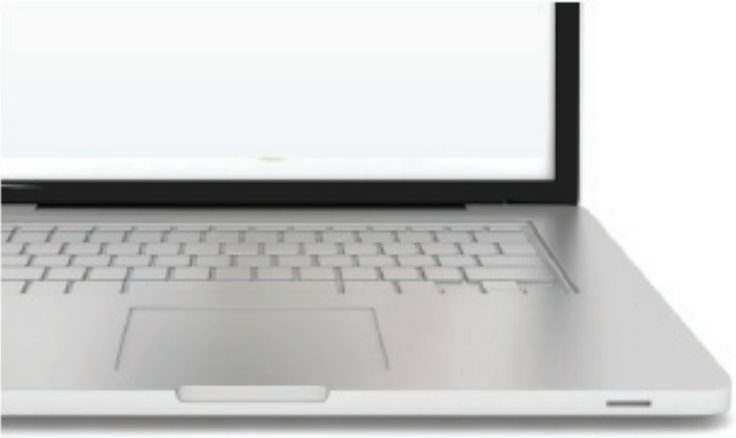

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Revisiting *RadLAX* and *Hall*: New Legal and Practical Impact of the Decisions

February 19, 2013

Susan M. Freeman
Lewis and Roca LLP; Phoenix

Adam A. Lewis
Morrison & Foerster LLP; San Francisco

Prof. Charles J. Tabb
University of Illinois College of Law; Champaign, Ill.

Eric E. Walker
Perkins Coie LLP; Chicago

THE APPELLATE ADVOCATE

NEWSLETTER OF THE AMERICAN ACADEMY OF APPELLATE LAWYERS ■ 2012 ISSUE 2

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IMPORTANT DATES

2012 Fall Meeting
Colorado Springs, CO
October 4–6, 2012

2013 Spring Meeting
Ottawa, Canada
April 25–27, 2013

Fall 2012 Meeting in Colorado Springs

The Fall 2012 Meeting of the Academy will be held at the Broadmoor Hotel in Colorado Springs on October 4 through 6. The Broadmoor is a historic hotel located near the southern edge of the Rocky Mountains and is famous for its beautiful setting.

The Program will focus on the State of Appellate Practice in 2012. We will start on Friday morning with a panel discussion that traces the historic evolution of appellate practice as a specialty and the impact of appellate bars in many jurisdictions on that practice. The speakers will include Judge Harris Hartz of the United States Court of Appeals for the 10th Circuit, Professor Jeffery Fisher, co-director of the Supreme Court Litigation Clinic of Stanford Law School, and AAAL Fellow **Patricia Millett** of Akin Gump with **Dan Polsenberg** as the moderator.

The second panel will consider the state of appellate practice and specialization from the point of view of the judges who hear and decide appeals. Our panel includes Judge Timothy Tymkovich of the United States Court of Appeals for the 10th Circuit, Justice (and former Chief Justice) Christine Durham of the Utah Supreme Court and AAAL Fellow and former Chief Justice of the Virginia Supreme Court **John Charles Thomas. Michael Zimmerman** will act as the moderator of this panel.

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The Broadmoor Colorado Springs, Colorado

First Supreme Court Argument: Ready, Set, Go

By Susan M. Freeman, Lewis and Roca LLP
Phoenix, Arizona

I argued my first appeal to the Ninth Circuit, a pro bono criminal case, my first year in practice. I learned over the years that I loved appellate practice, and was good at it. I had the honor of being inducted into the Academy in 1995. Now, in my 37th year as a lawyer, I finally had the opportunity to present a case at the U.S. Supreme Court, which was a fabulous experience.

A little over a year ago, I was asked to represent an Arizona farmer on a pro bono basis, seeking a petition for review to the U.S. Supreme Court from an adverse decision by the Ninth Circuit in what became *Hall v. United States*, 132 S.Ct. 1729 (2012). I have an unusual practice combination of business bankruptcy cases and civil appeals of all kinds—tort, tax, contract, ERISA, you name it—and was asked to represent the Halls for that reason. I had filed amicus briefs at the Supreme Court before and petitions for certiorari, but none that were accepted. Lewis and Roca agreed to take this case on, and star bankruptcy associate Justin Henderson and partner Larry Kasten, who is a former Supreme Court clerk, agreed to help me.

The *Hall* case concerns treatment of capital gains taxes upon sales of farm assets in Chapter 12 bankruptcy cases. We sought review due to the consequences of a split between the Eighth and Ninth Circuits on the point, and also the broader ramifications for treatment of taxes in Chapter 11 corporate reorganizations. Although he was tied up in a lengthy trial, **Don Ayer** took the time to look at my draft petition and give me a few helpful suggestions that were much appreciated.

Lo and behold, the Court accepted review. At that point the in-depth research accelerated. Knowing that the Court doesn't decide many bankruptcy cases, we had to put the issue into context, and explain how the provisions at issue relate to many other provisions on plans, discharges, taxes and post-petition operating expenses, and do all this within the Court's page limit. I read every U.S. Supreme Court case on bankruptcy and tax, and used many of them. We also worked with two amici groups, coordinating their arguments to best assist ours.

When we received the Solicitor General's response, it was apparent that his office has a lot more background in tax than in bankruptcy, and we needed to explain misunderstandings in our reply. Then I prepared for oral argument. Other appellate lawyers, tax and bankruptcy lawyers at Lewis and Roca acted as mock judges and questioned me in a moot court. Then several of my AAAL colleagues in other Phoenix firms—**Chas Wirkin**, **Tim Berg** and **Thom Hudson**, did another moot court at the ASU College of Law before the Chapter 11 bankruptcy seminar students, with teacher, former L&R partner and Bankruptcy Judge Randy Haines also serving as a moot judge. I did a third moot court at Georgetown University School of Law under its program where former Supreme Court clerks and frequent litigators volunteer to judge moot courts for first-time Court presenters. With each moot court, my answers to expected questions became more general and practical. In this Code-intensive case, they helped me move from statutory section numbers to words, and showed me that I could not assume court familiarity with Bankruptcy 101 concepts.

I argued the case on November 28, 2011, the Tuesday after Thanksgiving. I had memorized my four-sentence opening and practiced it at length before a mirror. I had my new conservative suit. I had flown to Washington, D.C. on Saturday, to avoid

possible Thanksgiving air traffic and weather problems on Sunday. I had a multi-page list of potential questions and my answers that I gave to my children who came to Washington D.C. to watch, and they had questioned me while we walked the monuments. I had observed the Monday arguments, picturing myself at the podium, and silently speaking to myself the names of each Justice when they asked questions.

Mine was the first argument on Tuesday. I took a deep yoga breath before standing up, and I was able to get my opening sentences out before I was peppered with questions. I did have answers to each question, and was able to bring out the points I wanted to make in the course of doing so. I used a statement made by the Assistant Solicitor General to my advantage in the brief time I had left for a rebuttal to his argument. In an hour, it was all over.

Afterwards, we had a celebratory lunch and flew back to Phoenix. The decision wasn't issued until May 14. My client lost, 5:4, in an opinion written by Justice Sonya Sotomayor with a dissent by Justice Stephen Breyer.

My farmer clients will end up losing their house to the Internal Revenue Service because homestead exemptions don't protect against federal tax liens, a significant and serious effect on them. I'm still thrilled at having had the opportunity to argue to the Supreme Court. I've even been referred more appellate work since then, which has helped the firm to recoup the significant pro bono work and costs (nearly 500 hours of my time, plus more from other lawyers).

If you're interested in a more detailed explanation of the legal issue, arguments, and legal ramifications of the decision, see "Supreme Court's Hall v. United States Ruling Has Significant Impact," Bloomberg BNA, June 2012. ❖

Fall 2012 Meeting in Colorado Springs *[continued from page 1]*

Following the second panel, Justice Monica Marquez of the Colorado Supreme Court will be the luncheon speaker. The program will resume with a third panel that looks at appellate specialization and practice from the point of view of the sophisticated consumer, in-house counsel who are responsible for the decision to hire or not hire appellate specialists to handle appeals. The panel will consist of Laurie Korneffel of CenturyLink, Ken Cammarato of United Technologies Corporation and Larraine L. Gerelick, formerly with Hospital Corporation of America. Each of these panelists is or has been responsible for their companies' decisions on how to staff appeals in state and federal court and will discuss how they make the decision whether (and, if so, when) to bring in appellate specialists to handle their cases. **Nancy Winkelman** will be the moderator of this panel.

The last panel on Friday deals with the role of appellate practice and specialization from the point of view of the attorneys involved. Our panel will discuss the extent to which trial and appellate counsel work together in both the trial and appellate courts. The panel will consist of Francis Wikstrom, a trial attorney at Parsons Behle & Latimer in Salt Lake City, AAAL Fellows **Mike Hatchell** and **Robin Meadow. Dan Polsenberg** will be the moderator.

The first panel on Saturday morning will focus on the development of appellate lawyers. How are appellate lawyers trained in law school and within the profession? Professor Fisher and AAAL Fellows **Eric Magnuson** and **Diane Bratvold** will provide their insights on these issues. **Tim Berg** will serve as the moderator of this panel.

The final panel will continue the discussion begun at the meeting in Phoenix of how an appellate practice is developed and maintained in 2012 with a focus on the role of specialization and different practice models. AAAL Fellows **Jim Martin, Roger Townsend** and Peter Goldberger will develop further the practice issues arising from being an appellate lawyer in a large firm, an appellate boutique and a small firm or solo practices. **Walter Sargent** will be the moderator of this panel.

We think this will be an excellent meeting with a thought-provoking program held in a beautiful setting. We hope that each of you will be able to attend. ❖

The End of the Road: The Supreme Court Unanimously Upholds Credit Bidding in a "Free and Clear" Plan Sale

By Adam A. Lewis, Norman S. Rosenbaum, Deanne Maynard, and Erica J. Richards[1]

In an 8-0 decision[2] on May 29, 2012, the United States Supreme Court in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*[3] unequivocally held that a reorganization plan that proposes to sell a secured creditor's collateral free and clear of liens *must* permit the secured creditor to credit bid its claim absent "cause" to deny it the right to do so. The Supreme Court's decision provides the final word on the contours of credit bidding in bankruptcy. In affirming the Seventh Circuit's June 28, 2011 ruling in *River Road Hotel Partners, LLC v. Amalgamated Bank*,[4] the decision overrules a contrary opinion of the Court of Appeals for the Third Circuit in *In re Philadelphia Newspapers LLC*.[5] The effect of the decision is to close *Philadelphia Newspapers*' loophole in the ring of statutory protections for the secured creditor's historic right to "get its money or its collateral." Debtors will not be able to use free and clear plan sales to shift value from a secured creditor to other interests without the secured creditor's consent.

Statutory Framework

The requirements for confirmation of a Chapter 11 plan appear in section 1129 of the Bankruptcy Code.[6] Normally, section 1129(a)(8) requires that all impaired classes vote in favor of the plan.[7] However, section 1129(b)(1) provides that a plan may be confirmed over the objections of an impaired class if, among other things, the plan is "fair and equitable" to that class. The plan proponent (typically the debtor-in-possession) has the burden of proof on this issue.

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[1] The Morrison & Foerster team of Adam A. Lewis, Norman S. Rosenbaum, Deanne Maynard, and Erica Richards successfully represented Amalgamated Bank, the secured creditor, in this case, with Ms. Maynard presenting oral argument before the Supreme Court.

[2] Justice Kennedy recused himself from the case.

[3] *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-166, 2012 U.S. LEXIS 3944 (May 29, 2012) ("*RadLAX*").

[4] *River Rd. Hotel Partners, LLC v. Amalgamated Bank* (*In re River Rd. Hotel Partners, LLC*), 651 F.3d 642 (7th Cir. 2011) ("*River Road*"). *River Road* addressed two related bankruptcy cases pending in the Bankruptcy Court for the Northern District of Illinois: *In re River Road Hotel Partners, LLC*, Case No. 09-30029 and *In re RadLAX Gateway Hotel, LLC*, Case No. 09-30047. The two bankruptcy proceedings were separately administered; however, because the hotels (and their related properties) that were the primary assets in each case shared common management and ownership, the cases were generally conducted in parallel and each raised the identical issue in the Seventh Circuit appeal.

[5] *In re Phila. Newspapers, LLC*, 599 F.3d 298, 318 (3d Cir. 2010).

[6] The "Bankruptcy Code" is 11 U.S.C. sections 101-1532. Hereinafter, unless otherwise specified, all statutory references are to the Bankruptcy Code.

[7] Essentially, a class is impaired if the plan modifies the class's rights in any way (even if apparently favorably).

Section 1129(b)(2)(A) provides three alternative circumstances, enumerated in three separate subsections, that a plan must satisfy at a minimum to be "fair and equitable" to a dissenting class of secured creditors.[8]

- under subsection (i), retention by the secured creditors of their liens and the receipt of deferred cash payments totaling at least the allowed amount of their claims with a value at least equal to the present value of the secured creditors' interest in their collateral;

- under subsection (ii), a sale of the assets free and clear of the secured creditors' liens, provided that the secured creditors are furnished the right to credit bid their claims in accordance with section 363(k), with the liens to attach to the proceeds of sale; or

- under subsection (iii), the realization by the secured creditors of the "indubitable equivalent" of their claims.

Section 363(k), which subsection (ii) imports, allows a secured creditor that bids on a sale of its collateral under section 363(b) to offset, as against its bid, up to the full amount of its claim, although the bankruptcy court can condition the right to credit bid if "cause" to do so is shown.

The Credit Bidding Landscape Before *RadLAX*

In March 2010, the Court of Appeals for the Third Circuit, by a 2-to-1 majority, issued its much-publicized *In re Philadelphia Newspapers LLC* decision.[9] There, the Third Circuit ruled that a plan of reorganization that provides for a sale of assets free and clear of liens does not have to permit the secured creditors the right to credit bid as specified in section 1129(b)(2)(A)(ii). Rather, in a departure from the long-held conventional view, the Third Circuit found that a plan of reorganization can satisfy the requirement that the plan be fair and equitable to a secured creditor by providing the secured creditor with the "indubitable equivalent" of its claim under section 1129(b)(2)(A)(iii) in the form of the sale proceeds and/or other compensation.[10]

***RadLAX*: The Bankruptcy Court Decision**

In the Fall of 2009, the River Road debtors and the RadLAX debtors filed voluntary Chapter 11 petitions in the Bankruptcy Court for the Northern District of Illinois. Each

[8] Though not an issue in *RadLAX*, a plan can satisfy one of these standards but not be fair and equitable; they are necessary, but not necessarily sufficient, conditions for such a cramdown (*e.g.*, *Fed. Savs. & Loan Ins. Corp. v. D & F Constr., Inc.* (*In re D & F Constr., Inc.*), 865 F.2d 673, 675 (5th Cir. 1989); *In re Riddle*, 444 B.R. 681, 686 (Bankr. N.D. Ga. 2011); In *re Atlanta S. Bus. Park, Ltd.*, 173 B.R. 444, 448 (Bankr. N.D. Ga. 1994)).

[9] *In re Phila. Newspapers, LLC*, 599 F.3d 298, 318 (3d Cir. 2010).

[10] The Third Circuit found support for its ruling in a prior decision of the Court of Appeals for the Fifth Circuit. *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

set of debtors owned a hotel and related assets. At the time the petitions were filed, the RadLAX debtors owed their lenders, represented by Amalgamated Bank as agent ("Amalgamated"), over $130 million secured by a blanket lien on their assets, and the River Road debtors owed the same lenders, also agented by Amalgamated, over $160 million secured by the River Road debtors' assets. These loans were underwritten and made essentially at the peak of the recent economic bubble. However, by the time the cases were filed, the bubble had burst; and in the case of both sets of loans, the value of the collateral was well short of the claims it secured; and as a result the estates were vastly underwater.

In mid-2010, the RadLAX and River Road debtors filed plans of reorganization modeled largely on the plan at issue in *Philadelphia Newspapers*. The plans provided for the sale of the assets free and clear of liens at an auction at which the lenders would be denied the right to credit bid outright (or for "cause" if the Bankruptcy Court disagreed with *Philadelphia Newspapers*). The Bankruptcy Court would then assess whether the winning bid provided the lenders with the indubitable equivalent of their claims under section 1129(b)(2)(A)(iii). In both cases, the "stalking horse" bids that formed the starting point for the auction were well below both the total debt that the respective assets secured and even the apparent value of those assets.

Amalgamated filed objections to the bid procedures motions, asserting that because the debtors' plans sought to sell assets free and clear of liens while precluding credit bidding, they contravened the express terms of the Bankruptcy Code and could not be confirmed. In response to the debtors' alternative approach, Amalgamated contended that the debtors had also failed to demonstrate sufficient cause to deny credit bidding. The Bankruptcy Court agreed with Amalgamated that as a matter of law any sale free and clear of liens under a plan had to proceed under section 1129(ab)(2)(A)(ii). Thus, the debtors would have to prove that there was cause to deny the lenders the right to credit bid. After a trial, the Bankruptcy Court also found that the debtors had failed to show any such cause.

The debtors' appeal of the Bankruptcy Court's orders[11] was fast tracked to the Seventh Circuit pursuant to 28 U.S.C. § 158(d), which authorizes a direct appeal under certain circumstances.[12] On June 29, 2011, the Seventh Circuit panel unanimously affirmed the

[11] The Appeal was limited to the issue of whether the Bankruptcy Court erred in holding that the debtors must proceed under 11 U.S.C. § 1129(b)(2)(A)(ii) and provide their secured creditors with an opportunity to credit bid, where the Debtors proposed, under a plan of reorganization, to sell free and clear of liens the collateral securing such secured creditors' claims. The debtors did not appeal the Bankruptcy Court's determination that "cause" to deny the lenders the right to credit bid pursuant to 11 U.S.C. § 363(k) did not exist.

[12] 28 U.S.C. § 158(d)(2)(A) provides in relevant part:

> The appropriate court of appeals shall have jurisdiction of appeals . . . if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or all the appellants and appellees (if any) acting jointly, certify that—
>
> > (i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of

Bankruptcy Court's decision,[13] creating a split among the circuits because of the *Philadelphia Newspapers* decision by the Third Circuit.

Just over a week after the Seventh Circuit's decision, the lenders confirmed their own plan of reorganization in the River Road cases, mooting any further appeal by those debtors. Notably, under the plan, the lenders deliberately left some value on the table for other creditors to which the lenders would otherwise have been entitled since there was no value in the debtors' assets over and above the amount of the lenders' secured claims. The RadLAX debtors petitioned the Supreme Court for a review by a writ of certiorari, and the Supreme Court granted certiorari on December 12, 2011. Oral argument was held on April 23, 2012.

The Parties' Arguments in the Supreme Court

The RadLAX debtors' fundamental argument in the Supreme Court was, as it had been below, an appeal to the "plain language of the statute" rule of statutory interpretation. Relying primarily on the reasoning in *Philadelphia Newspapers*, the debtors contended that because section 1129(b)(2)(A) is phrased in the disjunctive "or," a plain reading of that section indicates that a plan can be confirmed as long as it meets the requirements of any one of the three subsections, regardless of whether the plan's structure more closely resembled another subsection. Under the interpretation advocated by the debtors, a plan proponent has the flexibility to propose a plan that provides for a free and clear sale of assets without credit bidding so long as the plan provides the "indubitable equivalent" of the secured claims. In other words, the debtors asserted that section 1129(b)(2)(A)(ii) does not exhaust the field when it comes to plan sales free and clear of liens. Instead, they argued that a plan sale free and clear can also proceed under section 1129(a)(iii), which includes no requirement that the secured creditor be allowed to credit bid absent cause. The debtors contended that the proceeds of sale could provide the lenders with the indubitable equivalent of their claims, although they acknowledged that the lenders were at confirmation entitled to challenge whether the sale proceeds did so. In this connection, the debtors expressed the view that the Bankruptcy Court could conclude from the marketing and auction *process* alone that the sale provided the indubitable equivalent, but also conceded that other evidence—such as appraisals—might be relevant.

The debtors added some secondary arguments of less note. One was, essentially, that if the Supreme Court affirmed the decision, debtors would never be able to confirm a plan and provide benefits to other creditors in cases in which the debtor is under water.

> appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;
>
> (ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or
>
> (iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken.

[13] *River Rd. Hotel Partners, LLC v. Amalgamated Bank* (*In re River Rd. Hotel Partners, LLC*), 651 F.3d 642 (7th Cir. 2011).

Amalgamated's arguments appealed to both principles of statutory interpretation and policy considerations. In connection with statutory interpretation, Deanne Maynard first rejected the debtors' "disjunctive" argument by pointing out that there was no dispute that subsections (i), (ii) and (iii) were, indeed, in the disjunctive. However, the question was not simply whether they were in the disjunctive, but what the contents of the disjuncts were; in other words, the issue is, "or *what*." Does subsection (ii) exhaust the field when it comes to any kind of plan sale free and clear, or does subsection (iii) include other kinds of free and clear sales in which the secured creditor cannot credit bid? In connection with such statutory construction, Ms. Maynard pointed out, the basic rule is that the specific governs the more general. In this situation, that means that the provisions of subsection (ii), in which free and clear plan sales are *specifically* covered, are Congress's final words on such plans and sales. Whatever (iii) and its indubitable equivalence standard includes within its "or," it does not include free and clear plan sales.

Turning to policy considerations, Ms. Maynard argued that there are no good policy arguments that support the debtors' position. As long as a secured creditor's collateral is worth less than the amount of its claim, there is *no* value for *any other junior creditor*. Thus, confirming of a plan that produces a cash sale price that is below the secured creditor's claim cannot benefit any other bankruptcy-recognized constituency junior to the secured creditor, although it might benefit the buyer (who, as in *RadLAX*, included opportunities for insiders) if the price is also less than the real value of the collateral. The latter might very well occur if the creditor lacks access to funds to cash bid. In this connection, there is no rational purpose in requiring a secured creditor to put cash into an estate with one hand via a cash bid, only to take it all back with the other because the collateral is worth less than its claim.

On a larger scale, the debtor's position violates the traditional rule that a secured creditor is entitled to its money or its collateral. That rule is embedded in various provisions of the Bankruptcy Code. For example, an undersecured creditor's right to make an election to be treated as fully secured under section 1111(b)(2) provides some protection for a creditor from being cashed out at too low a value. Normally, an undersecured creditor is entitled to a stream of payments having the present value of a secured claim measured by the value of the collateral underlying its claim; the undersecured portion of the claim is treated as an unsecured claim, which may be paid pennies on the dollar, or even nothing. Moreover, such a creditor risks being underpaid on his secured claim if the bankruptcy court undervalues his collateral. This is a serious risk; courts which have repeatedly recognized that the valuation of collateral not already priced on a regular market (such as publicly traded stock) is a somewhat speculative exercise. But when the creditor makes the Section 1111(b) election, although the stream of payments must still have only the present value of the collateral, it must total the *gross* amount of the creditor's claim (that is, both the secured portion and what would otherwise be the unsecured portion). Thus, while such a creditor still faces the risk of misvaluation of the collateral by a bankruptcy court in determining what the present value of the payment stream must be, Congress has given the secured creditor some back-end protection in the form of the objective number represented by the gross amount of its claim.

Section 363(k) provides the secured creditor with another form of protection against undervaluation of its collateral. That protection is granted because if the secured creditor is not satisfied that the amount offered by another buyer is acceptable (*e.g.*, close enough to the secured creditor's view of the collateral's real value), the secured creditor can try to force the bid up by credit bidding up to the full amount of its claim, at which point any overbid would both pay that creditor in full *and* produce a surplus for other creditors.

Ms. Maynard urged that there it does not make sense to suppose that Congress left an enormous hole in the protective scheme for secured creditors represented by sections 363(k) and 1111(b) by allowing free and clear sale plans that prohibit credit bidding. Nor is there any policy reason why Congress would permit treatment of secured creditor claims differently in free and clear plan sales from sales under section 363(b). Finally, of course, Ms. Maynard pointed out that Amalgamated's view preserves the secured creditor's traditional right to either be paid its claim or get its collateral that its customary right to credit bid under state law allows.

Addressing the debtors' argument that Amalgamated's position means that it will be impossible to confirm plans in many cases, Ms. Maynard made several points. First, she noted that since there is no value for other creditors in an underwater estate except what the secured creditor may choose to make available to them (as the lenders did in their River Road plan), there can be no plan without the secured creditor's consent. Nothing in the Bankruptcy Code contemplates transferring a secured creditor's value to other interests over that creditor's objection, most especially not to a stranger to the bankruptcy process such as a buyer. Moreover, although a secured creditor is entitled to its money or its property, most secured creditors do not want the property. Hence, they are often willing to agree to a plan under which they get enough money on account of their collateral to warrant avoiding the hassle of foreclosing on, caring for, and marketing the property. In such circumstances, a *consensual* plan is often worked out under which some value that would not otherwise be available goes to other creditors with the secured creditor's blessing.

The Final Word: The Specific Governs the General

The Supreme Court affirmed the Seventh Circuit's decision in an opinion based on established principles of statutory interpretation. The Court found that no textual ambiguity existed in section 1129(b)(2)(A), and therefore there was no need to consider pre-Code practices, the merits of credit-bidding, or the objectives of the Bankruptcy Code.[14] As well, the unanimous opinion eschewed considerations of policy. The Court's opinion leaves little room for debate and contains no stray comments or dicta upon which future parties and courts might seize to undermine the decision.

The opinion, authored by Justice Scalia, held that the debtors' reading of section 1129(b)(2)(A)—"under which clause (iii) permits precisely what clause (ii) proscribes—to be hyperliteral and contrary to common sense."[15] Relying on the "general/specific

[14] *RadLAX*, 2012 U.S. LEXIS 3944, at *17.

[15] *Id.* at *3.

canon" of statutory construction, the Court noted that clause (ii) is a detailed provision that describes the requirements for selling collateral free of liens, while clause (iii) is a broadly worded provision that says nothing about such a sale. "The general/specific canon explains that the 'general language' or clause (iii), 'although broad enough to include it, will not be held to apply to a matter specifically dealt with' in clause (ii)."[16] More specifically,

> the structure of the statute it suggests that clause (i) is the rule for plans under which the creditor's lien remains on the property, (ii) is the rule for plans under which the property is sold free and clear of the creditor's lien, and (iii) is a residual provision covering dispositions under all other plans—for example, one under which the creditor receives the property itself, the "indubitable equivalent" of its secured claim. Thus, debtors may not sell their property free of liens under § 1129(b)(2)(A) without allowing lienholders to credit-bid, as required by clause (ii).[17]

In addition to addressing the textual arguments, the Court's questioning at oral argument also focused on policy and the practical implications of allowing free and clear sales without credit bidding. The Court's underlying concerns were not absent from its opinion. In an apparent nod to the effects its decision might have on the Federal Government—"which is frequently a secured creditor in bankruptcy and which often lacks appropriations authority to throw good money after bad in a cash-only bankruptcy auction"[18]—the Court, in a footnote, gave heed not only to the fundamental protections that credit bidding provides to secured creditors, but also to the logistical hurdles that the United States, as a secured creditor, would have to face if the Court were to adopt the debtors' position.

Conclusion

Philadelphia Newspapers provided the template for a credit bid override in the context of a free and clear plan sale. From the perspective of third parties, this template presented the potential for acquiring assets at attractive valuations where the secured creditor elects not to, or simply cannot, cash bid. From the secured creditor's perspective, the decision in *Philadelphia News* posed a very real threat to its bargained-for state law rights and long-held expectations concerning its ability to get its money or its collateral. In this regard, *RadLAX* is a critical victory for the secured lending community, effectively restoring their bedrock protections. But although *RadLAX* settles this issue decisively in favor of secured creditors, it does not necessarily spell the end for cases or other creditors in which a secured creditor's claim consumes an estate. For as noted above, although a secured creditor generally wants its money or its property, it is often willing to compromise its rights because it would rather have money than its collateral. Moreover,

[16] *Id.* at *13.

[17] *Id.* at *14-15.

[18] *Id.* at *9, n2.

secured creditors can perhaps expect debtors to explore more vigorously whether there is "cause" under section 363(k) to deny a secured creditor the right to credit bid.

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Bankruptcy Law Reporter™

Supreme Court's *Hall v. United States* Ruling Has Significant Impact

By Susan M. Freeman
Lewis and Roca LLP, Phoenix, Ariz.

Hall v. United States, 2012 BL 118497 (U.S. May 14, 2012) (24 BBLR 653, 5/17/12) construes Bankruptcy Code § 1222(a)(2)(A) (the ''Farm Sale Statute''), which demotes § 507 priority claims of governmental units arising from the sale or other disposition of farm assets in Chapter 12 cases, and treats them as unsecured claims as long as the debtor receives a discharge. The Court held that capital gains income taxes due to a farm sale during a Chapter 12 case of an individual debtor do not qualify for the special treatment. The taxes cannot be paid from the sale proceeds, and must be paid by the individuals after their bankruptcy stay expires because they are not dischargeable.

The Farm Sale Statute was enacted because such taxes were considered to be administrative expenses, entitled to nearly top priority treatment in bankruptcy cases. Administrative expenses must be paid in full to confirm a plan. Family farms often have low tax basis because property has been in the family for generations. When values escalated, farm property was used to collateralize loans, and when property values crashed, farmers suffered forced sales and foreclosures but at prices still substantially exceeding their low basis. This means high capital gains taxes, and an inability to confirm a reorganization plan providing for a sale or transfer of property to the secured creditor.

Susan M. Freeman is a partner at Lewis and Roca LLP. She argued for the debtors in the Hall case before the Supreme Court. She specializes in appellate as well as bankruptcy law. She has briefed over 300 appeals and argued nearly 100, and is a fellow of both the American Academy of Appellate Lawyers and American College of Bankruptcy. For more information about this case, or to hear the original oral arguments, please visit her bio at www.LRLaw.com/Freeman. She can be contacted at SFreeman@LRLaw.com.

The IRS had sought administrative priority for taxes incurred during bankruptcy reorganizations, including as a result of asset sales, until the Farm Sale Statute stripped that status from priority tax claims. In cases such as *Nicholas v. United States*, 384 U.S. 678 (1966), the IRS successfully argued for such taxes incurred by Chapter 11 individual and corporate debtors in possession to have administrative expense priority. The IRS also persuaded Congress to amend § 507(a)(8) at the same time the Farm Sale Statute was enacted to give administrative expense priority to income taxes incurred prepetition during the year of a bankruptcy petition filing. That amendment belies the notion that the IRS never considered income taxes to have administrative status. The § 507(a)(8) amendment also means that the Farm Sale Statute only applies to prepetition farm sales closing before the petition filing year if it does not cover administrative expenses, since only those earlier taxes would have § 507 priority treatment. Sales considerably prior to filing are infeasible in many cases and impossible in cases like the Halls, where the filing was precipitated by a foreclosure sale that would have precluded closing their third party sale to realize on their equity value.

Senator Chuck Grassley (R-Iowa) worked for years to persuade Congress to enact the Farm Sale Statute, as recounted by the dissent. The majority acknowledged Congress may have intended robust relief from taxes in Chapter 12 cases, but said the statutory language was insufficient to accomplish that result. Given its conclu-

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sion that postpetition income taxes are not administrative expenses and cannot be collected under a Chapter 12 plan, the Court held that the Farm Sale Statute is ineffective and must be rewritten if Congress wants such relief.

Taxes as Administrative Expenses

The *Hall* case turns on the meaning of § 503(b)(1)(B), which makes ''any tax . . . incurred by the estate'' into an administrative expense priority claim under § 507(a)(2). The Halls argued that ''incurred'' means ''to take on liability,'' and that the ''estate'' consists of property operated and liquidated for creditors that can generate taxable income. They said that when a bankruptcy estate comes into existence upon a bankruptcy petition filing, and assets are operated or sold and generate income, the estate incurs liability for the resulting taxes just like it incurs expenses to preserve and use the assets in the debtor's business. The Halls argued that taxes should be paid from the proceeds of bankruptcy estate asset sales by the debtor in possession or trustee operating the bankruptcy estate, unless, as here, the Bankruptcy Code provides for a specific exception. The Assistant Solicitor General agreed during his oral argument in Hall that this is the usual practice:

> How the tax liability would be dealt with under the government's view is at the same time the debtor moves to sell the farm asset during the case. Like in this case, that sale of the farm asset generated $960,000. That was the sale price. The capital gain tax liability in this case is $29,000. If they would have set aside from that $960,000 sale price $29,000 to pay the capital gains tax debt, that would resolve the issue. Official transcript of oral argument at 30.

Rather than construing the Farm Sale Statute in light of that practice and policy, the Court held that such taxes in individual Chapter 12 cases are not administrative expenses payable by the bankruptcy estate because that debtor is not a separate taxable entity under Internal Revenue Code §§ 1398, 1399. Those IRC sections, providing for a separate taxable estate in some bankruptcy cases, were enacted two years after Bankruptcy Code § 503(b), whose own legislative history shows at that time debtors paid taxes on income earned during bankruptcy with administrative expense priority and without new tax identification numbers for bankruptcy estates. *See In re Pacific-Atlantic Trading Co.*, 64 F.3d 1292, 1299-1300 (9th Cir. 1995).

Two Types of Debtors

IRC §§ 1398, 1399 established different income tax treatment for two types of debtors, depending on whether their postpetition income was part of the bankruptcy estate: (a) all Chapter 7 and (at that point) individual Chapter 11 debtors, who earn postpetition income not included in their bankruptcy estates, and (b) non-individual reorganizing debtors whose postpetition income is part of their bankruptcy estates. In type (a) cases, the trustee obtains a separate tax identification number and pays for taxation of income from asset sales, and the debtor is responsible for paying taxes on postpetition, non-estate income. In type (b) corporate Chapter 11 cases, the debtor in possession or trustee is responsible for paying taxes on income that is property of the estate. The Halls argued that does not make the DIP or trustee personally liable, but only responsible to use estate funds in their capacities as authorized agents of the reorganizing bankruptcy estate, a principle recognized in cases such as *Nicholas*. They argued this means a single taxable estate instead of a separate taxable estate in reorganization cases where postpetition income is part of the estate. IRC §§ 1398, 1399 says nothing about the priority status of tax payments under the Bankruptcy Code, and IRC § 6658, enacted at the same time for ''Coordination with Title 11 [the Bankruptcy Code],'' provides no penalties or interest are due if a tax is incurred by the estate and there are insufficient funds to pay administrative expenses, showing that Congress intended administrative priority for such taxes. The Supreme Court previously held that the Internal Revenue Code provides for taxation, but the Bankruptcy Code determines priority treatment of taxes. *E.g. United States v. Randall*, 401 U.S. 513, 514-16 (1971).

State Tax Provisions

The Court held that a tax is ''incurred by the estate'' under § 503(b)(1)(B) if it ''is a tax for which the estate itself is liable.'' 2012 BL 118497 *4. The Court accordingly held that taxes on income generated from estate assets are not collectible from the asset proceeds or dischargeable in a Chapter 12 case. *Id*. at 5. It supported its conclusion by looking to other Bankruptcy Code sections, primarily § 1305 dealing with taxation in Chapter 13 cases, and § 346 dealing with state and local taxes.

Bankruptcy Code § 346 says that where there is no separate federal taxable estate, income that is taxed to or claimed by the debtor may not be taxed to or claimed by the estate on state tax returns. The Court's interpretation is logical under that particular language. But it is inconsistent with the overall Bankruptcy Code, the historical treatment of taxes as administrative expenses in corporate Chapter 11 cases where there is no separate taxable estate, and the reasons for the separate taxable entity provisions of the IRC. The Court looked to § 346 as drafted in 1978, focusing on language at that time to the effect that in a Chapter 13 case, income would be taxed to the debtor and not the estate. The Court did not address another subsection in the 1978 version cited by the Halls, original § 546(e), and its legislative history which made it clear that a federal tax in a reorganization case is an administrative expense, but not deductible, like other administrative expenses.

Second Rationale—Chapter 13 Impact

The Court's second rationale for its decision was analogizing Chapter 12 to Chapter 13 provisions and case law. The Halls had argued that Chapter 12 is a hybrid between Chapter 11 and 13, and is much more like Chapter 11 in many respects because farm reorganizations are business reorganizations, a rarity in Chapter 13 wage-earner cases. The Court cited to various Chapter 13 provisions similar to those in Chapter 12, but not the Chapter 11 counterparts. Chapter 13 has a unique section providing taxing authorities the option to file proofs of claim for taxes ''that become payable to a governmental unit while the case is pending,'' § 1305.

While § 1305 case law is contradictory, most courts interpreting § 1305 (and the IRS, and Collier's treatise) have not considered the ability of taxing authorities to file administrative expense claims if and when taxes are incurred during the brief period of administration before the plan is confirmed in addition to § 1305 proofs of claim for taxes payable during the entire 3-5 year

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postpetition period of plan implementation. Most Chapter 13 debtors are not sole proprietor businesses, don't sell property during the brief administration period, and most of the time that period does not encompass April 15, when the IRS contends that taxes for the prior year become due and are thus ''incurred.'' Most Chapter 13 income taxes are incurred post-confirmation of a plan, in relatively small amounts given the debtors' limited means, deducted in the calculation of disposable income that is used to pay creditors under the plan, and if not paid in the ordinary course during plan implementation result in dismissal of the case. § 521(j).

The Supreme Court found Chapter 13 cases holding that postpetition taxes are liabilities of the debtor alone, and are not collectible or dischargeable without a § 1305 proof of claim. The Court concluded that Chapter 13 case law is reliable authority in Chapter 12 cases, not focusing on the differences between business and wage-earner debtors and the taxes likely incurred before plan confirmation. It said the absence of a § 1305 counterpart in Chapter 12 ''only clarifies that such taxes fall outside of the plan.'' 2012 BL 118497 *11 n. 6. It did not address the Chapter 12 disposable income provision that appears to exclude pre-confirmation taxes, unlike Chapter 13. § 1225(b)(1)(B), (C); *In re Stimac*, 366 B.R. 889, 892-94 (Bankr. E.D. Wis. 2007).

The majority appeared to be concerned with the impact a decision for the farmer might have in Chapter 13 cases, stating that ''any conflicting reading of § 503(b) here could disrupt settled Chapter 13 practices,'' and noting that ''Chapter 13 filings outnumber Chapter 12 filings six-hundred-fold.'' 2012 BL 118497 *11. It feared that ''adopting petitioners' reading of § 503(b) would mean that, in every Chapter 13 case, the Government could ignore § 1305 and expect priority payment of postpetition income taxes in every plan.'' *Id*.; see also *Id*. at 10 (''Petitioners' position threatens ripple effect beyond this individual case for debtors in Chapter 13'').

The Halls contended, however, that administrative priority would only extend to taxes incurred during the brief period of bankruptcy case administration, postpetition and pre-confirmation of the plan, which would not be disruptive in the vast majority of Chapter 13 cases. The dissent recognized that some bankruptcy court Chapter 13 cases have held that taxes on income earned postpetition/pre-confirmation are not ''incurred by the estate. *Id*. at *17. The dissent did not ''see the serious harm'' in treating taxes during the administration period in Chapter 13 as well as Chapter 12 cases as administrative expenses, given the short period of administration in Chapter 13, and said this would limit the scope of § 1305 to the period of time after confirmation of the Chapter 13 plan and while the case remains pending. *Id*. Since § 1305 applies to taxes ''payable to a governmental unit while the case is pending'' and § 503(b)(1)(B) applies to ''any tax incurred by the estate,'' the Court could also have held all postpetition taxes are ''payable . . . while the case is pending,'' and thus all within the scope of § 1305, thus avoiding the forecast Chapter 13 repercussions. *See In re Joye*, 578 F.3d 1070 (9th Cir. 2009) (discussing meaning of ''payable'').

Distinguishing Chapter 11

The Court's holding that income taxes in individual Chapter 12 cases are not administrative expenses payable by the bankruptcy estate because that debtor is not a separate taxable entity under the Internal Revenue Code applies equally to Chapter 12 and Chapter 11 corporate debtors, which are likewise not separate taxable entities. The Supreme Court has repeatedly recognized that corporate debtors nonetheless pay income taxes from operations and asset sales during estate administration from estate assets as administrative expenses. *E.g*. *Nicholas*, 384 U.S. at 687-88, *United States v. Noland*, 517 U.S. 535, 543 (1996). The majority found a way to distinguish the Chapter 11 case law. It said an IRC provision that a trustee in a corporate debtor case must file tax returns means that trustees ''may shoulder responsibility that parallels that borne by the trustee of a separate taxable entity.'' 2012 BL 118497 *15, citing IRC § 6012(b)(3). The Court implied that this IRC provision could make postpetition taxes into administrative expenses in corporate Chapter 11 cases, but did not outright say so. Interpreting the Internal Revenue Code and Bankruptcy Code as argued by the Halls would be a more consistent and coherent interpretation of the priority and administrative expense provisions in all bankruptcy cases, but the Court's holding does appear to prevent adverse ramifications from its holding in Chapter 11 cases.

Consequences of the Decision

The decision makes farm asset sales more problematic in Chapter 12 cases, and has broader impact as well, because it interprets the Bankruptcy Code administrative priority section for taxes of all kinds, § 503(b)(1)(B). First, it applies not only to capital gains taxes from estate assets sales, but also to wages and operating income from operating the family farm. These taxes are no longer payable from the income from which they are derived. The family farmer will have to bear the taxes individually, but since all postpetition income and assets are property of the estate under § 1207, he will have no assets with which to pay, other than exempt assets. The Halls, for example, will lose their home because a homestead exemption doesn't protect against income tax liens. A family farmer must use estate assets under his plan to pay prepetition creditors and other administrative expenses. Since the court held that taxes are not administrative expenses, the capital gains tax won't prevent a plan from being confirmed. But it will eviscerate the farmer's discharge.

Second, the decision authorizes different treatment for individual and corporate Chapter 12 debtors. The majority's basis for distinguishing a long history of administrative expense treatment in Chapter 11 corporate cases with no separate taxable entity is the IRC provision requiring a trustee holding title to the property or business of a corporation to file its income tax returns. IRC § 6012(b)(3). That provision is not limited to Chapter 11 cases. Family farmers would be well-served by incorporating before filing a Chapter 12 case, although they will have to do so well in advance, given the definitional limitations of § 101(19A) and ''new debtor syndrome'' dismissal case law, and will likely need secured creditor consent to transfer the secured loan to the corporation with individuals as guarantors.

Third, the substantially-reduced value of a Chapter 12 case will need to be weighed against the hurdles to reorganization imposed by Chapter 11. Family farmers have a choice of reorganizing under Chapter 11 or 12. Creditors don't vote on Chapter 12 plans, the entire chapter is more streamlined and beneficial for typical

farm indebtedness and operations, and the Farm Sale Statute is not available in Chapter 11 cases. But in some circumstances, it may be better to file under Chapter 11 where an individual debtor's Chapter 11 estate is still considered a separate taxable entity. Congress did not change IRC treatment for individual Chapter 11 debtors when it made their postpetition income into estate property in 2005, an apparent oversight causing difficulty in individual Chapter 11 cases. *See* Hall Opening Br. n. 5.

Fourth, the ramifications of the Court's broad interpretation of the administrative priority tax section, § 503(b)(1)(B), will play out over time as issues arise in various cases. The majority declined to address whether employment taxes would be accorded administrative expense priority under the category of § 503(b)(1)(A) as an actual and necessary cost of preserving the estate. 2012 BL 118497 *9 n. 15. Property taxes might be distinguished as *in rem*, but there are many other types of taxes. The priority status of taxes incurred by a limited liability corporate debtor is also questionable, given its hybrid character as a corporation for management purposes but a partnership with pass-through tax liability to owners.

Fifth, Senator Grassley has stated that he will introduce legislation to effectuate the results Congress intended when enacting the Farm Sale Statute. Given the Court's reasoning, that will not be simple, and likely require amendments to the IRC as well as the Bankruptcy Code.

Finally, this case shows that on one hand, the Court can insist on narrow construction of statutory provisions, even when contrary to practice and precedent. Payment of taxes during a reorganization as an administrative expense—especially sale related taxes from estate asset sale proceeds—is a pretty fundamental bankruptcy concept. And on the other hand, the Court cares about whether the bankruptcy system works smoothly. If a majority of the justices had not believed that Chapter 13 cases would have been disrupted by a ruling for the Halls, or had not found a rationale to avoid the impact of its decision in Chapter 11 corporate cases, the decision quite likely would have been different.

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Faculty Biographies

Susan M. Freeman is a partner at Lewis and Roca LLP in Phoenix, where her bankruptcy practice includes representing debtors in possession, secured and unsecured creditors, committees, trustees and asset-buyers. She has served as the liquidating trustee of the Oregon Arena Corporation liquidating trust in Portland, Ore. Ms. Freeman is a Fellow and former director and vice president of the American College of Bankruptcy, and she is a member of ABI, the American Academy of Appellate Lawyers and the Arizona State Bar. She has been a Certified Specialist in Bankruptcy Law since 1987, and co-chairs the Secured Creditors Subcommittee of ABA Business Bankruptcy Committee; Ms. Freeman formerly co-chaired its Chapter 11 Subcommittee and chaired its Professional Responsibility Subcommittee. She is also a member of the American Academy of Appellate Lawyers and teaches at national and state Appellate Practice Institutes. Ms. Freeman has briefed more than 300 appeals in state and federal courts, and has served as a judge *pro tem* at the Arizona Court of Appeals and on several appellate court committees including the Ninth Circuit Rules Committee. A frequent lecturer and author, she co-authored the Civil Appeals section of the *Arizona Appellate Handbook* and contributed Chapter 172 on professional responsibility in bankruptcy cases in *Norton Bankruptcy Law & Practice*. She has also been listed in *Best Lawyers in America* since 1989 and listed in the "Top 50 in Arizona" by *Southwest Super Lawyers* Ms. Freeman received her B.A. from Mount Holyoke College (with distinction) and her J.D. from New York University School of Law, where she was a Root-Tilden scholar.

Adam A. Lewis is senior counsel at Morrison & Foerster LLP in San Francisco, where his practice includes structuring transactions to minimize the impact of bankruptcy, representation of creditors such as lenders, landlords and other parties to executory contracts and sureties, and assisting clients in the purchase of assets or companies in distressed circumstances or bankruptcy. He has represented debtors and creditors' committees as well as creditors, bidders, contract counterparties and other interested parties. Mr. Lewis has experience in telecommunications, agriculture, intellectual property, high technology, energy, construction, asset-based finance and real estate. In 2008, he was appointed by the judges of the U.S. District Court for the Northern District of California to a three-year term as one of the district's lawyer representatives to the Judicial Conference of the U.S. Ninth Circuit Court of Appeals. In 2010, the state Bar appointed him to a three-year term on its Insolvency Committee. From mid-2006 to mid-2010, Mr. Lewis was a member of the Bar-Bench Liaison Committee of the U.S. Bankruptcy Court for the Northern District of California, serving as co-chair of that committee in 2009-10. He also was one of the two lawyer members of the Forms Subcommittee of the Bar-Bench Liaison Committee working with judges on the development of standardized forms for select bankruptcy proceedings, and was a member of the committee updating the Local Rules to comport with the revised national rules. He proposed new attorney discipline provisions and interim rules for the Federal Rules of Bankruptcy Procedure. Mr. Lewis has been included in *The Best Lawyers in America* for 2008-12, "Super Lawyers" for 2008-10 by Corporate Counsel, and *Northern California Super Lawyers* for 2007-12. He was also named among the "Best Lawyers in the Bay Area" by the *San Francisco Business Times*. Mr. Lewis received his B.A. in 1968 and his M.A. in 1974 in philosophy from the University of California, Santa Barbara. He earned his J.D. in 1979 from the University of California, Davis, School of Law, where he was elected to the Order of the Coif.

Prof. Charles J. Tabb is the Mildred Van Voorhis Jones Chair in Law at the University of Illinois College of Law in Champaign, where he has published several dozen articles and six books, most

recently *The Law of Bankruptcy* (Foundation Press 2nd Ed. 2009). He practiced law with Carrington Coleman in Dallas before joining the Illinois faculty in 1984. Prof. Tabb has won numerous teaching awards and has served as a visiting professor at Texas and Colorado, as a visiting scholar at Cambridge University and Nottingham, and as the SBLI Distinguished Visiting Professor at Georgia State. He is also on the global law faculty at Católica Global School of Law, Universidade Católica Portuguesa, in Lisbon, Portugal. In 1993, Prof. Tabb was appointed by Chief Justice Rehnquist to the Advisory Committee on the Federal Rules of Bankruptcy Procedure of the Judicial Conference of the United States, serving two terms. He also served as a commissioner from Illinois for the National Conference of Commissioners on Uniform State Laws from 1997-2001. Prof. Tabb is a member of the American Law Institute and a Fellow of the American College of Bankruptcy, where he serves on the Board of Regents. He received his bachelor's degree *summa cum laude* Phi Beta Kappa from Vanderbilt University and his J.D. from the University of Virginia, where he was on the *Virginia Law Review* and was elected to the Order of the Coif.

Eric E. Walker is an associate at Perkins Coie LLP in Chicago, where he focuses his practice on financial restructuring and bankruptcy, representing debtors, creditors, various committees and trustees in bankruptcy proceedings, as well as on counseling emerging businesses and hotels in out-of-court workouts and restructurings. Mr. Walker also has significant commercial litigation and appellate experience. He was previously an associate at DLA Piper US LLP in Chicago. Mr. Walker is an active member of the American Bar Association, Chicago Bar Association and ABI and has authored numerous articles on bankruptcy and insolvency law. He received his J.D. from the University of Connecticut School of Law, where he was the "Notes & Comment" Editor for the *Connecticut Law Review*, and his B.S.B.A. in finance from Miami University.