversed and held that the consolidation order was appealable and affirmed the bankruptcy court's order consolidating the non-debtors with Bonham.

The Court discussed the "two broad themes" to consider in substantive consolidation motions:

A. Whether there is a disregard of corporate formalities AND commingling of assets by various entities; and
B. Balancing the benefits that substantive consolidation would bring after the harms that it would cause.

The Court then discussed the **D.C. Circuit test**[1] which was "a three-part burden-shifting test" as follows:

1. The proponent of substantive consolidation must first show that:
    a. "there is a substantial identity between the entities to be consolidated; and
    b. Consolidation is necessary to avoid some harm or to realize some benefit."
2. Once the above prime facie showing is made, "a presumption arises 'that creditors have not relied solely on the credit of one of the entities involved" shifting the burden to an objecting creditor to show that:
    a. It has relied on the separate credit of one of the entities to be consolidated; and
    b. It will be prejudiced by substantive consolidation."
3. If the objecting creditor makes the required showing above- "the court may order consolidation only if it determines that the benefits of consolidation 'heavily' outweigh the harm."

The Court then discussed the **Second Circuit test for substantive consolidation**[2], which required only a showing one of two factors:

1. "Whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending creditor; or
2. Whether the affairs of the debtor are so entangled that consolidation will benefit all creditors."

The first factor justifies substantive consolidation because lenders "structure their loans according their expectations regarding the borrower and do not anticipate either having the assets of a more sound company…or the creditors of a less sound debtor to compete…".

The second factor justifies substantive consolidation "only where 'the time and expense necessary even to attempt to unscramble them is so substantial as to threaten the realization of any net assets for all the creditors' or where no accurate identification and allocation of assets is possible."

[1] *In re Auto-Train Corp., Inc.,* 810 F.2d 270 (D.C. Cir. 1987).
[2] *In re Augie/Restivo Baking Co., Ltd.,* 860 F.2d 515 (2nd Cir. 1988).

Here, the Court adopted the 2nd Circuit test and found that under either factor, the bankruptcy court properly granted substantive consolidation of Bonham, WPI and APFC.

***Clark's Crystal Springs Ranch, LLC v. Gugino (In re Clark)* (9th Cir. 2017)**

In this case, the Court considered whether "the bankruptcy court err by entering a judgment to substantively consolidate the estate of Debtor with the LLC and its member Trust?" after the Supreme Court's decision in *Law v. Siegel*, 134 S. Ct. 1188 (2014).

The Court found that *Law v Siegel*, did not do away with bankruptcy courts' right to order substantive consolidation. It reasoned that *Law v Siegel* may have held that "a bankruptcy court may not contravene specific statutory provisions" of the Bankruptcy Code, but ordering "substantive consolidation…does not contravene specific provisions of the Bankruptcy Code. While the Code does not explicitly authorize substantive consolidation, neither does the Code forbid it. That there are other ways to bring non-debtors into a bankruptcy case also does not render substantive consolidation in conflict with express provisions of the Code. Bankruptcy courts retain equitable power to grant substantive consolidation notwithstanding Congress's amendment of the Code without codifying that power."

***Branch Banking & Tr. Co. v. Shapiro (In re R&S St. Rose Lenders, LLC)* (9th Cir. 2019)**

The Court held that the bankruptcy court did not err in denying substantive consolidation under the framework set forth in *In re Bonham*, and held that "substantive consolidation should be used 'sparingly and in keeping with [its] equitable nature."

The bankruptcy court "*considered* all creditors" but ultimately focused on the "expectations" of the largest "value" creditor, rather than the largest "number" of creditors, to determine that the largest creditor, BB&T's predecessor, Colonial Bank, NA, dealt with the entities as "separate economic units" in extending credit.

***Allen v. Old Nat'l Bank of Wash. (In re Allen)*, 896 F.2d 416 (9th Cir.1990)**

The Court held that a Motion for Substantive Consolidation is an immediately appealable order because of the irreparable harm that can be done to parties involved.

***In re Pearlman*, 23 Fla. L. Weekly Fed. B 209, 55 Bankr.Ct.Dec. 275, 66 Collier Bankr.Cas.2d 1522, 462 B.R. 849 (Bankr. M.D. Fla. 2012)**

The Court considered whether to substantively consolidate eleven debtors (the "Debtors") with other Pearlman-related entities not in bankruptcy—the "Non–Debtors" when defendants of the Debtors' trustee's fraudulent conveyance proceedings, "arguing that the Debtors and Non–Debtors together consist of 'one intertwined enterprise,' and that substantive consolidation will

reduce time and administrative costs associated with untangling their individual assets and liabilities."

In deciding not to allow substantive consolidation of the Debtor's with the Non-Debtors, the court held that "under § 105(a) of the Bankruptcy Code because (substantive consolidation) is not an act that is 'necessary or appropriate' to carry out any legitimate bankruptcy purpose," and any such motion should fail.

The court reasoned that "parties have other tools, albeit accompanied by stringent and befitting proof requirements, to force a non-debtor entity into bankruptcy. Parties can file involuntary bankruptcy petitions if they can plead and meet all the requirements of § 303 of the Bankruptcy Code. Alternatively, they can rely on state law and the attendant legal theories of alter ego and piercing the corporate veil. But, they cannot get the shortcut of relying on § 105 to substantively consolidate non-debtors."

VI. ADDITIONAL CASES ON RESTRICTED AND CONTINUING GUARANTOR LIABILITY AND THE CHAPTER 7 DISCHARGE

***Dulles Elec. & Supply Corp. v. Shaffer (In re Shaffer)*, 585 B.R. 224 (Bankr. W.D. Va. 2018)**

The Court held "as a matter of law that the debts to Dulles Electric that arose after the individual guarantors filed chapter 7 were not discharged in the individual guarantors' bankruptcy cases."

Here, the debtors did not list the vendor/Dulles Electric, the debt that the vendor sought to be excluded from the debtors' discharge was a debt incurred by their business, postpetition, which the Court found to be a continuing guaranty, "which means that the individuals guaranteed an unlimited series of transactions, each of which is a new debt" rather than a restricted guaranty. "The liability on the continuing guaranty…did not arise until (Debtor's non-filing corporation) made a purchase, which is an independent transaction and a new debt. The Court reasoned that if the debtors wanted to discharge the guaranteed debt at issue here, they should have "revoked" or "terminated" the guaranty with the vendor.

***Orlandi v. Leavitt Family Ltd. P'ship (In re Orlandi)*, 612 B.R. 372 (B.A.P. 6th Cir. 2020)**

The BAP considered whether the "bankruptcy court had jurisdiction to determine whether the debtor's personal guaranty of the original lease between the parties was reinstated under a renewed post-petition extension of the lease."

The Panel agreed with a "line of cases holding that a pre-petition personal guaranty is a contingent debt that is discharged in bankruptcy." The Court reasoned that "'debt' and 'claim' are defined in the Code as broadly as possible 'to enable the debtor to deal with all legal obligations in a bankruptcy case.'" And "(t)hese broad definitions are consistent with '[t]he

principal purpose of the Bankruptcy Code [ ] to grant a 'fresh start' to the 'honest but unfortunate debtor.'"

In this case, the debtor listed the personal guaranty in his petition and received a discharge which seems to be a largely considered factor by most courts grappling with whether a guaranty debt like that in this case is discharged or not.

***Reinhart FoodServ. v. Schlundt* (E.D. Wis. 2022)**

This appeal concerned "the application of (the discharge) to liabilities arising after the bankruptcy but based on the debtor's pre-bankruptcy promise to guarantee the obligations of a third party. " Here, the debtor did not list the vendor as a creditor in the bankruptcy. However, "the bankruptcy court concluded it was bound by the Seventh Circuit's decision in *Saint Catherine Hospital of Indiana, LLC v. Indiana Family and Social Services Administration*, 800 F.3d 312 (7th Cir. 2015) to hold the debts in this case were discharged even though it is undisputed that the transactions that gave rise to the debts did not occur until four years after the debtor filed his joint bankruptcy petition."

***In re Getzoff, 180 B.R. 572* (B.A.P. 9th Cir. 1995)**

The bankruptcy court held that "a guaranty executed postpetition was invalid under Section 524 of the Bankruptcy Code because it was based on a discharged debt." The creditor appealed from the summary judgment entered against it and the BAP affirmed.

***Umpqua Bank v. Burke (In re Burke)* (B.A.P. 9th Cir. 2019)**

"In 2017, Ms. Burke/("Debtor") sold her home. But, as a result of error, Umpqua/("Creditor") submitted a demand into escrow that was approximately $250,000 too low." When the sale closed, Creditor got a smaller payment than it should have, and Debtor "received a substantially enhanced payment"—at Creditor's expense.

The BAP held that because "the demand bound Umpqua as a matter of California law, Umpqua's trust deed was reconveyed. And because of (Debtor's) bankruptcy discharge, it (could not) sue (Debtor) on the guaranty." The only issue before the BPA was whether Debtor's "2009 bankruptcy discharge bars Umpqua from bringing an unjust enrichment action." The bankruptcy court concluded that any claims by Umpqua against Debtor were discharged; the BAP reversed.

Though the Court acknowledged that "the Bankruptcy Code broadly defines 'claim' and may allow for discharge of litigation claims even if not yet ripe for adjudication" at the time of the bankruptcy;" and "Umpqua's guaranty claim was discharged, it retained an *in rem* claim that survived discharge and allowed recovery from proceeds (from the Debtor's home securing its debt), but its erroneous demand into escrow extinguished its ability to obtain recovery on account of its *in rem* rights." However, because a "California unjust enrichment claim does not

arise under a contract" and it is a common law cause of action, Creditor's claim "arose postpetition because it was not fairly contemplated on a prepetition basis." One of panelists dissented.

***Thompson Tractor Co. v. Schleicher (In re Schleicher)* (Bankr. N.D. Ala. 2018)**

The Debtor filed a Chapter 7 on October 10, 2016, and received a discharge. The guaranty between Debtor and Creditor was executed pre-petition, but the credit advances were made to the principal obligor/("Debtor's corporation"/"Dixie") post-petition. Debtor listed a debt to Creditor of approximately $138,000 and no issue arose as to this debt being discharged. However, after filing, Dixie, through Debtor, sought approximately $86,000 of more credit from Creditor which it extended. Debtor argued "Dixie's post-petition debts were contingent and unliquidated claims under the Guaranty, and thus subject to discharge." The Court disagreed and held that the post-petition debts were "not claims at all—not contingent, unliquidated, or any other kind of claim." The court further held "there was nothing contingent or unliquidated" about the post-petition debts that did not exist at the time of filing, especially where the creditor had "no obligation to extend further credit and the borrower has no obligation to request and accept further extensions of credit." Instead, the Court found the Debtor's guaranty to be a continuing guaranty that had to be specifically revoked to discharge any liability arising from post-petition credit that the Debtor sought from the Creditor for the Debtor's non-filing corporation.

VII. OTHER MISCELLANIOUS ISSUES TO CONSIDER WHEN REPRESENTING INDIVIDUALS WITH BUSINESSES

***In re Long*, BAP No. MT-08-1165-DMoPa (B.A.P. 9th Cir. (B.A.P. 9th Cir. 2009)**

"Beginning sometime in 2003, Mr. Long/"Debtor" became AboutMontana's/(the "Corp's) controlling shareholder." The Corp created a "Business Plan" and borrowed $100,000 from MW Bank/"Creditor" in 2004 to implement same which was secured against all of its assets. The Business Plan failed and Montana Sky bought the Corp's assets for approximately $141,000 in 2005. Debtor did not tell Creditor of the sale and did not pay over any of the sale proceeds to the Creditor pursuant to its lien rights. Debtor testified in the bankruptcy:

1. The Corp continued on in existence and tried to different business models, however, it was clear from the evidence that it did not generate any income after the sale; and
2. The Corp used the funds from the sale to service its debts until the Corp ultimately closed, however, it was clear from the evidence that Debtor used the majority of the funds for his personal use.

Debtor filed for bankruptcy in 2007 after Creditor obtained a judgment against Corp and Creditor was in the process of pursuing Debtor on his personal guaranty.

Creditor filed an adversary against Debtor pursuant to § 523(a)(4) and (a)(6) as well as § 727(a)(3) and (a)(4)(A). The bankruptcy court's concluded that Creditor did not meet its burden of proof to prevail on any its claims. The BAP agreed with the bankruptcy court as to its ruling on § 523(a)(4) and § 727(a)(3) and (a)(4)(A) claims. However, the BAP reversed as to § 523(a)(4). The reasoned that Debtor's "fruitless efforts to start a new business were not the same as a good faith effort to keep his business going within the meaning of *Transamerica Comm'l Fin. Corp. v. Littleton (In re Littleton)*, 942 F.2d 551 (9th Cir. 1991), when he sold the principal assets of his corporation, failed to disclose the sale and remit the sale proceeds to the creditor with a security interest in those assets, and appropriated a substantial portion of those sale proceeds for his personal use." Therefore, the BAP reversed the bankruptcy court's judgment in favor of Debtor on the § 523(a)(6) cause of action.

This case serves as a very good example that it is important to "look under the hood" of an individual debtor's case and circumstances (including their closed business' books and records), before filing, to determine if there are going to be issues pursuant to 523 and 727, based on actions they took as the principal in control of business' assets and liabilities, that can be rectified/addressed before filing their individual bankruptcy.

In re Boyajian, 564 F.3d 1088 (9th Cir. 2009)

Individual debtors (sisters/"Debtors") each filed their own Chapter 7 bankruptcy, after they entered into leases with Epic Leases/("Epic") on behalf of their corporation, "Blue Diamond." The Debtors, as the principals of Blue Diamond provided financial statements for Blue Diamond to Epic and each guaranteed the debt, and after Blue Diamond ultimately failed. The debt owing to Epic was assigned multiple times to various companies and ultimately ended up with New Falls/"Creditor" just before Debtors filed their bankruptcies. Creditor filed an adversary against the Debtors pursuant to 523(a)(2)(B).

"The bankruptcy court determined as a matter of law that in order for an assignee creditor to prevail in an exception to discharge adversary proceeding brought pursuant to § 523(a)(2)(B), the assignee creditor must have reasonably relied on the materially false financial statement provided by the debtor." The BAP reversed and the 9th Circuit affirmed the BAP.

Again, this case is an example of why it is imperative to obtain documents and information relating to a debtor's open **and** closed business to determine if there are nondischargeability issues underlying in actions the debtor took in their capacity as a business owner, and further, that "debt buyers" still hold the same rights the original creditor held when giving the initial credit…at least in the 9th and 6th Circuits.

Also, see attached ABI Article regarding "Secret Creditor" issues arising in "business cases.

AN EXAMPLE OF "OUTSIDE OF THE BOX" ANSWERS TO BUSINESS DEBTS ARISING FROM THE RESULTS OF THE PANDEMIC:

***Melendez v. City of N.Y.*, 16 F.4th 992 (2nd Cir. 2021)**

After the COVID-19 pandemic, the New York City Council passed the "Personal Liability Provisions in Commercial Leases" law, commonly referred to as the "Guaranty Law," which took effect on May 26, 2020. *See* N.Y.C. Admin. Code § 22-1005. The Guaranty Law permanently rendered, unenforceable, "personal liability guaranties on certain commercial leases for any rent obligations arising during a specified pandemic period." The Guaranty Law pertained to "leases held by commercial tenants who were required to cease or limit operations under Executive Orders…As to those leases, the law applies retroactively to rent arrears dating from March 7, 2020, as well as prospectively through June 30, 2021, without regard to the financial circumstances of the tenant, the guarantor, or the landlord. In sum, for rent arrears arising during that almost sixteen-month period, the Guaranty Law does not simply defer a landlord's ability to enforce a personal guaranty" as did many cities and state and counties legislate, "it forever extinguishes" the liability.

"Plaintiffs appealed the dismissal of their Contracts Clause challenge to the Guaranty Law, arguing that the district court misapplied that constitutional protection in concluding that they failed to state a plausible claim."

The Court discussed why there were lots of good arguments on both sides of the issue in passing the Guaranty Law. However, it held that when it viewed "all factual allegations and draw all reasonable inference in favor of plaintiffs," it agreed that the Plaintiffs' claims could not be dismissed as a matter of law under Rule 12(b)(6). The Court reasoned that in "granting dismissal, the district court applied a three-part balancing test derived from the Supreme Court's recent Contracts Clause jurisprudence:

"At the first step, the district court concluded that the challenged law did substantially impair plaintiffs' commercial leases. Nevertheless, at the second step, it concluded that the impairment served a significant and legitimate public purpose and, at the third step, that the challenged law was appropriate and reasonable to advance that purpose." The appellate court held that it was bound by the same precedent, but we did "not reach the same conclusion at the last step."

Instead, the Court, here, held that the "Plaintiffs state(d) a plausible Contracts Clause challenge to (the Guaranty Law)." Reviewing that claim by reference to "balancing principles identified in the Supreme Court's most recent Contracts Clause jurisprudence, this Court conclude(d) that:

a. the challenged Guaranty Law significantly impairs personal guaranty agreements;
b. the record thus far demonstrate(d) a plausible significant public purpose for the impairment; **but**

c. the same record raise(d) at least five serious concerns about that law being a reasonable and appropriate means to pursue the professed public purpose, and, thus, that determination cannot now be made in favor of defendants as a matter of law.

This case teaches us, as bankruptcy practitioners, that drastic times often require drastic measures and that there may be laws outside the confines of the Bankruptcy Code that may assist our clients with debt issues they are facing.

DUE DILIGENCE CHECK LIST FOR INDIVIDUAL DEBTOR/CLIENT WHO OWNS A BUSINESS/CLOSELY HELD CORPORATION PREPARING TO FILE A CHAPTER 7 BANKRUPTCY			
		Documents/Information Needed	**Affected Schedules**
A.	**Is the business a "dba"/sole proprietorship or a separate corporate entity?-**		
		Secretary of State status information- is the entity "active"?	*Voluntary Petition*
		Articles of Incorporation, partnership agreement, operating agreement, corporate governance documentation	
		Business License(s)	
B.	**Is the business' income reported in a separate tax return or on the Debtor's Schedule C in their personal return?-**		
		Even if the Debtor operates within an corporate entity, is it a disregarded entity and reported on Debtor's individual taxes?	
		Corporate Tax returns	
C.	**How much does the Debtor own of the entity and through what mechanism?-**		*Schedule A/B*
		Stock certificates	
		Operating agreement and ALL amendments	
D.	**Who are the other shareholders/partners/members of the business?-**		*Schedule E/F & H*
		List of these parties and their addresses to be listed in Sch E/F	
E.	**Does the business have insurance that may affect the Debtor?-**		*Schedule A/B & E/F*
F.	**What does the Business Entity own?-**		*Schedule A/B*
		Balance Sheet for list of assets with "book value"	
		Liquidation analysis- list of assets with actual liquidation value	
		Recent Appraisals	
		Title documents for assets (Are assets really in business name or indivdual's name?)	
G.	**What does the Business Entity owe?- List all corporate creditors on personal filing on Sch E/F (possibly as disputed)-**		*Schedule G & H*
		Secured debt list/statements	*Schedule D*
		Unsecured debt list	*Schedule E/F*
		UCC-1 Search and any recordings	
H.	**What has the Debtor Guaranteed for the Business Entity?**		*Schedule F/F, G & H*
		Contracts	
		Lines of Credit	
		Leases	
I.	**What has the Debtor received from the Business Entity?**		*Schedule I & SOFA*
		Monthly Profit & Losses for prior year and current year	*Means Test, if applicable*
		Yearly P&L's for prior year and last year	
		General Ledger for prior two (2) years	
		Transaction Report for Shareholder Loan(s)	
		Transaction Report for Wages to Officers or Insiders	
		Transaction Report for Distributions to owners/insiders	
J.	**Has the Debtor prepared/signed any financial statements for the Business Entity recently?**		*SOFA & 523 issues*
		Financial Statements or Applications	
K.	**Has the Business Entity filed all appropriate taxes? And are taxes owing for which the Debtor may be responsible?**		*Schedule E/F*
		Tax Transcripts for Business Entity	
		Have the corporate taxes been assessed against the Debtor, personally, if applicable	
L.	**Did the Debtor's Business have employees**	List of any and all employees	*Schedule E/F*

Feature

By William J. Hanlon and Timothy J. McKeon

Restricted vs. Continuing Guaranties and the § 727 Discharge

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A decision from the U.S. Bankruptcy Court for the District of Massachusetts highlights the distinction between a "restricted guaranty" and a "continuing guaranty," and the effect of a guarantor's bankruptcy on the enforceability of the guaranty. A continuing guaranty is "a contract pursuant to which a person agrees to be a secondary obligor for *all* future obligations of the principal obligor to the obligee."[1] For example, a guaranty of a revolving line of credit is "continuing." In this scenario, the guaranty will be enforceable as to each transaction and arises at the time of each transaction rather than when the guaranty is executed.

However, a restricted guaranty concerns a specifically contemplated extension of credit. For example, a guaranty could be "restricted" when it is granted as part of a loan for a limited purpose, such as a retail installment contract. A restricted guaranty arises upon the execution of the guaranty and not, as with a continuing guaranty, upon each subsequent extension of credit.

In *National Lumber Co. v. Reardon, et al. (In re Reardon)*, the bankruptcy court analyzed the distinction between a continuing and restricted guaranty for the purposes of determining whether liability under a guaranty had been discharged under § 727 of the Bankruptcy Code. The court's analysis, including its consideration of the nature of the loan in addition to the terms of the guaranty, is noteworthy to debtors and creditors alike.

Background

In *Reardon*, a husband and wife (the "debtors") had jointly signed two separate pre-petition guaranty agreements with National Lumber Co.[2] Under the first agreement (the "first guaranty"), the debtors provided a guaranty of a $5,000 line of credit provided by National Lumber to Beachwood Village Realty Trust.[3] Under the second agreement (the "second guaranty," and with the first guaranty, the "guaranties"), the debtors guaranteed Beachwood's obligations under a construction loan agreement with National Lumber for $230,000 for a specific construction project.[4]

In December 2009, the debtors commenced a joint chapter 7 case, and several months later received a discharge under § 727.[5] The debtors did not provide National Lumber with notice of their bankruptcy, nor did they list National Lumber as a creditor nor identify the guaranties in their schedules.[6] In 2010, 2011 and 2012, National Lumber sold goods to Beachwood on credit.[7] Most of such credit was repaid, except a balance of $56,667 remained outstanding.[8] National Lumber demanded payment from the debtors and commenced an action in state court to enforce the guaranties.

In response, the debtors reopened their bankruptcy case "in order to amend the schedule of nonpriority unsecured creditors that they had filed in their case by adding previously omitted creditors, including National [Lumber]."[9] National Lumber commenced an adversary proceeding seeking a declaration that the debtors' chapter 7 discharge did not release them from their liability under the guaranties.[10] The debtors disputed National Lumber's allegations and argued that "by operation of law, their bankruptcy filing extinguished any continuing liability [that] they might otherwise have had to National [Lumber] on the guarantees for post-petition advances of credit."[11]

The Guaranty at Issue[12]

The second guaranty was granted in connection with a construction loan agreement between Beechwood and National Lumber in order to fund the completion of a model home in a residential development.[13] The second guaranty states:

> [T]he undersigned personally guarantee due fulfillment of all BORROWER's "OBLIGATIONS" (as hereinafter defined) to LENDER, together with all costs associated with enforcement of and collection of the OBLIGATIONS and this GUARANTY.
>
> 1. "OBLIGATIONS" as used in this GUARANTY means all present and

1 *Restatement (Third) of Suretyship & Guaranty* § 16 (Am. Law Inst. 1996) (emphasis added).
2 *See Nat'l Lumber Co. v. Reardon (In re Reardon)*, 566 B.R. 119, 123-24 (Bankr. D. Mass. 2017).
3 *Id.* at 123-24.
4 *Id.* at 124.
5 *Id.* at 125.
6 *Id.*
7 *Id.*
8 *Id.*
9 *Id.* at 121.
10 *Id.* at 122.
11 *Id.*
12 The court found that the first guaranty was "too illegible to permit a finder of fact to discern its terms with any fair degree of confidence." *Id.* at 124. As a result, the court held that the debtors "did not sustain their burden of establishing that [the first guaranty] was restricted or that obligations thereunder arose before the date of their bankruptcy filing," and therefore failed to establish that their obligations under the first guaranty had been discharged. However, the primary focus of the decision was the second guaranty.
13 *Id.*

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> future OBLIGATIONS of BORROWER to LENDER, direct or indirect, absolute or contingent, due or to become due, including without limitation, the prompt and seasonable performance and observance of all of BORROWER'S covenants, agreements and conditions under the following documents of even date herewith (the "LOAN DOCUMENTS"): an Acquisition and Construction *125 Loan Note in the principal amount of [$230,000]; a Construction Loan Mortgage And Security Agreement And Assignment; and all other instruments securing or relating to any loan by LENDER to BORROWER or executed in connection therewith relative to a construction project at the property known as and/or located at Unit 58, Beechwood Village, Rockland, Massachusetts.
>
> 2. This GUARANTY shall operate as a *continuing GUARANTY*. The liability of the undersigned shall continue regardless of any reduction (except by payment hereunder) until the OBLIGATIONS have been paid or otherwise discharged. The OBLIGATIONS shall not be impaired by the death, termination, dissolution, bankruptcy, insolvency, business cessation, or other financial deterioration of BORROWER, or by any state of facts including without limitation the invalidity, irregularity, illegality, or unenforceability of, or any defect in any of the documents constituting the OBLIGATIONS, and any loss, sale, release, loss of value, or other change in the collateral for any of the OBLIGATIONS.[14]

Bankruptcy Court's Analysis of the Second Guaranty and Resulting Impact of the Debtors' Discharge

In addressing the parties' dispute, the bankruptcy court framed the principal issue as being "whether the [debtors'] liability under the guaranties, if any, for post-petition advances of credit is debt that arose before the date of the filing of their bankruptcy petition." Recognizing that liability for the post-petition advances would have constituted a "contingent claim" as of the petition date, the court narrowed its analysis to "whether the debt arose when the guaranty was executed or when credit was later extended to the principal obligor."[15]

The "question of when the debt arose is one of federal law as informed by state law."[16] Massachusetts law distinguishes between restricted guaranties and continuing guaranties, and "a continuing guaranty would be seen as giving rise to a divisible series of individual transactions, with liability for each extension of credit arising at the time of its extension."[17] Conversely, "liability under a restricted guaranty — one that concerns a contemplated and specified extension of credit — arises, for purposes of § 727(b), upon execution of the guaranty."[18]

In applying this analysis, the court noted that the second guaranty guaranteed "all present and future" obligations under the loan documents, which were "an Acquisition and Construction Loan Note in the principal amount of [$230,000]; a Construction Loan Mortgage and Security Agreement and Assignment; and all other instruments securing or relating to any loan by Lender to Borrower or executed in connection therewith *relative to a constructive project at the property known as and/or located at Unit 58, Beechwood Village, Rockland, Massachusetts*."[19] Based on this language, the court found that "the Second Guaranty is restricted to obligations arising under loan documents relative to the construction of Unit 58 of Beechwood Village."[20]

Although the second guaranty provided that it "shall operate as a continuing Guaranty," the court found that such language did not extend or expand the obligations guaranteed by the debtors.[21] The second guaranty only applied to credit extended to construct Unit 58 of Beechwood Village. The court found that "by 'continuing,' [the second guaranty] means only that the guaranty 'shall continue regardless of any reduction (*except by payment hereunder*) until the obligations have been paid or otherwise discharged' and regardless of certain other circumstances."[22] The court noted that the phrase "except by payment hereunder" made it "clear that the payment of the Obligations *would* cause the guaranty to terminate."[23] The court was "well satisfied that the Second Guaranty was a restricted guaranty."[24] Consequently, the court found that the debtors' liability under the second guaranty arose upon the *execution* of the second guaranty and was therefore a pre-petition claim that was discharged in the debtors' bankruptcy.[25]

The Treatment of Continuing Guaranties in Bankruptcy

While *Reardon* provides an example of the resulting impact that a bankruptcy discharge might have on a party's liability under a restricted guaranty, at least one other decision decided post-*Reardon* demonstrates the treatment of a continuing guaranty. In *Dulles Electric & Supply Corp. v. Shaffer (In re Shaffer)*, the husband-and-wife debtors had guaranteed the payments of their jointly owned business for

14 *Id.* at 124-25 (emphasis added).
15 *Id.* at 127.
16 *Id.*
17 *Id.* at 128.
18 *Id.*
19 *Id.* (emphasis added).
20 *Id.*
21 *Id.*
22 *Id.* (emphasis added).
23 *Id.*
24 *Id.* at 128-29.
25 *Id.*

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all future purchases.[26] In this case, the guaranty stated that it was a "guaranty of payment" and the debtors were liable for "future obligations incurred by the primary obligor."[27] As in *Reardon*, the court looked at both "the language of the guaranty and the nature of the associated credit application," and concluded "that the guaranty is a continuing guaranty."[28]

However, the treatment of the debtors' liabilities under the continuing guaranty was not a foregone conclusion. Noting that "the Fourth Circuit applies the 'conduct test' even to a non-tort action to determine when the obligation arose," the bankruptcy court employed that test to determine when the debtors' obligations under the guaranty arose, "and hence when the personal liability arose."[29] The timing for when the debtors' obligations arose and became contingent claims is relevant for determining whether liability was discharged.

In addressing the issue, the court noted that there is a split in authority on when the conduct that causes liability under a guaranty occurs. Some courts have held that "the conduct [that] gives rise to the contractual obligation can only occur if credit [has been] extended and a default occurs."[30] Under this theory, contingent liability arises upon the extension of credit.

Other courts have held that "the conduct is pre-petition simply because the guaranty was signed pre-petition."[31] Under this theory, contingent liability arises upon executing the guaranty based on the assumption that "the contingency is the future default on existing right to payment, not that the contingency is the extension of new credit."[32] The court addressed the split, stating:

> All of this means that it is not enough that the guaranty is signed pre-petition if there is no ascertainable liability to guarantee.... [A] restrictive guaranty will establish a right to payment for future credit based on the specific transaction with ascertainable terms. *See Reardon*, 556 B.R. at 128-29 (guaranty of construction loan project found to be a restrictive guaranty). Under a continuing guaranty, it is unknown what future extensions may be made and thus the liability as of the signing of the guaranty is not ascertainable. For these reasons, the continuing guaranty signed pre-petition, while establishing a right to payment on current or committed rights to payment, did not create the liability for extensions of credit yet to be entered into or contemplated.[33]

Regarding the case before it, the bankruptcy court held that the debtors, because they signed a continuing guaranty, "did not at the petition date have liability for extensions of credit for purchases not yet contemplated or committed to be made."[34] The debtors' discharge under § 727 "did not discharge liability under the guaranty for the post-petition extensions of credit."[35] However, the court further notes that "[u]nder a continuing guaranty, each new purchase is a distinct debt; *hence, the guarantor could terminate or revoke the guaranty to avoid liability for future transactions*."[36]

Conclusion

Lenders and borrowers should consider the nature of a loan or an extension of a line of credit — not just the terms of the loan documents — when determining whether a guaranty is continuing or, in reality, restricted. The key lesson from *Reardon* and *Shaffer* is that a guaranty must be read in the context of the entire loan in order to determine whether it is continuing or restricted. Be aware that a restricted guaranty might be discharged in bankruptcy and a continuing guaranty might be revoked post-petition. abi

26 *Dulles Elec. & Supply Corp. v. Shaffer (In re Shaffer)*, 2018 WL 1116543, at *1 (Bankr. W.D. Va. 2018).
27 *Id.* at *4.
28 *Id.*
29 *Id.* (citing *Helcombe v. US Airways Inc.*, 369 Fed. App'x. 424, 428 (4th Cir. 2010)).
30 *Id.* at *5 (citing *In re Brand*, Civ. No. TDC-16-2882, 2017 WL 4162248, at *4 (D. Md. Sept. 19, 2017)).
31 *Id.* (citing *Russo v. HD Supply Elec. Ltd. (In re Russo)*, 494 B.R. 562, 564-66 (Bankr. M.D. Fla. 2013); *In re Lipa*, 433 B.R. 668, 669-70 (Bankr. E.D. Mich. 2010)). The court noted that "[t]hese courts [have found that] the guaranty is contingent and unmatured because it only obligates the guarantor if the other party (the maker) defaults; so the guaranty is contingent in the natural sense of the word." *Id.*
32 *Id.*
33 *Id.*
34 *Id.*
35 *Id.*
36 *Id.* (emphasis added).

Consumer Corner

By Michael N. Nicastro and Martina A. Slocomb

Secret Creditors

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Section 521(1) requires debtors to file a list of *all* creditors. If a debtor fails to comply with this mandate, costly amendments may be required, the case may have to be reopened years later, and in a worst-case scenario, the debtor could be denied a discharge of the claims held by creditors that are not scheduled. This article addresses an entire *category* of claims that often remain unlisted despite the directive in 11 U.S.C. § 521, because neither the debtor nor counsel are aware of their existence.

The existence of unknown claims is an ever-present problem in the bankruptcy world. To mitigate this threat, debtors are routinely advised to be as over-inclusive as possible when completing the list of creditors. This list will often include every employee who worked for the debtor. However, it will rarely include the names and addresses of every *employee of every vendor who had provided services to the debtor, the names and addresses of every service provider who worked on every property owned by the debtor, and the names and addresses of every customer who purchased products from the debtor*. The latter disclosures might seem over the top, if not within the realm of paranoid. But maybe they are not.

"Secret" claimholders within these constituencies can exist and can be substantial. These claims can include unknown workers' compensation and state labor code claims arising under particular statutes. These labor code sections allow, for example, the employees of a debtor's vendors to pursue the debtor for as long as a decade after a bankruptcy filing on a strict liability basis.

The Challenge of Preparing Accurate Schedules

In the best of circumstances, it is difficult for bankruptcy counsel to obtain accurate and complete information from a debtor, with supporting documents, prior to a chapter 7 filing. Debtors rarely understand the distinction between the term "creditor" (as in one who is owed money) and "claimholder" (a category that includes unliquidated, disputed and/or contingent liabilities), despite clear guidance from counsel. Statutes, such as those previously described, will only further exacerbate this burden.

Examples of Secret Creditors

Unknown Workers' Compensation Claims

One type of secret claim can arise from the workers' compensation system. These claims can expose a business owner to substantial liability and legal costs years after an accident occurs. For example, in California, workers' compensation claims are subject to a one-year statute of limitations from the date of *discovery* of a compensable disease.[1] This means that a former employee can bring a claim against a former employer/debtor for a work-related disease or injury long after a claims bar date, and long after a case has been closed. Florida and Texas appear to have similar *discovery* statutes of limitations.[2]

If the debtor had workers' compensation insurance, at least in California, the former employee would be compelled to pursue this omitted claim with the workers' compensation appeal board and with the debtor's insurer. This affords the debtor a measure of protection.[3] However, no protection is available if the workers' injuries are "discovered" and asserted after an asset case has closed, the claimholder did not receive timely notice of the bankruptcy and the employer cannot establish that insurance was in place.

Subcontractors and Contractors

In addition, if the debtor uses subcontractors, California Labor Code § 2750.5 makes the debtor liable as an "employer" for all a subcontractor's employees *if the subcontractor* fails to secure workers' compensation insurance.[4] This liability can also arise where a property owner/debtor has work performed at their residence by a worker who is not covered by workers' compensation insurance and a claim arises years later.[5] These workers' compensation statutes convert the employees of subcontractors, general contractors and all workers performing tasks on the debtor's property into potential claimholders — secret, unknown claimholders.

1 Cal. Labor Code § 5405; *Arndt v. Workers' Comp. Appeals Bd.*, 56 Cal.App.3d 139, 144 (Cal. App. 1976) ("date of injury" means "the time when the accumulated effects culminate in a disability traceable to the latent disease as the primary cause, and by the exercise of reasonable care and diligence it is discoverable and apparent that a compensable injury was sustained in performance of the duties of the employment").

2 Fla. Stat. § 440.19 (petition must be "filed within [two] years after the date on which the employee knew or should have known that the injury or death arose out of work performed in the course and scope of employment"); Texas Labor § 409.003 ("An employee ... shall file with the division a claim for compensation for an injury not later than one year after the date on which: (1) the injury occurred; or (2) if the injury is an occupational disease, the employee knew or should have known that the disease was related to the employee's employment").

3 Cal. Labor Code § 3602.

4 *See Hernandez v. Chavez Roofing Inc.*, 235 Cal. App. 3d 1092, 1095 (Cal. App. 2 Dist. 1991) ("Section 2750.5 can create a dual-employment relationship whereby a worker may be an employee of both a general contractor and a subcontractor.... The price that must be paid by each employer for immunity from tort liability is the purchase of a worker's compensation policy.").

5 *Jones v. Sorenson*, 236 Cal. Rptr. 3d 271, 279, 25 Cal. App. 5th 933, 943 (Cal. App. 3 Dist. 2018) (homeowner is liable in torts for injuries to unlicensed contractor at his residence).

Statutory Rights to Sue: Garment Workers

Other labor-centric statutes can expand liability to third parties, creating a potential class of unknown claimholders for those third parties. One such example is found in California Labor Code § 2673.1, which is designed to protect Los Angeles garment workers, who have historically been paid less than minimum wage:

> (a) To ensure that employees are paid for all hours worked, a person engaged in garment manufacturing, as defined in Section 2671, who contracts with another person for the performance of garment manufacturing operations shall guarantee payment of the applicable minimum wage and overtime compensation, as required by law, that are due from that other person to its employees that perform those operations.[6]

For a manufacturer/debtor, California Labor Code § 2673.1 means that every employee of a subcontractor-manufacturer is a potential claimholder in the manufacturer/debtor's bankruptcy case. This body of potential claimholders could include hundreds or thousands of subcontractor employees who are unknown to the debtor/manufacturer, which creates a potentially massive hole in a debtor's bankruptcy notice.[7]

Strict Product Liability

If the debtor was involved in the retail sale of a product that is later determined to be defective, and a customer suffers an injury resulting from the use of the product, the customer has two years from the date the customer knew, or should have known, about the injury to assert a claim (not from the time the product was purchased).[8] In some instances, a product may not be deemed defective until years later or the customer could have paid for the product with cash, leaving no record. Accordingly, the debtor would have no ability to identify these customers and send them notice.

Secret Creditors in No-Asset Cases

In "no asset" cases, there is a level of protection from later collection attempts by omitted creditors,[9] as "the Bankruptcy Code discharges debts [that] are never listed on a schedule. If a creditor has knowledge of the debtor's bankruptcy case in time to file a proof of claim and to bring a § 523(2), (4) or (6) cause of action, the omission of the claim is not a bar to its discharge."[10] Thus, a discharge under 11 U.S.C. § 727 and the resulting permanent injunction under § 524 control in no-asset cases, even where creditors are omitted from a debtor's schedules. In *In re Nielsen*,[11] the Ninth Circuit held that any creditor's pre-petition claim omitted from the schedules of a no-asset chapter 7 case is discharged whether the creditor actually received notice or not.

In sum, case law supports the concept that where creditors are never required to file a proof of claim, the period within which a creditor must file a proof of claim never begins, and since it never begins, it never ends. Therefore, it is never too late to file a "timely" proof of claim, and the exception to discharge, set forth in 11 U.S.C. § 523(a)(3), does not apply, so unscheduled debts are discharged.

This discharge of unscheduled claims in a no-asset case still comes at the cost of either convincing the creditor that the discharge applies informally at the state court level,[12] or by reopening the bankruptcy case, scheduling and providing notice to the creditor. Reopening the bankruptcy case might come with increased risk of an adversary proceeding if the debtor has assets or resources after "recovering" from their prior discharge of debt.

Secret Creditors in an Asset Case

In an asset case, if a distribution has not yet been made, there is a window of opportunity to amend and send notice of an asset case to a previously unknown creditor even after the deadline to file a proof of claim has expired.[13] This line of cases holds that because 11 U.S.C. § 726(a)(2)(C) allows "claimants who did not receive notice of the bankruptcy case … to file a proof of claim [that] will be allowed as if the creditor had notice and had timely filed a proof of claim," § 523(a)(3)'s exception to discharge does not apply.

If a client does not identify and provide notice to a previously unknown claimant in time for the claimant to file a proof of claim and receive a distribution, the claim will be nondischargeable pursuant to § 523(a)(3). This circumstance becomes a real possibility when you consider the fact that it might not be possible for a client to obtain potential creditor contact information, *even if they know that particular potential creditor exists*.

Is There a Solution?

One possible solution to the secret claimant notice issue is to require all employees to direct their claims to the Department of Industrial Relations (DIR) (in California) or similar state agency. In California, the DIR oversees workers' compensation, health and safety, and other labor and employment issues. It provides the exclusive mechanism for workers' compensation claims as long as the employer had workers' compensation insurance. It provides a nonexclusive remedy for unpaid wages claims. Allowing debtors to give notice to the DIR of the bankruptcy and deeming such notice to be notice to all potential claimants is a possible solution.

If the debtor has workers' compensation insurance or homeowners' insurance (in the case of a homeowner who hires an unlicensed contractor who suffers injuries), any

6 Cal. Labor Code § 2673.1.

7 Likewise, a manufacturer/debtor might face liability for penalties when a subcontractor/manufacturer fails to register. Again, this is information that the manufacturer might not know they are able to schedule in a bankruptcy petition. *See* Cal. Labor Code § 2677 ("(a) Any person engaged in the business of garment manufacturing who contracts with any other person similarly engaged who has not registered with the commissioner or does not have a valid bond on file with the commissioner, as required by Section 2675, shall be deemed an employer, and shall be jointly liable with such other person for any violation of Section 2675 and the sections enumerated in that section.").

8 *Dominguez v. Hayward Indus. Inc.*, 201 So.3d 100, 101-02 (Fla. App. 3 Dist. 2015); Fla. Stats. §§ 95.11, 95.031; *Sevilla v. Stearns-Roger Inc.*, 101 Cal. App. 3d 608, 610-11 (Cal. App. 1980) ("[A]n injured employee's cause of action against the manufacturer of defective equipment runs from the date of injury, rather than the date the product was purchased.... Theoretically, manufacturers remain liable indefinitely for injuries proximately caused by their defective products."); *Texas Civ. Prac. & Rem.* § 16.012 (15 years).

9 *In re Beezley*, 994 F.2d 1433, 1436 (9th Cir. 1993).

10 *In re Peacock*, 139 B.R. 421, 424 (Bankr. E.D. Mich. 1992); *see also id.*; § 523(a)(3); *In re Soult*, 894 F.2d 815, 817 (6th Cir. 1990) (noting that omission must not be willful).

11 383 F.3d 922 (9th Cir. 2004).

12 "State and federal courts have concurrent jurisdiction over actions brought under § 523(a)(3), which allows debtors to extend the coverage of the discharge order to creditors who were not listed but who had actual notice of the bankruptcy proceedings." *In re McGhan*, 288 F.3d 1172, 1181 (9th Cir. 2002).

13 *In re Horlacher*, 2009 WL 903620, at *4 (N.D. Fla. 2009) ("Thus, § 523(a)(3)(A) is 'inapplicable to the situation where the creditor receives notice of the bankruptcy case too late to allow the filing of a claim by the bar date, but in time to allow the creditor to file a proof of claim prior to distribution.'"); *In re Ricks*, 253 B.R. 734, 744 (Bankr. M.D. La. 2000); *In re Snyder*, 544 B.R. 905, 909 (Bankr. M.D. Fla. 2016).

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unknown workers' compensation claims that the debtor learns of can be satisfied through insurance. However, this assumes that the debtor maintains records of insurance policies indefinitely and that coverage is not subject to a "claims made" deadline.

Notice by Publication

Another solution for debtors who suspect they might have secret but unknown creditors is to obtain court approval for notice by publication. Due process is satisfied if unknown claimholders who hold potential or speculative claims receive notice by publication.[14] A bankruptcy court explained in *In re Energy Future Holdings Corp*.[15] the level of notice required to unknown creditors:

> A debtor must provide actual notice to all "known creditors" in order to discharge their claims. Known creditors include both claimants actually known to the debtor and those whose identities are "reasonably ascertainable." "A creditor's identity is reasonably ascertainable if that creditor can be identified through reasonably diligent efforts. Reasonable diligence does not require impracticable and extended searches. The requisite search for a known creditor, instead, usually requires only a careful examination of a debtor's books and records." By contrast, the debtor need only provide "unknown creditors" with constructive notice by publication. Constructive notice must be "reasonably calculated, under the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." "Publication in national newspapers is regularly deemed sufficient notice to unknown creditors, especially where supplemented ... with notice in papers of general circulation in locations where the debtor is conducting business."

A diligent bankruptcy attorney must confer with a debtor to determine the probability of unknown claimholders and the amount of their potential debt to advise the debtor as to whether the cost of a motion to the court to allow notice by publication is in the debtor's best interest.

A Court-Adopted Form Motion for Notice

A better solution would be a court-adopted form motion that asks debtors to identify past financial circumstances, indicate due-diligence efforts to identify potential creditors and request case-specific orders for how to give notice by publication in cost-sensitive ways. Notice by publication is commonly allowed in, for example, asbestos cases, where there is a large body of potential unknown claimholders. Such a mechanism would protect the right of the honest, unfortunate and diligent debtor to receive the benefit of a full discharge of pre-petition-based claims in asset cases.

Conclusion

Given the foregoing risks, counsel should make an effort to ascertain whether "secret" claims of the kind addressed in this article may exist. If they do, notice by publication might be the only practical option. To limit the burdens on the courts and the bar, each jurisdiction should adopt a form motion and order providing this relief. abi

14 *In re Gencor Indus. Inc.*, 298 B.R. 902, 916-17 (Bankr. M.D. Fla. 2003) ("[C]reditors holding 'merely conceivable, conjectural, or speculative claims' are not entitled to receive actual notice in a bankruptcy case."); *In re Placid Oil Co.*, 463 B.R. 803, 817 (Bankr. N.D. Tex. 2012).

15 522 B.R. 520, 529 (Bankr. D. Del. 2015).

Chapter 7 Due Diligence List for Businesses

1. The nature and type of business in which the Company was engaged
2. General background history of the business
3. The year the Company commenced operations
4. Reason(s) for the Company's failure to thrive
5. Efforts made by management to remedy the Company's problem(s)
6. Information regarding efforts sell or refinance the Company
7. The amount(s) and source(s) of initial capitalization
8. The amount(s) and source(s) of financing of the Company
9. Copies of financial statements provided to actual or potential lenders or investors
10. The nature of the business entity (corporation, LLC, partnership, etc.), if any
11. Corporate structure and related entities
12. Names and addresses of all equity holders
13. Names and addresses of all directors, officers, managers and controlling persons
14. The number of employees
15. List of equipment held by the Company as of Petition Date/conversion date
16. List of accounts receivables or other receivables owed to the Company as of the Petition Date/conversion date

17. List of bank accounts held by the Company as of the Petition Date/conversion date

18. Location of physical bank statements of the Company

19. List of intellectual property held by the Company as of the Petition Date/conversion date

20. List of significant contracts or leases to which the Company was a party

21. List of insurance policies to which the Company was a party including, without limitation, D&O policies

22. Complete copies of tax returns were filed for the Company for the last 4 years

23. If the Company was part of a consolidated group for tax reporting purposes -- details regarding mechanics of tax reporting

24. Location of the books and records of the Company, including corporate and accounting records; contact information of the person(s) who can provide access to such books and records

25. Location of computers, laptops, BOD resolutions, minute books, etc.

26. Accounting system used (i.e., QuickBooks) and contact info of CFO or other knowledgeable persons

27. If the accounting records of the Company were kept electronically -- credentials, usernames, passwords and other information necessary to access such accounting records.

28. Contact information for the Company's outside accountant/auditor

29. Copies of year-end financial statements, balance sheets and P&L Statements for the last 4 years

30. Major transactions in which the Company engaged in the last 4 years including, without limitation, assets sales, capital raises, stock or other equity transactions, financings/refinancings or LBO's

31. Litigation in which the Company was involved including, without limitation, foreclosures or repossessions

32. Insider transactions in the last 4 years including, without limitation, dividends, bonuses, loans and severance payments

33. Total income received by insiders from the Company in each of the last 4 years including, without limitation, salary, loans, benefits and other perquisites of employment 401k Plan – contact information for third party administrator and other managers, if any

34. The address where mail received and who has been collecting the mail after the Petition Date

"When a Business Owner Files Chapter 7"
April 22, 2023 at 8:30 a.m.

I. DEFINING PROPERTY OF THE ESTATE

A. The Code's Definition of "Property of the Estate"

Section 541(a) defines "property of the estate" as "all legal or equitable interest of the debtor in property as of the commencement of the case." Section 541(c)(1) further provides:

> Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement transfer instrument, or applicable nonbankruptcy law—
>
> (A) that restricts or conditions transfer of such interest by the debtor; or
>
> (B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

B. Section 541 Preempts State Law Termination of Membership Interests

Courts have consistently held that 11 U.S.C. § 541(c) preempts any provision in state law or within specific operating agreements that purports to terminate a member's interest in a business entity upon bankruptcy or that otherwise restricts the transfer of a debtor's interest to the trustee.

> *In re All Year Holdings Ltd.,* 2022 WL 17584254, at *17 (S.D.N.Y. Dec. 12, 2022) (Chapter 11) (finding that "Section 541(c) squarely precludes" termination of membership interest due to bankruptcy filing)
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> *In re William H. Thomas, Jr.*, 2020 WL 2569993, at *9 (Bankr. W.D. Tenn. May 8, 2020) (Chapter 11) ("[U]pon the filing of the Debtor's bankruptcy petition, his membership interest in [the LLC] became property of his bankruptcy estate notwithstanding the attempt by [Tennessee state law] to prevent that result.")
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> *In re Minton*, 2017 WL 354319, at *6 (Bankr. C.D. Ill. Jan. 24, 2017) ("Under [541], a debtor's interest in an LLC becomes property of the estate even though some provision of the operating agreement or nonbankruptcy law would otherwise prevent the transfer.")
>
> *In re Prebul*, 2012 WL 5997927, at *10-11 (E.D. Tenn. Nov. 30, 2012) (finding that applicable NY state law "was rendered inapplicable here because it would modify or terminate" the debtor's interest in an LLC, and that section 541 "renders inapplicable termination or modification of an interest solely due to a debtor's bankruptcy.")

In re Klingerman, 388 B.R. 677 (Bankr. E.D. N.C. 2008) (Chapter 11) ("Section 541(c) provides that all of the debtor's interest passes to the estate notwithstanding applicable nonbankruptcy law that effects a modification or termination of the debtor's interest upon the commencement of a bankruptcy case.")

But see Northwest Wholesale, Inc. V. PAC Organic Fruit, LLC, 357 F.3d 650 (Wash. 2015) (Supreme Court of Washington holding that the Bankruptcy Code did not preempt state law, and that bankruptcy filing would restrict trustee's interest to that of an assignee)

C. Trustee's Rights to Non-Economic Interests in Business Entity

Similarly, courts have generally recognized that the trustee acquires the non-economic rights and interests (e.g., voting rights, dissolution rights, etc.) associated with debtor's membership interest in a business entity. Notably, this is true regardless of whether or not the operating or partnership agreement governing the entity is determined to be executory in nature.

In re William H. Thomas, Jr., 2020 WL 2569993, at *9 (Bankr. W.D. Tenn. May 8, 2020) (collecting cases) (Chapter 11) ("The Debtor's membership interest included both financial rights and governance rights. Upon the appointment of the Trustee, the right to exercise the governance rights for the benefit of the estate passed to the Trustee.")

In re Altman, 2018 WL 3133164, at *5 (B.A.P. 9th Cir. June 26, 2018) (Chapter 11) (collecting cases and recognizing that "membership in a limited liability company may confer both economic and non-economic rights and that both fall within the § 541(a)'s definition of estate property")

In re First Prot., Inc., 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010) ("We conclude that all of the Debtors' contractual rights and interest in [the LLC] became property of the estate under § 541(a) by operation of law when they filed their petition.")

In re Antonelli, 4 F.3d 984 (4th Cir.1993) (Chapter 7 converted to Chapter 11) ("When bankruptcy proceedings commenced, Antonelli's general partnership interests became the property of the Debtor's bankruptcy estate. Both the economic interest in the partnerships and the right to participation in the management of the partnerships' affairs vested in the estate.")

In re Tarkanian, 562 B.R. 424, 455 (Bankr. D. Nev. 2014) ("If the member files a Chapter 7 petition, both the member's economic and non-economic interests become property of the bankruptcy estate, and the bankruptcy trustee may exercise the management rights, if any, that the debtor has in the limited liability company.")

In re Lee, 524 B.R. 798, 804 (Bankr. S.D. Ind. 2014), *aff'd sub nom. Lee Grp. Holding Co., LLC v. Walro*, 2015 WL 4724944 (S.D. Ind. Aug. 10, 2015) ("Based on these authorities,

Indiana law and the clear terms of the Operating Agreement, the Court concludes that Debtor's voting rights in the Lee Group were property of the estate as of the Petition Date.")

In re Jundanian, 2012 WL 1098544, at *6 (Bankr. D. Md. Mar. 30, 2012) (Chapter 11) ("The Court concludes that the Voting and Management Rights became property of the estate upon the filing of the petition.")

In re Warner, 480 B.R. 641, 653 (Bankr. N.D.W. Va. 2012) ("The court finds that these and similar voting rights—non-economic contractual rights—are property of the Debtor's estate under § 541(a)(1).")

In re Liber, 2012 WL 1835164, at *2 (Bankr. N.D. Ohio May 18, 2012) ("[I]n a Chapter 7 case, where a debtor owns an interest in a business entity, the trustee is entitled to administer that interest—as well as any rights derived from that interest—in the stead of the debtor.")

But see In re Marchese, 2018 WL 3472823, at *16 (Bankr. E.D. Pa. July 16, 2018) ("It is not settled whether a bankruptcy trustee can succeed to the managerial rights of an individual debtor who is an LLC member.")

D. Trustee Does Not Acquire Interest in Underlying Assets of Business Entity

Although there is a consensus that the bankruptcy estate acquires the economic rights of the membership interest, the business entity's underlying assets nonetheless remain with the entity.

In re Chatha, 2022 WL 4101292, at *5 (Bankr. E.D. Cal. Sept. 6, 2022) (distinguishing between trustee's ownership interest in LLC and assets of LLC)

In re Johnson, 2021 WL 5496731, at *4 (Bankr. E.D. Va. Nov. 22, 2021) (refusing to compel sale of LLC property pursuant to 363(h) because debtors "did not have a direct interest" in the property but rather "membership interests in [the LLC], which were owned by them individually")

In re Hess, 618 B.R. 13, 17 (Bankr. D.N.M. 2020) (residential property owned by LLC not included in property of the estate)

In re McCauley, 549 B.R. 400, 410 (Bankr. D. Utah 2016) ("Under Utah law, a member of an LLC has no interest in specific property of the company.")

Manson v. Friedberg, 2013 WL 2896971, at *3 (S.D.N.Y. June 13, 2013) ("Whatever legal or equitable interest an individual has in an LLC is personal property within the meaning of the bankruptcy estate under § 541. But property of the LLC is not property of individual members and members of an LLC have no interest in the specific property of the LLC.")

In re Rodio, 257 B.R. 699 (Bankr. D. Conn. 2001) (Chapter 13) (holding that property of LLC in which Debtor is a member is not property of Debtor's estate)

II. SALE OF DEBTOR'S MEMBERSHIP INTEREST

A. Trustee's Sale of Equity in Single-Member Business Entity

If the debtor possesses complete ownership in a business entity, and there are no other members, the courts generally recognize that a trustee succeeds to all of the debtor's rights, including control of the business entity, as well as the right to sell the entity's assets.

> *In re Morreale,* 595 B.R. 409, 417 (10th Cir. BAP 2019), *aff'd*, 959 F.3d 1002 (10th Cir. 2020) (explaining that where Chapter 7 trustee succeeded to interest in LLC, the trustee also obtains the right to "control and manage the LLC and its assets")
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> *In re Blair Oil Invs., LLC*, 588 B.R. 579, 595 (Bankr. D. Colo. 2018) ("[A] Chapter 7 debtor's membership interests in a Chapter 11 limited liability company pass to the Chapter 7 bankruptcy estate. At that point, a Chapter 7 trustee, acting as the sole member of a Chapter 11 limited liability company, may control all governance of a Chapter 11 limited liability company.")
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> *In re Cleveland*, 519 B.R. 304, 306 (D. Nev. 2014) ("[W]here a debtor has a membership interest in a single-member LLC . . . the Chapter 7 trustee succeeds to all of the debtor's rights, including the right to control that entity, and a trustee need not take any further action to comply with state law before exercising such control.")
>
> *In re Wallace*, 2013 WL 1681780, at *3 (Bankr. D. Idaho Apr. 17, 2013) ("[W]hen debtor is the sole member of an LLC, all of the debtor's rights in the LLCs become property of the estate, including both economic and management rights.")
>
> *In re B & M Land & Livestock, LLC*, 498 B.R. 262, 267 (Bankr. D. Nev. 2013) ("This Court concludes that, where a debtor has a membership interest in a single-member LLC and files a petition for bankruptcy under Chapter 7, the Chapter 7 trustee's rights automatically include the right to manage that entity.")
>
> *In re Albright*, 291 B.R. 538, 540 (Bankr. D. Colorado, 2003) ("Because there are no other members in the LLC, no written unanimous approval of the transfer was necessary. Consequently, the Debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the Trustee obtained all her rights, including the right to control the management of the LLC.")
>
> *In re First Prot., Inc*., 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010) (finding trustee "stepped into Debtors' shoes, succeeding to all of their rights, including the right to control [LLC].")

B. Effect of the Automatic Stay on Single-Member and Multi-Member Business Entities

As a general matter, the courts will not allow other members of a business entity to terminate or interfere with the debtor's post-petition membership or voting rights in the business entity.

Because the debtor's membership in the business entity is part of the estate, any governance or membership changes that affect that interest may violate the automatic stay. Similarly, certain courts have held that the automatic stay extends to a business entity of which the debtor is the sole member.

> *In re Bello,* 612 B.R. 389, 391 (Bankr. E.D. Mich. 2020) (Chapter 11) (collecting cases) ("[W]hen a bankruptcy debtor owns a 100%, or the majority, interest in a corporation, it is a violation of the automatic stay for a creditor to file a motion seeking the appointment of a receiver of the corporation in a non-bankruptcy case.")
>
> *In re Qarni*, 2019 WL 6817106, at *3-5 (Bankr. E.D. Cal. Dec. 11, 2019) (Chapter 13) (holding that creditor's filing of a lawsuit against corporation for appointment of receiver violated automatic stay where debtor was sole shareholder and possessed contractual right, based on corporate bylaws, to control the activities of the corporation as receivership would alter debtor's right to control)
>
> *In re Altman,* 2018 WL 3133164, at *6 (B.A.P. 9th Cir. June 26, 2018) (Chapter 11) ("[U]nder the Operating Agreement, [debtor] had the prepetition contractual right to manage [LLC]. The bankruptcy court correctly found that this non-economic contractual right to manage [the LLC] was property of [the debtor's] estate under § 541(a)(1) and therefore protected by the automatic stay.")
>
> *In re McCabe*, 345 B.R. 1, 7 (D. Mass. 2006) (holding that non-debtor member's post-petition amendments to LLC agreement reallocating debtor's membership interest violated automatic stay)
>
> *Matter of Daugherty Const., Inc*., 188 B.R. 607, 615 (Bankr. D. Neb. 1995) (Chapter 11) (finding "pospetition acts of other LLC members seeking to terminate or modify the debtor's interests," including by voting to continue LLC business, removing LLC manager, and by adding new members, all violated automatic stay)
>
> *See also In re Jorgensen,* 2011 WL 6000871, at *5 (Bankr. D. Wyo. Nov. 30, 2011) (holding that collateral securing promissory note was an asset of multi-member LLC and creditor suit for default did not violate automatic stay)
>
> *But see In re McCormick*, 381 B.R. 594, 602 (Bankr. S.D.N.Y. 2008) (Chapter 13) (refusing to expand automatic stay to wholly-owned LLC through which debtor carried out general contracting business (chapter 13 case))

C. Validity of Restrictions on Trustee's Membership Interests

In contrast to section 541's preemption of state law and operating agreements purporting to limit the property of the estate, a business entity's operating agreement (and applicable state law) may validly restrict the trustee's ability to sell the estate's interest in the business entity once the trustee succeeds to that interest.

Mission Prod. Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1663 (2019) (holding that with respect to contract rights "Section 365 reflects a general bankruptcy rule: The estate cannot possess anything more than the debtor itself did outside bankruptcy")

In re Kramer, 2022 WL 17176411, at *8 (B.A.P. 10th Cir. Nov. 23, 2022) (upholding operating agreement's transfer restrictions on LLC interests and enforcing restrictions with respect to Trustee's proposed sale of capital interests)

In re Chatha, 2022 WL 4101292, at *10 (Bankr. E.D. Cal. Sept. 6, 2022) (concluding that under Texas law and restrictions in the operating agreements the court could "not authorize the chapter 7 trustee to use his 100% interest in [the LLC], and his status as the Manager and sole member of [the LL], to transfer the Hotel to the bankruptcy estate for the purpose of selling the Hotel under 11 U.S.C. § 363")

In re Ogletree, 2020 WL 6557434, at *4 (B.A.P. 9th Cir. Nov. 4, 2020) (Chapter 13) ("[T]he rights to which the trustee succeeds are defined and limited by the LLC's operating agreement.")

In re Minton, 2017 WL 354319, at *6 (Bankr. C.D. Ill. Jan. 24, 2017) ("Section 541(c)(1) [] does not provide authority for the Trustee to sell the estate's interest in [the LLC] free of the constraints of the Operating Agreement . . . [S]ale restrictions in LLC operating agreements are generally enforced in bankruptcy where they do not significantly impair a trustee's ability to obtain the fair market value of the estate's interest in the LLC.")

In re Garbinski, 465 B.R. 423, 426 (Bankr. W.D. Pa. 2012) (noting that an operating agreement "might contain provisions that would prevent the trustee from transferring an interest in the entity")

In re Liber, 2012 WL 1835164, at *3 (Bankr. N.D. Ohio May 18, 2012) (finding pension fund possessed superior claim to sales proceeds and noting that "Trustee, while stepping into the Debtor's shoes insofar as it concerns the Debtor's membership interest in [LLC], takes that interest subject to any applicable legal limitations imposed on that interest.")

In re Crossman, 259 B.R. 301, 307 (Bankr. N.D. Ill. 2001) (finding that trustee could not sell or assign debtor's right to future payments under settlement agreement)

See also In re IT Grp., Inc., Co., 302 B.R. 483 (D. Del. 2003) (right of first refusal under LLC operating agreement held enforceable (chapter 11 case))

III. TRUSTEE'S LIQUIDATION OF A BUSINESS ENTITY

A. Trustee's Liquidation of One-Member Business Entity

As with a trustee's right to sell a membership interest, where a debtor is the sole member of a business entity, the courts recognize that a trustee succeeds to all of the debtor's rights, including the right to wind down or dissolve the business entity.

> *In re Johnson*, 2021 WL 5496731, at *6 (Bankr. E.D. Va. Nov. 22, 2021) (refusing to dismiss trustee's claim for dissolution and noting that "the Trustee is not without rights" both "economic and non-economic")
>
> *In re Dzierzawski*, 528 B.R. 397, 410 (Bankr. E.D. Mich. 2015) (collecting cases) (noting as "correct" the parties' assumption that trustee could exercise debtor's 100% management rights in order to make distributions, sell assets, or "cause the LLC to dissolve, wind down, and thereby liquidate under Michigan law")
>
> *In re Klingerman*, 388 B.R. 677, 679 (Bankr. E.D.N.C. 2008) (Chapter 11) ("[Debtor's rights and interest in the LLC, economic and non-economic, became property of the estate upon the filing of his petition. As a member of the LLC, the estate has standing to ask for dissolution of ExecuCorp.")
>
> *In re Albright*, 291 B.R. 538, 539 (Bankr. D. Colo. 2003) (finding trustee could use 100% interest as manager and sole member of debtor's entity to sell entity's property and distribute net proceeds or distribute entity's property to the estate and liquidate the property)

B. Trustee's Liquidation of Multi-Member Business Entity

Where the debtor is one of several members in a business entity, the trustee's ability to liquidate the entity may be dependent on other factors, including specific corporate governance rights, whether the operating agreement is deemed an executory contract and, if so, whether it was assumed or rejected.

> *Sullivan v. Mathew*, 2015 WL 1509794, at *8 (N.D. Ill. Mar. 30, 2015) ("By failing to assume the partnership agreement, Sullivan rejected the contract and cannot now enforce it. The relief [the trustee] seeks in his complaint—dissolution pursuant to the partnership agreement, judicial supervision of winding up, and an accounting to ensure that the partnership was properly dissolved and wound-up—are based on the management rights included in the agreement that he rejected.")
>
> *In re Ogletree*, 2020 WL 6557434, at *4 (B.A.P. 9th Cir. Nov. 4, 2020) (Chapter 13) ("A chapter 7 trustee would step into [the debtor's] shoes and assume only the rights she had under the operating agreement. Because [the creditor] failed to present the court with the LLC's operating agreement, there was no factual basis for her argument that a chapter 7 trustee . . . could have liquidated the [LLC property]"

In re Tsiaoushis, 383 B.R. 616, 618 (Bankr. E.D. Va. 2007), *aff'd*, 2007 WL 2156162 (E.D. Va. July 19, 2007) (Chapter 11) (finding that because operating agreement was not an executory contract, § 365 was "not applicable" and provisions providing for dissolution of LLC and liquidation of company property were "fully enforceable")

In re Garbinski, 465 B.R. 423, 427 (Bankr. W.D. Pa. 2012 (recognizing that in the absence of operating agreements the trustee could "exercise rights as a partner/member seeking to obtain a judicial dissolution and winding up of the entities by invoking state law remedies involving dissolution or liquidation of LLC or limited partnership entities")

IV. OPERATING AGREEMENTS AS EXECUTORY CONTRACTS

A. Courts Apply the Countryman Test to Operating Agreements

Generally, courts will evaluate an operating agreement using the *Countryman* standard *i.e.* whether both parties to the contract have unperformed obligations that would constitute a material breach if not performed. To make this determination, the courts will carefully review the agreement's text and analyze the particular circumstances.

Operating Agreement Deemed Executory Contract

In re Woodfield, 602 B.R. 747, 760–61 (Bankr. D. Or. 2019) (Chapter 11) ("Given the particular facts of this case, I hold that a breach of any of the ongoing obligations in the Operating Agreements would be material, thus making the agreements executory contracts for purposes of § 365.")

In re Allentown Ambassadors, Inc., 361 B.R. 422, 444 (Bankr. E.D. Pa. 2007) (Chapter 11) ("I conclude that the Operating Agreement is an executory contract. I find that the members of the NAB, LLC had ongoing, material, unperformed obligations to one another and the LLC as of the commencement of this bankruptcy case. These obligations included: (1) the duty to manage the [LLC] and (2) the duty to make additional cash contributions if needed by the LLC.")

Matter of Daugherty Const., Inc., 188 B.R. 607, 611 (Bankr. D. Neb. 1995) (Chapter 11) ("[T]he LLC Articles of Organization and the Operating Agreement among the LLC members (together the "LLC Articles and Agreements") constitute, on the facts of this case, executory contracts which the debtor may attempt to assume under section 365….")

In re Ichiban, Inc., 2014 WL 2937088, at *4 (Bankr. E.D. Va. June 30, 2014) ("The operating agreement is an executory contract and the right of first refusal, if it did not expire earlier, was rejected by the trustee's failure to assume it on July 2, 2006.")

In re DeLuca, 194 B.R. 65, 77 (Bankr. E.D. Va.1996) (Chapter 11) (LLC operating agreement was an executory contract where the "object of the agreement—the

development of the Parc City Center project—has not yet been accomplished and the parties have on-going duties and responsibilities")

Operating Agreement Not an Executory Contract

In re Duncan, 2023 WL 2229349, at *7 (Bankr. D. Idaho Feb. 24, 2023) ("None of these rights [first refusal and tax gross up], however, are performance obligations that transform the Agreement into an executory contract under the Countryman definition and the existing case law.")

In re All Year Holdings Ltd., 645 B.R. 10, 36 n.23 (Bankr. S.D.N.Y. 2022), *aff'd*, 2022 WL 17584254 (S.D.N.Y. Dec. 12, 2022) (Chapter 11) ("With only one member to the LLC Agreement here, the contract is not executory.")

In re Yow, 590 B.R. 696, 701 (Bankr. E.D.N.C. 2018) (operating agreements not executory where only ongoing responsibility was to conduct and attend annual meeting and agreements did not "otherwise obligate the members to perform any managerial duties" nor did they "delineate or specify any required action or outstanding material obligations")

In re Minton, 2017 WL 354319, at *5 (Bankr. C.D. Ill. Jan. 24, 2017) ("The Debtor was not in a managerial role in BMA Ventures, and whatever other obligations he may have had are not material. The Operating Agreement is therefore not an executory contract that could be assumed or rejected pursuant to § 365.")

In re Cap. Acquisitions & Mgmt. Corp., 341 B.R. 632, 636–37 (Bankr. N.D. Ill. 2006) (Chapter 11) ("Having reviewed the specific operating agreement at issue in this case, and finding neither current obligations nor any role, let alone an important one, for CAMCO in the management of the LLC, the court concludes that the Operating Agreement is not an executory contract and cannot be assumed, assigned or rejected.")

In re Ehmann, 319 B.R. 200, 205 (Bankr. D. Ariz. 2005) ("In the absence of any obligation on the part of the member, it is difficult to see where an executory contract lies.")

In re Richardson Miles Hanckel, III, 2015 WL 7251714, at *5 (D.S.C. Mar. 10, 2015) ("Like the Bankruptcy Court, this Court finds that the Operating Agreement is not an executory contract.")

In re Garrison-Ashburn, L.C., 253 B.R. 700, 708 (Bankr. E.D. Va. 2000) (Chapter 11) ("In this case, the Operating Agreement merely provides the structure for the management of the company. It imposes no additional duties or responsibilities on the members.")

In re Knowles, 2013 WL 152434, at *3 (Bankr. M.D. Fla. Jan. 15, 2013) ("The Court, after reviewing the Operating Agreement and considering the undisputed evidence as to the Debtors' limited roles in the management of the LLC and the actual operations of the LLC, easily finds the agreement is not executory.")

In re Warner, 480 B.R. 641, 652 (Bankr. N.D.W. Va. 2012) (operating agreement of LLC was not executory because "there are no material unperformed and continuing obligations owed by the Debtor")

In re Denman, 513 B.R. 720, 725 (Bankr. W.D. Tenn. 2014) (Chapter 13) ("Based on the foregoing, the court finds here that Tennessee LLC operating agreements are not per se executory contracts governed by § 365 of the Bankruptcy Code because of their unique elements and features under state law that are inconsistent with contract law.").

In re Hanckel, 512 B.R. 539, 548 (Bankr. D.S.C. 2014) (concluding that the operating agreement is not an executory contract.")

In re Smith, 185 B.R. 285, 293 n.10 (Bankr. S.D. Ill. 1995) (collecting cases)

B. Effect of Executory Contract Determination on a Trustee's Non-Economic Rights

Courts have analyzed the impact of whether or not an operating agreement is executory on governance rights in various ways.

In re Yow, 590 B.R. 696, 706 (Bankr. E.D.N.C. 2018) (finding operating agreements were non-executory and permitting sale of "bare economic interests" while noting that trustee had "not requested authority to sell or otherwise convey the non-economic interests.")

In re Minton, 2017 WL 354319, at *3 (Bankr. C.D. Ill. Jan. 24, 2017) (distinguishing between management and property rights for purposes of rejecting an operating agreement)

Sullivan v. Mathew, 2015 WL 1509794, at *8 (N.D. Ill. Mar. 30, 2015) ("[Trustee] rejected the contract and cannot now enforce it. The relief [the trustee] seeks in his complaint [corporate dissolution] . . . [is] based on the management rights included in the agreement that he rejected.")

In re Garbinski, 465 B.R. 423, 426 (Bankr. W.D. Pa. 2012) ("[I]f an operating agreement is found to be an executory contract, Section 365(c) permits a non-debtor party to enforce specific transfer restrictions contained in it against the trustee. For instance, the agreement might contain provisions that would prevent the trustee from transferring an interest in the entity." Further, the Court recognized that in the absence of operating agreements the trustee could "exercise rights as a partner/member seeking to obtain a judicial dissolution and winding up of the entities by invoking state law remedies involving dissolution or liquidation of LLC or limited partnership entities.")

In re Ehmann, 319 B.R. 200, 206 (Bankr. D. Ariz. 2005) ("Because there are no obligations imposed on members that bear on the rights the Trustee seeks to assert here, the Trustee's rights are not controlled by the law of executory contracts and Bankruptcy Code § 365. Consequently the Trustee's rights are controlled by the more general provision governing property of the estate, which is Bankruptcy Code § 541.")

In re Tsiaoushis, 383 B.R. 616, 618 (Bankr. E.D. Va. 2007), *aff'd*, 2007 WL 2156162 (E.D. Va. July 19, 2007) (Chapter 11) (finding that because operating agreement was not an executory contract, § 365 was "not applicable" and provisions providing for dissolution of LLC and liquidation of company property were "fully enforceable")

In re DeVries, 2014 WL 4294540, at *13–14 (Bankr. N.D. Tex. Aug. 27, 2014) (finding operating agreement was an executory contract rejected by the trustee and that trustee was therefore entitled to economic rights but not management rights in LLC)

Faculty

Don A. Beskrone is a director in Ashby & Geddes' Bankruptcy and Insolvency group in Wilmington, Del. For more than 35 years, he has practiced bankruptcy law in several jurisdictions, including Delaware, New Jersey, Pennsylvania, New York and Arizona. Prior to joining Ashby & Geddes in 2003, Mr. Beskrone was a trial attorney with the Office of the U.S. Trustee in Region 3. He is currently a chapter 7 panel trustee in Delaware. Mr. Beskrone received his B.A. in 1981 from the University of South Florida and his J.D. in 1985 from Rutgers University School of Law - Camden.

Hon. Bruce A. Harwood is Chief U.S. Bankruptcy Judge for the District of New Hampshire in Concord, appointed to the bench in March 2013. He also serves on the First Circuit's Bankruptcy Appellate Panel. Prior to his appointment to the bench, Judge Harwood chaired the Bankruptcy, Insolvency and Creditors' Rights Group at Sheehan Phinney Bass + Green in Manchester, N.H., representing business debtors, asset-purchasers, secured and unsecured creditors, creditors' committees, trustees in bankruptcy, and insurance and banking regulators in connection with the rehabilitation and liquidation of insolvent insurers and trust companies. He was a chapter 7 panel trustee in the District of New Hampshire and mediated insolvency-related disputes. Judge Harwood is ABI's Vice President-Communication, Information & Technology, and serves on its Executive Committee. He previously served as ABI's Secretary, as co-chair of ABI's Commercial Fraud Committee, as program co-chair and judicial chair of ABI's Northeast Bankruptcy Conference, and as Northeast Regional Chair of the ABI Endowment Fund's Development Committee. He also served on ABI's Civility Task Force. Judge Harwood is a Fellow in the American College of Bankruptcy and was consistently recognized in the bankruptcy law section of *The Best Lawyers in America*, in *New England SuperLawyers* and by *Chambers USA*. He received his B.A. from Northwestern University and his J.D. from Washington University School of Law.

Summer M. Shaw is the managing attorney at Shaw & Hanover PC, a bankruptcy boutique law firm serving Southern California with its main office located in Palm Desert, Calif. She is a Bankruptcy Specialist certified by the State Bar of California and represents debtors, creditors and trustees in chapter 7, 11, 12 and 13 bankruptcy proceedings and enjoys litigating matters before the U.S. Bankruptcy Courts in the Central District of California. Ms. Shaw is a very active member of the bankruptcy bar and has served as a professor of bankruptcy law at the California Desert Trial Academy (CDTA). She also served as co-chair of ABI's first Consumer Practice Extravaganza in 2021, and she served as an education co-chair for the Consumer Education Programs at the Annual California Bankruptcy Forum Conferences for 2016 and 2019. In addition, she has been invited to speak at various education programs covering secured debt litigation, small business bankruptcies, individual chapter 11s, and bankruptcy law and crossover issues with civil litigation, family law, probate law and criminal law. Ms. Shaw is admitted to practice in all state and federal courts in California as well before the Ninth and Tenth Circuit Court of Appeals, and before the U.S. District Court for the Central District of California. She enjoys volunteering her time as often as possible through her local bar association's "Lawyer in the Library" program, assisting veterans through the Veterans Legal Institute, and volunteering her time to help educate new attorneys in the bankruptcy community whenever possible. Ms. Shaw was a selected as a member of the inaugural class of ABI's "40 Under 40" in 2017, and in 2018, she received the National Association of Consumer Bankruptcy Attorney's National Distinguished

Service Award. She has also been named one of *Palm Springs Life Magazine*'s Top Bankruptcy Lawyers and was honored to be a part of the 2015 and 2016 Central District of California Bankruptcy Court's *Pro Bono* Honor Roll. Ms. Shaw received her B.S. in political science with a minor in law and society from the University of California, Riverside and her J.D. from Western State College of Law.