AMERICAN BANKRUPTCY INSTITUTE

2020 Virtual Winter Leadership Conference

Judicial Round-and-Round

PLENARY SESSION

2020

American Bankruptcy Institute's 2020 Winter Leadership Conference
December 4, 2020, Noon Eastern Time
Judges' Roundtable
"Alternatives to Bankruptcy Under State Law"

Bankruptcy Judge Daniel P Collins (District of Arizona)

Many states have statutes that feel like bankruptcy proceedings. These include assignments for the benefits of creditors (ABC's), receiverships, compositions, and foreclosures under the Uniform Commercial Code (UCC). Some have observed that these state proceedings increasingly drive small business debtors away from bankruptcy.[1] This might not be a bad development in certain arenas. Think marijuana business issues which, by and large, have been found to impermissibly tread on the federal Controlled Substances Act (CSA) and, therefore, not susceptible to resolutions in federal bankruptcy courts. In some matters, these bankruptcy alternatives may provide the only avenue to resolve commercial disputes. In other contexts, however, one wonders whether these state debtor/creditor statutes impermissibly tread upon the federal law memorialized in our beloved Bankruptcy Code.

Some federal laws also compete for supremacy over the Bankruptcy Code. For instance, Congress has given us the Federal Arbitration Act (FAA). The U.S. Supreme Court has increasingly strengthened its view that the FAA provides the channel through which many commercial matters are to be resolved.[2] One wonders whether arbitration provisions in contracts may someday be read to require core bankruptcy proceedings to be resolved, not by bankruptcy courts but in arbitration.

[1] *Better Than Bankruptcy*, 69 Rutgers U. L. Rev. 137 (2016) by Andrew B. Dawson.
[2] See, for example, *Henry Schein Inc. v. Archer & White Sales Inc.,* 139 S. Ct. 524 (2019).

Article I § 8, clause 4 of the U.S. Constitution empowers Congress to establish uniform bankruptcy laws. Article VI, clause 2 of the Constitution (the Supremacy Clause) provides that federal law is the supreme law of the land. At what point do state statutes pertaining to debtor-creditor relationships run afoul of the federal bankruptcy laws? In which instances will bankruptcy law preempt these state statutes?

The U.S. Supreme Court has held that state statutes which provide a discharge for debtors are preempted by federal law.[3] In 2005, the 9th Circuit struck down a California statute that gave the assignee for the benefit of creditors the ability to avoid preferential transfers. The court in *Sherwood Partners*[4] held that "statutes that give state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench too close upon the exercise of the federal bankruptcy power."[5]

The Uniform Commercial Real Estate Receivership Act (UCRERA) has been adopted by a number of states. The UCRERE imposes a stay from proceeding against receivership property, arms a receiver with most of the powers of a bankruptcy trustee, and permits the receiver to assume or reject executory contracts. These are all, of course, terms familiar to bankruptcy lawyers. Do any of these provisions run afoul of the Supremacy Clause? Do the powers and rights created by state ABC's impermissibly tread on bankruptcy turf? What about compositions? Perhaps state UCC foreclosure laws?

[3] See *International Shoe Co. v. Pinkus*, 278 U.S. 261, 265-66 (1929), *Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 525 (1933) and *Stellwager v. Clum*, 245 U.S. 605 (1918).
[4] *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.2d 1198 (9th Cir. 2005)
[5] *Id.* at 1205.

According to the N.Y. Court of Appeals, preemption can occur in three different scenarios: (1) where a federal statute expressly preempts the domain (Express Preemption), (2) where the federal law implicitly pervades the field so comprehensively that there is no room for state legislation (Field Preemption) or (3) where the federal statute impliedly preempts a state statute where the state statute so far conflicts with the federal statute that it undermines the full purposes of the federal law (Conflict Preemption).[6] In *Sutton 58*, the N.Y. Court held that a tortious inference claim was not preempted by the Bankruptcy Code where it was brought in state court by a bankruptcy debtor's creditor against non-debtors who allegedly asserted that debtor is breaching its contract with the creditor.

In an even more recent preemption decision[7] Judge Gary Spraker, writing for the 9th Circuit BAP, cited the 9th Circuit's *MSR Exploration*[8] case for the proposition that:

> the highly complex laws needed to constitute the bankruptcy courts and regulate the rights of debtors and creditors . . . underscore the need to jealously guard the bankruptcy process from even slight incursions and disruptions…

The BAP then ascertained that the 9th Circuit looks to:

> five considerations driving the application of federal preemption in this area:
> (1) the provision for uniform federal bankruptcy laws under Art. I, § 8, cl. 4 of the United States Constitution, *Miles II*, 430 F.3d at 1090; *MSR Expl., Ltd.*, 74 F.3d at 913–15;
> (2) the congressional grant of exclusive bankruptcy jurisdiction to the federal courts, *Miles II*, 430 F.3d at 1090; *MSR Expl., Ltd.*, 74 F.3d at 913;

[6] *Sutton 58 Associates, LLC v. Pilevsky*, (N.Y. Court of Appeals, no 80, November 24, 2020). See also *ABI's Rochelle's Daily Wire*, December 2, 2020.
[7] *In re Bral*, (9th Circuit BAP, November 30, 2020). In *Bral*, the BAP affirmed Bankruptcy Judge Erithe Smith's finding that a creditor's claims against Bral for tortious interference and abuse of process (related to Bral's filing two bankruptcies for an entity in which he was involved) was preempted by the Bankruptcy Code.
[8] *MSR Expl., Ltd. V. Meridian Oil, Inc*., 74 F. 3d 910, 912-13 (9th Cir. 1996).

> (3) Congress' enactment of a "complex, detailed, and comprehensive" scheme of bankruptcy laws, *Miles II*, 430 F.3d at 1089 (quoting *MSR Expl., Ltd.*, 74 F.3d at 914);
> (4) the federal remedies Congress provided for improper conduct in bankruptcy proceedings, thereby indicating "that Congress has considered the need to deter misuse of the process and has not merely overlooked the creation of additional deterrents." *Miles II*, 430F.3d at 1089 (quoting *MSR Expl., Ltd.*, 74 F.3d at 915); and
> (5) the policy concern that Congress and the federal courts – rather than state courts – should decide what incentives and penalties should apply in connection with the use (and misuse) of the bankruptcy process. *Miles II*, 430 F.3d at 1090; *Gonzales*, 830 F.2d at 1036.

Bankruptcy lawyers tend to think bankruptcy should be a forum available to resolve most, if not all, of a debtor's financial woes and controversies. Case law occasionally suggests otherwise. More to the point, those who lobby state legislatures are creatively looking to find vehicles to keep their interests out of the hands of bankruptcy courts. As state legislatures continue to wade into debtor-creditor relationship issues, parties who feel they are not well served by such legislation should consider possible constitutional challenges to these state laws as impermissibly swimming in the Bankruptcy Code's preemptive waters.

For a much more comprehensive review of preemption in the bankruptcy context, see:

1. *Rethinking Preemption and Constitutional Parameters in Bankruptcy*, 59 Wm. & Mary L. Rev. 147 (2017) by Bankruptcy Judge and former law professor Michelle M. Harner.
2. *Bankruptcy Code and Preemption of State Law*, 21 J. Bankr. L. & 2 Art. 2 by Jeffrey B. Ellman and Brett J. Berlin.
3. *Has the 9th Circuit Finally Seen the Light? The Latest Development in Bankruptcy Preemption*, 2009 Ann. Surv. of Bankr. Law 13 (2009) by Anthony W. Austin and Scott K. Brown.

2020 ABI Winter Leadership Conference Judges Round and Round
Judge Janet S. Baer (ND. IL)
Student loans – Where is the pendulum swinging?

1. The statute

What kinds of loans are excepted from discharge under Section 523(a)(8)?

(A)(i) an educational loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a government unit or a nonprofit institution (i.e., federal, state and school loans);

(ii) an obligation to repay funds received as an educational benefit, scholarship or stipend (i.e. defaulted conditional educational grants); or

(B) any other educational loan that is a qualified educational loan (i.e., some private loans).

The exception to the exception: These loans are non-dischargeable *unless* excepting such debt from discharge would impose "an undue hardship on the debtor and the debtor's dependents."

2. How did we get here?

The current law is the result of several Bankruptcy Code amendments that have gradually made it more and more difficult to obtain a discharge of educational debt.

Legislative history suggests that section 523(a)(8)(A)(i) was never meant to extend to commercial loan programs—private loans.

BAPCPA presumably took the pendulum the entire way to the non-dischargeable side when it made both public and private educational debtors non-dischargeable.

3. Ways around reading that all educational loans are non-dischargeable

- 523(a)(8)(A)(ii) uses the term, educational "benefit," not educational "loan."
  A broad reading is contrary both to the general rule that dischargeability exceptions should be narrowly construed and to principles of statutory construction.
- 523(a)(8)(B). Not all loans are "qualified educational loans."
  Loans made to students at ineligible institutions (non-accredited schools)
  Loans made for ineligible expenses (expenses above the cost of attendance; mixed use loans)
  Direct-to-consumer loans—issued directly to the borrower without any school certification of student eligibility
- Classify the educational debt separately from other general unsecured creditors in a chapter 13 plan and cure and maintain it. (This does not discharge the debt but helps to address it.)

4. The undue hardship exception

The Brunner Test: Most circuit courts have adopted the *Brunner* test. (*See Brunner v. N.Y. State Higher Educ. Servs, Corp.*, 831 F.2d 395 (2nd Cir. 1987).

Under this test, an undue hardship exists if:

- The debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for the debtor and the debtor's dependents if forced to repay the loan;
- Additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loan; and
- The debtor has made a good faith effort to repay the loan.

Is this test impossible to meet or is the pendulum swinging toward a more liberal reading of the statute?

See, e.g., Tetzlaff v. Educ. Credit Mgmt. Corp., 794 F. 3d 756 (7th Cir. 2015). Remember: the *Brunner* test was adopted when student loans were automatically discharged after five years. Given the present situation, is it time to reexamine this test?

5. CARES Act provisions concerning student loans

Waiver of payments and interest.

The original act contained a two-month waiver of both payments and interest for many federal student loans borrowers. This waiver was then extended to six months.

- Eligible if you borrowed money from the federal government in the past ten years. Loans not owned by the U.S. Department of Education are not eligible, nor are loans from private lenders.
- Interest "shall not accrue" during the suspension period.
- The suspension does not cost you time if you are trying to qualify for a public service loan forgiveness program—payment count goes up each month during suspension period.
- Wage garnishment and seizures of tax refunds are suspended.
- There should be no damage to your credit if you took advantage of any virus-related payment relief.

6. Proposals for student loan relief

There have been many recent proposals for student loan relief and forgiveness, including:

- Forgive $10,000 in federal student debt per borrower
- Forgive all tuition-related undergraduate federal student loans from borrowers who attended public colleges and universities and who earn less than $125,000 per year
- Cut the monthly requirement for income-driven repayment plans from 10% to 5% of discretionary income
- Restore bankruptcy rights to discharge student loans

Which of these, if any, can the President do without congressional approval? Which of these or what other ideas makes sense?

2020 ABI Winter Leadership Judges Round and Round: Kevin Carey

Topic: Was the U.S. Supreme Court's decision in Merit Management really the last word on the Section 546(e) safe harbor in light of the Second Circuit's decision in Tribune?

Prior to its bankruptcy, Tribune was the largest media conglomerate in the United States reaching 80% of American households. It owned the Chicago Tribune, the Los Angeles Times, many regional newspapers and television and radio stations.

The company's 2008 bankruptcy followed shortly after its failed 2007 leveraged buyout. On the filing date, Tribune owed almost $13 billion in debt and had a complex capital structure. In consummating the LBO, Tribune borrowed over $11 billion, secured by its assets. Samuel Zell, a billionaire investor, contributed $315 million in equity. This was used to refinance some of Tribune's pre-existing bank debt and to cash out Tribune's shareholders for over $8 billion (at a premium price above its trading range).

After considering competing plans, the bankruptcy court ultimately confirmed Tribune's plan. In 2010, the Official Committee of Unsecured Creditors commenced an intentional fraudulent transfer action against the cashed out Tribune shareholders, various officers and directors, financial advisors, Zell and others. In 2011, two subsets of unsecured creditors filed state law constructive fraudulent conveyance claims in various state and federal courts. But before bringing the constructive fraudulent conveyance actions, the plaintiffs sought an order stating that since the two-year statute of limitations for bringing such claims in the bankruptcy proceeding had passed under section 546(a), the claims had reverted to creditors. While clarifying that the bankruptcy court was not resolving the issues of whether such creditors had standing to bring such actions or whether such claims were preempted by section 546(e) of the bankruptcy code, Judge Carey granted relief from the stay to permit eligible creditors to pursue such actions to the extent they might have the right to do so. Whether the creditors had any such rights was the one of the best decisions that Judge Carey says he never made.

The constructive fraudulent conveyance actions were eventually transferred to the U.S. District Court for the Southern District of New York and consolidated with the intentional fraudulent transfer claims in a multi-district litigation proceeding.

In 2013, the district court rejected the defendant's preemption argument and held that section 546(e) did not bar the actions because the prohibition on avoiding designated transfers applied only to a bankruptcy trustee and that Congress had declined to extend 546(e) to state law fraudulent conveyance claims brought by creditors, but dismissed the action on standing grounds.

Meanwhile, in 2018, the U.S. Supreme Court, in Merit Management, held that section 546(e) does not protect transfers in which financial institutions served as mere conduits.

In 2019, on appeal of the district court decision to the Second Circuit, the Court held, notwithstanding the Supreme Court's holding in Merit Management, the payments at issue were still subject to the 546(e) safe harbor. Nonetheless, the Court found that dismissal of the plaintiff's fraudulent conveyance claims was warranted as the purposes and history of that section – intended to protect payments essential to the operation of the securities markets – reflected Congressional

intent to preempt such claims. The Second Circuit's decision is subject to a petition for certiorari to the U.S. Supreme Court.

Finally, in August of this year, after all appeals were exhausted, the Third Circuit affirmed confirmation of Tribune's plan.

Successor Liability Under CMS Provider Agreements in the Sales of Hospitals

Summary: Debtor asserts that the Bankruptcy Code allows for the sale of Medicare/Medicaid Provider Agreements (the "CMS Agreements") between the hospital debtor (the "Hospital") and the Centers for Medicare & Medicaid Services ("CMS") free-and-clear of successor liability, if any. Recent decisions by bankruptcy courts have held that CMS Agreements are statutory entitlements, not "executory contracts" under Section 365 of the Bankruptcy Code. Under relevant bankruptcy law, the assignee of an executory contract assumes the debtor's liability under that contract. However, the assignee of a statutory entitlement has no successor liability, and the debtor's liability under an entitlement program remains a claim against the debtor's bankruptcy estate.

Background on CMS Agreements: The Hospital operates a separate rural Critical Access Hospital pursuant to a CMS Agreement. Each agreement provides that the Hospital shall comply with certain federal laws and regulations regarding the provision of services to Medicare/Medicaid recipients as well as reporting the costs of such services ("Cost Reports") to CMS on both interim and final (annual) bases. After receipt of a Cost Report, CMS distributes funds to the Hospital. In some instances, interim Cost Report payments can lead to CMS overpaying a Hospital when determined after submission of the annual Cost Report, leaving the Hospital with a liability to CMS in the amount of the overpayment. Additionally, the failure to pay certain taxes or funds into Medicare Trust Funds can create potential liabilities to CMS. The Debtor continues to investigate whether any of the Hospitals has any liability to CMS for pre-petition overpayments.

Treatment of CMS Liabilities in Bankruptcy Courts: Bankruptcy courts have previously treated CMS Agreements as executory contracts.[1] An executory contract contains, as of the petition date, ongoing, unperformed obligations between the parties other than merely the payment of money.

Section 365(b) of the Bankruptcy Code provides that a party to an executory contract with a bankruptcy debtor must receive adequate assurance of prompt cure and future performance in any proposed assignment of that contract. In the context of a Chapter 11 bankruptcy of a healthcare provider seeking to assign a CMS Agreement to a third-party, courts previously required the assignee to agree to cure the debtor's outstanding liabilities owed to CMS, thus requiring a potential assignee to factor into a purchase price the amount of any outstanding liability to CMS.

Recent Decisions Analyzing CMS Agreements as Statutory Entitlements: Recently, two bankruptcy courts on opposite sides of the country rejected the common and established approach to the assignment of CMS Agreements by characterizing CMS Agreements as statutory entitlement programs and not as executory contracts.

[1] See, e.g., In re University Medical Center, 973 F.2d 1065, 1075 n.13 (3d Cir. 1992); In re Advanced Professional Home Health Care Inc., 94 B.R. 95, 96–97 (E.D. Mich. 1988); In re Heffernan Memorial Hosp. Dist., 192 B.R. 228, 231 (Bankr. S.D. Cal. 1996); In re St. Johns Home Health Agency, Inc., 173 B.R. 238, 242 (Bankr. S.D. Fla. 1994); Matter of Visiting Nurse Ass'n of Tampa Bay, Inc., 121 B.R. 114, 118–19 (Bankr. M.D. Fla. 1990).

These decisions allow a debtor or trustee to transfer a CMS Agreement "free and clear of any interest," which, in the context of a CMS Agreement, would allow a purchaser to take that CMS Agreement without any obligation to pay a debtor's outstanding liabilities to CMS.

The first of those decisions was issued by the Bankruptcy Court for the District of Delaware in In re City Center Healthcare, LLC, et al, Case No. 19-11466 without a written opinion on the matter. Judge Gross stated simply in an order that "the [P]rovider [A]greement . . . is a statutory entitlement and not a contract and, as such, debtors are entitled to sell the [P]rovider [A]greement pursuant to [Bankruptcy] Code Section 363. And the purchaser . . . does not take with successor liability."

The Bankruptcy Court for the Central District of California issued its analysis of CMS Agreements in a written opinion: In re Verity System of California, Inc., Case No. 18-20151, 2019 WL 4729457 (Bankr. C.D. Cal. Sept. 26, 2019). In Verity, the court cited numerous opinions issued outside of the bankruptcy context by the Third, Ninth, and Eleventh Circuit Courts of Appeal that characterized the Medicare reimbursement program as a regulatory regime creating certain benefits for compliance with statutes, and not a bilateral contract. On those bases, courts have time and again denied contractual challenges to legislative reductions in Medicare reimbursements[2] and even permitted such reductions to have retroactive effect.[3]

Further, the Verity Court noted that CMS Agreements do not impose bilateral duties between the parties; to obtain reimbursements, a provider must only comply with pre-existing legal and regulatory requirements, and CMS will, in turn, act in accordance with its statutory and regulatory mandates. Gratuitous promises of legal duties cannot constitute consideration and thus do not create a contract.

The decisions in City Center and Verity have been appealed by CMS (in the City Center case) and the California Medicaid counterpart (in the Verity case). Both opinions raise valid points regarding the nature of CMS agreements, and the Debtor adopts those positions in the upcoming sale of the Hospital. Practically speaking, if the bankruptcy court sides with the Debtor, offers for the Hospital's assets would not need to factor in any potential CMS liability.

[2] PAMC, Ltd, v. Sibelius, 747 F.3d 1214 (9th Cir. 2014); Mem'l Hosp. v. Heckler, 706 F.3d 1130 (11th Cir. 1983).
[3] Germantown Hosp. & Med. Ctr. v. Heckler, 590 F. Supp. 24 (E.D. Pa. 1983), *aff'd sub nom* Germantown Hosp. & Med. Center v. Schweiker, 738 F.2d 631 (3d Cir. 1984).

Dissecting the Discharge Injunction: Parties' Postconfirmation Rights and Remedies

Michelle M. Harner[1]
U.S. Bankruptcy Judge, District of Maryland

One primary objective of most every bankruptcy case—whether a chapter 11 business reorganization or a chapter 13 individual rehabilitation—is for the debtor to receive the benefits of the coveted bankruptcy discharge. Section 524 of the Bankruptcy Code provides in relevant part,

> **(a)** A discharge in a case under this title--
>
> **(1)** voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, 1192, 1228, or 1328 of this title, whether or not discharge of such debt is waived;
>
> **(2)** operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and
>
> **(3)** operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1192, 1228(a)(1), or 1328(a)(1), or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

11 U.S.C. § 524. In addition, the relief provided by section 524 often is supplemented by the terms of a confirmed plan and sections 1141 and 1328 of the Bankruptcy Code, as applicable.

Yet, things do not always go "according to plan" after the confirmation of the chapter 11 or 13 plan and the effective date of the debtor's discharge. A number of issues can emerge, including the res judicata effect of the confirmed plan; the scope of the bankruptcy discharge; and the appropriate sanctions, if any, for violations of the discharge injunction. This session will discuss these three potential issues, as well as others, relating to the bankruptcy discharge. The discussion also will touch on relevant case law, such as:

- *Taggart v. Lorenzen*, 139 S. Ct. 1795, 204 L. Ed. 2d 129 (2019) (alleged violation of discharge injunction)

[1] This paper is presented for educational purposes only and does not express any opinions or positions regarding any issues that may arise, or any parties that may appear, in any cases before Judge Harner.

- *County of San Mateo v. Peabody Energy Corp. (In re Peabody Energy Corp.)*, 958 F.3d 717 (8th Cir. 2020) (scope and enforcement of discharge)

- *South Coast Air Quality Mgmt. Dist. v. Exide Techs. (In re Exide Techs.)*, 613 B.R. 79 (D. Del. 2020) (scope of exceptions to discharge)

- *Citizens Against Corp. Crime, LLC v. Lennar Corp. (In re LandSource Communities Dev., LLC)*, 612 B.R. 484 (D. Del. 2020) (scope and enforcement of discharge and res judicata effect)

- *In re RailWorks Corp.*, 613 B.R. 853 (Bankr. D. Md. 2020) (scope and enforcement of discharge)

- *In re City of Detroit, Michigan*, 614 B.R. 255 (Bankr. E.D. Mich. 2020) (alleged violation of plan injunction)

- *In re Kimball Hill, Inc.*, No. 08BK10095, 2020 WL 5834884 (Bankr. N.D. Ill. Sept. 30, 2020) (alleged violation of discharge injunction)

- *In re Parkland Properties, LLC*, 605 B.R. 509 (Bankr. N.D. Ill. 2019) (alleged violation of discharge injunction)

These cases highlight the importance of understanding the scope and effect of the bankruptcy discharge and considering any potential postconfirmation issues as parties work through the confirmation process.

AMERICAN BANKRUPTCY INSTITUTE
WINTER LEADERSHIP CONFERENCE

Judicial Round-and-Round
Friday, December 4, 2020
12:30 p.m. EST – 2:00 p.m. EST

CARES Act Changes to Eligibility Under the Small Business Reorganization Act of 2019: Increased Debt Limits, But What Else?

Hon. Hannah L. Blumenstiel
(Bankr. N.D. Cal. – San Francisco)

What makes eligibility under the SBRA worth talking about? Much of the early caselaw addressing the SBRA deals with eligibility questions. Challenging eligibility has become a strategy for creditors who want to avoid some of the debtor-friendly provisions of the SBRA. But most important – it's complicated! The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") temporarily revised the definition of "debtor" for purposes of the SBRA (Subchapter V of Chapter 11). So "debtor" means one thing in cases filed prior to March 27, 2020 (the effective date of the CARES Act) and filed after March 26, 2021 (when the temporary provisions of the CARES Act sunset) and means something else in cases filed between March 27, 2020 – March 26, 2021 (the effective period of the CARES Act). And the version of the Bankruptcy Code that's sitting on your desk likely doesn't have the CARES Act changes in it. I printed out the 3 pages of the CARES Act that set for the changes to the Bankruptcy Code and tucked them in to my 2020 version.

Where does an eligibility analysis start? §103. That section describes what chapters and subchapters apply to categories of bankruptcy cases. Pre-CARES Act, §103(i) stated that Subchapter V applied only to Ch. 11 cases in which a small business debtor elected to proceed under Subchapter V. Post-CARES Act, §103(i) provides that Subchapter V applies only to Ch. 11 cases in which a "debtor (as defined in §1182)" has elected to proceed under Subchapter V. So, pursuant to §103(i), you look to §1182 – not §101(13) – for the definition of "debtor" in a Subchapter V case.

Is the change to §103(i) permanent, or will it sunset after a year along with some of the other CARES Act changes to the Bankruptcy Code? Technically, the change to §103(i) is permanent, but the changes to §1182 will sunset after a year (on March 26, 2021), so the definition of "debtor" will revert back to its pre-CARES Act iteration as of that date.

What's the "big picture" in terms of CARES Act changes to eligibility under Subchapter V? The CARES Act expanded the types of debtors who can elect to proceed under Subchapter V. In non-CARES Act cases (commenced prior to March 27, 2020 or after March 26, 2021), only "small business debtors" (as defined in §101(51D)) can be debtors under Subchapter V. In CARES Act cases (commenced on or after March 27, 2020 through March 26, 2021), only debtors as defined in §1182(1) can be debtors under Subchapter V. That definition includes, but is not limited to, small business debtors under §101(51D), but also debtors who would otherwise be small business debtors, but whose debts exceed the limits applicable to small business debtors ($2,725,625), up to $7.5MM. In a CARES Act case, if a debtor meets the definition set forth in §1182, but its debts are more than $2,725,625 but below $7.5MM, it will nevertheless be eligible to be a Subchapter V debtor.

Did the CARES Act change §101(51D)'s definition of "small business debtor"? The CARES Act did *permanently* change §101(51D)(B) in one very important way. §101(51D)(B) lays out the types of debtors that are excluded from the definition of "small business debtor". Pre-CARES Act, §101(51D)(B)(iii) excluded corporations that are (I) subject to certain reporting requirements under the Securities Exchange Act of 1934 *and* (II) an affiliate of the debtor. Post-CARES Act, §101(51D)(B)(iii) excludes "any debtor that is an affiliate of an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78(c))". Although couched as a "technical correction", this change expanded the universe of affiliates that are excluded from the definition of "small business debtor".

What specific definitions apply to non-CARES Act cases (those filed prior to March 27, 2020 or after March 26, 2020)? First, and per §103(i), we look to the definition of "debtor" in §1182. In non-CARES Act cases, "debtor" means "small business debtor", as defined in §101(51D). Under §101(51D), "small business debtor" means a "person" (defined in §101(41)):

- Engaged in commercial or business activities

- With aggregate, noncontingent, liquidated, secured and unsecured debts as of the Petition Date (or entry of an order for relief) totaling no more than $2,725,625 (excluding debts to affiliates or insiders)

- At least 50% of those debts must have arisen from the debtor's commercial or business activities

- Includes an "affiliate" of such a "person" that is also a debtor in bankruptcy ("affiliate" is defined in §101(2))

- Excludes:

    - Persons whose primary activity is the business of owning single asset real estate (defined in §101(51B))

    - Any member of a group of affiliated debtors that has aggregate noncontingent, liquidated, secured and unsecured debts in excess of $2,725,625 (excluding debts owed to affiliates or insiders)

    - Any debtor that is a corporation subject to the reporting requirements of §§13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78(m) or 78o(d))

    - For cases filed prior to March 27, 2020, any corporation that – is subject to those reporting requirements and is an affiliate of a debtor

    - For cases filed after March 26, 2021, any debtor that is an affiliate of an issuer, as defined in §3 of the Securities Exchange Act of 1934

What specific definitions apply to CARES Act cases (those filed on or after March 27, 2020 through March 26, 2021)? Again, per §103(i), we look to §1182, but for CARES Act cases, that's where we stop – we don't need to refer to the definition of "small business debtor" in §101(51D). Per §1182, "debtor" means a "person" (defined in §101(41)):

- Engaged in commercial or business activities

- With aggregate noncontingent, liquidated, secured and unsecured debts as of the Petition Date (or entry of the order for relief) totaling no more than $7.5MM

- At least 50% of those debts must have arisen from the debtor's commercial or business activities

- An "affiliate" of such a "person" that is also a debtor in bankruptcy ("affiliate is defined in §101(2))

- Excludes:

    - Persons whose primary activity is the business of owning single asset real estate (as defined in §101(51B))

    - Any member of a group of affiliated debtors that has aggregate noncontingent, liquidated, secured and unsecured debts in excess of $7.5MM (excluding debts owed to affiliates or insiders)

    - Any debtor that is a corporation subject to the reporting requirements of §§13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. §§78(m) or 78o(d))

    - Any debtor that is an affiliate of an issuer, as defined in §3 of the Securities Exchange Act of 1934

These sound like very similar definitions. Is there any significant difference between them? The language is very, very similar, but the change is significant, principally because for CARES Act cases, we don't look to §101(51D)'s definition of "small business debtor" to determine eligibility – only to §1182. In a CARES Act case, if a debtor satisfies §1182, it can be a debtor under Subchapter V.

Let's take a quick example. Say you've been asked to analyze Subchapter V eligibility for corporate debtors with common ownership (affiliates per §101(2)). One of those debtors is a single asset real estate debtor – ineligible for relief under Subchapter V. In a non-CARES Act case, the debts of the SARE affiliate *would be* included in the debt limit calculation because that "affiliate" is a "debtor" under §101(13). In a CARES Act case, the SARE affiliate would be excluded from

§1182's definition of "debtor", so its debts would not count for purposes of Subchapter V's debt limits.

Recent Caselaw

Affiliate Exclusion

In re Serendipity Labs, Inc., Ch. 11 Case No. 20-68124-sms (Bankr. N.D. Ga. Oct. 19, 2020) (Sigler, J.) (discussed the exclusion of debtors that are "affiliates of an issuer" and found that because a publicly traded company held more than 20% of the debtor's voting shares, the debtor was ineligible for relief under Subchapter V; examined §1182(1)(B)(iii) and §101(2)'s definition of "affiliate").

Contingent Debt Exclusion

In re Parking Mgmt., Inc., 2020 WL 6146476 (Bankr. D. Md. Aug. 28, 2020) (Catliota, J.) (holding that lease rejection claims were contingent on the Petition Date and should be excluded from debt calculation for purposes of determining eligibility under Subchapter V).

Engaged in Commercial or Business Activities

In re Bonert, 619 B.R. 248 (Bankr. C.D. Cal. June 3, 2020) (Robles, J.) (individual debtors permitted to proceed under Subchapter V where debts arose from their prior operation of a business; i.e., no current business activities).

In re Wright, 2020 WL 2193240 (Bankr. D. S.C. Apr. 27, 2020) (Burris, J.) (individual who guaranteed debts of corporate entities that no longer operated could proceed under Subchapter V; individual was engaged in commercial or business activities by "addressing residual business debt").

In re Blanchard, 2020 WL 4032411 (Bankr. E.D. La. July 16, 2020) (Grabill, J.) (individual debtors who guaranteed debts of both operating and non-operating businesses eligible for relief under Subchapter V).

Non-Profits

In re Ellingsworth Residential Cmty. Assoc., Inc., 619 B.R. 519 (Bankr. M.D. Fla. July 10, 2020) (Jenneman, J.) (held that a non-profit community association was

engaged in commercial or business activities as required for eligibility under Subchapter V; no profit motive required).

Burden of Proof

In re Body Transit, Inc., 613 B.R. 400, 409 n.15 (Bankr. E.D. Pa. Mar. 24, 2020) (Frank, J.) (party objecting to eligibility bears the burden of proof).

Serendipity Labs, Ch. 11 Case No. 20-68124-sms, slip op. at 2 n.3 (same).

Consumer Corner

By Hon. Eugene R. Wedoff (ret.)

Return of Vehicles Seized Before a Chapter 13 Filing

Does the Debtor Have to File a Turnover Motion?

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Editor's Note: *This topic was one of the issues presented at the 27th Annual Duberstein Moot Court Competition, held in New York in early March. To learn more about the competition (jointly sponsored by ABI and St. John's University School of Law), please visit stjohns.edu/law/center-bankruptcy-studies/27th-annual-duberstein-moot-court-competition.*

One of the significant unresolved issues in consumer bankruptcy law is the right of a chapter 13 debtor to obtain the return of a vehicle seized before the bankruptcy was filed. The majority of the courts that have ruled on the issue, including the Seventh Circuit in *Thompson v. GMAC* and several other circuit courts, have held that creditors have a duty to return the seized vehicle to the debtor under the automatic stay set out in § 362(a)(3).[1]

However, the Tenth Circuit's recent *Cowen* decision adopted a minority interpretation, holding that the automatic stay does not apply to vehicles seized pre-petition and that a creditor need only return the collateral to a chapter 13 debtor if the bankruptcy court grants a debtor's motion for turnover.[2] ABI's *Rochelle's Daily Wire*, in reporting both this decision and a subsequent one by the Tenth Circuit, noted the potential for a grant of *certiorari* to resolve the circuit split.[3]

Before any consideration by the U.S. Supreme Court, the Seventh Circuit is being asked to address the issue. The City of Chicago has enacted ordinances that (1) allow the city to seize vehicles for parking, revenue and camera-recorded driving violations, and (2) grant the city a possessory lien on the seized vehicles.[4] Vigorous enforcement of these ordinances has resulted in thousands of chapter 13 filings in Chicago.[5]

In these cases, the debtors have cited the *Thompson* decision as requiring the city to return seized vehicles to them when it receives notice of their bankruptcy filings. However, the city has contested *Thompson*'s applicability, arguing that in order to retain its possessory lien, it is allowed to continue holding seized vehicles under § 362(b)(3), an exception to the automatic stay that allows creditor action to maintain lien perfection. The city's more basic argument is that *Thompson* was incorrectly decided, and that the Seventh Circuit should overrule it and adopt the minority interpretation of § 362(a)(3). Five bankruptcy judges have ruled on the city's arguments, and one found that the automatic stay exception applied.[6] The other four rejected that argument.[7] However, none of the judges found that *Thompson* should be overruled. The city has appealed the four decisions that denied it relief, and the Seventh Circuit has consolidated the cases for direct appeal.[8]

The narrow issue — application of the stay exception in § 362(b)(3) — will only be relevant in the appeal if *Thompson* is upheld. Unless § 362(a)(3) generally requires the return of seized collateral, there would be no need to consider a special exception for collateral subject to a possessory lien.[9] The applicability of § 362(a)(3)

1 *See Thompson v. Gen. Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009); *Weber v. SEFCU (In re Weber)*, 719 F.3d 72 (2d Cir. 2013); *Calif. Emp't Dev. Dep't v. Taxel (In re Del Mission Ltd.)*, 98 F.3d 1147 (9th Cir. 1996) (expressly adopting *Abrams v. Sw. Leasing & Rental Inc. (In re Abrams)*, 127 B.R. 239 (B.A.P. 9th Cir. 1991), which holds that failure to return repossessed car after receiving notice of debtor's bankruptcy violates § 362(a)(3)). *Knaus v. Concordia Lumber Co. (In re Knaus)*, 889 F.2d 773 (8th Cir. 1989), applied the same reading of § 362(a)(3) to require the return of collateral to a chapter 11 debtor. *See also Motors Acceptance Corp. v. Rozier*, 348 F.3d 1305 (11th Cir. 2003); *Rozier v. Motors Acceptance Corp. (In re Rozier)*, 376 F.3d 1323 (11th Cir. 2004) (requiring return of collateral obtained pre-petition as long as collateral remained estate property after repossession). *Accord, STMIMA v. Carrigg (In re Carrigg)*, 216 B.R. 303 (B.A.P. 1st Cir. 1998); *TranSouth Fin. Corp. v. Sharon (In re Sharon)*, 234 B.R. 676 (B.A.P. 6th Cir. 1999).

2 *WD Equip. v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. 2017), rejecting the contrary opinion, *Unified People's Fed. Credit Union v. Yates (In re Yates)*, 332 B.R. 1 (B.A.P. 10th Cir. 2005). A more extensive argument for the minority interpretation is set out in *In re Hall*, 502 B.R. 650 (Bankr. D.D.C. 2014).

3 Bill Rochelle, "Tenth Circuit's Narrow View of Automatic Stay Erodes Estate Property," *Rochelle's Daily Wire* (July 14, 2017), *available at* abi.org/newsroom/daily-wire/tenth-circuit's-narrow-view-of-automatic-stay-erodes-estate-property; Bill Rochelle, "Tenth Circuit Opinion Can Be the Springboard for a 'Cert' on the Automatic Stay," *Rochelle's Daily Wire* (Oct. 18, 2018), *available at* abi.org/newsroom/daily-wire/tenth-circuit-opinion-can-be-the-springboard-for-a-'cert'-on-the-automatic-stay (unless otherwise specified, all links in this article were last visited on Jan. 25, 2019).

4 Municipal Code of Chicago, Ill., §§ 9-100-120 (impounding vehicles), 9-92-080(f) (possessory lien).

5 *See* Melissa Sanchez and Sandhya Kambhampati, "Driven Into Debt: How Chicago Ticket Debt Sends Black Motorists into Bankruptcy," *ProPublica Illinois* (Feb. 27, 2018), *available at* features.propublica.org/driven-into-debt/chicago-ticket-debt-bankruptcy ("In 2007, an estimated 1,000 Chapter 13 bankruptcies included debts to the city, usually for unpaid tickets, with the median amount claimed around $1,500 per case. By last year, the number of cases surpassed 10,000, with the typical debt to the city around $3,900.").

6 *In re Avila*, 566 B.R. 558 (Bankr. N.D. Ill. 2017).

7 *In re Shannon*, 590 B.R. 467 (Bankr. N.D. Ill. 2018); *In re Peake*, 588 B.R. 811 (Bankr. N.D. Ill. 2018); *In re Fulton*, 588 B.R. 834 (Bankr. N.D. Ill. 2018); *In re Howard*, 584 B.R. 252 (Bankr. N.D. Ill. 2018).

8 *City of Chicago v. Robbin L. Fulton*, No. 18-2527, Docket Nos. 2, 6 and 14. The author is serving as counsel to debtors in this appeal.

9 The treatment of possessory liens in bankruptcy is beyond the scope of this article, but are discussed in Eugene R. Wedoff, "The Automatic Stay Under § 362(a)(3) — One More Time," 38 *Bankr. L. Letter* No. 7, at 5-6 (July 2018); and Ralph Brubaker, "Turnover, Adequate Protection and the Automatic Stay: A Reply to Judge Wedoff," 38 *Bankr. L. Letter* No. 11, at 11-12 (Nov. 2018).

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then becomes the principal issue to be determined by the Seventh Circuit, and it is a major issue for consumer bankruptcy, since it affects not only Chicago vehicle seizures but the repossession of vehicles for ordinary auto loan defaults across the nation. There are three major arguments about the application of § 362(a)(3) to repossessed collateral: (1) the requirements for turnover under § 542(a); (2) the meaning of § 362(a)(3); and (3) compliance with general bankruptcy policy.

Turnover Under § 542(a)

Section 542(a) provides that a party holding property that a trustee can use under § 363 must deliver that property to the trustee unless it has inconsequential benefit to the estate.[10] Section 1306(b) generally places chapter 13 debtors in possession of estate property; § 1303 gives them the general rights of a trustee under § 363; and § 542(a) gives them the right to receive property that a trustee could use under § 363. Minority decisions acknowledge that chapter 13 debtors have the property rights of trustees, but argue that § 542 requires the debtors to obtain a court order before creditors are required to turn over seized property to the debtor.[11]

The difficulty with this argument is that it contradicts the text of the statute. Section 542(a) does not condition its turnover requirement on court orders, but simply states that property that can be used under § 363 "shall" be delivered. The congressional reports setting out the effect of § 542(a) confirm its plain meaning,[12] and the majority decisions have interpreted § 542(a) accordingly.[13] *Cowen* expressly declines to challenge this interpretation and only asserts that if it is correct, § 362(a)(3) is not necessary to enforce the turnover obligation, since § 105(a) would allow debtors to seek sanctions for a creditor's failure to turn over property voluntarily.[14]

The Meaning of § 362(a)

The majority interpretation of § 362(a)(3) is also grounded in the plain meaning of its terms. Section 362(a)(3) applies the automatic stay to "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate," and the majority decisions hold that a creditor "exercises control" over a debtor's vehicle by continuing to hold it after the bankruptcy filing. *Thompson* made the point this way:

> Webster's Dictionary defines ''control'' as, among other things, ''to exercise restraining or directing influence over'' or ''to have power over.'' *Merriam-Webster's Collegiate Dictionary* (11th ed. 2003). Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within this definition, as well as within the commonsense meaning of the word.[15]

On the other hand, *Cowan* focused on the action prohibited by the paragraph:

> [Section] 362(a)(3) prohibits "any act to obtain possession of property" or "any act to exercise control over property." "Act," in turn, commonly means to "take action" or "do something." *New Oxford American Dictionary* 15 (3d ed. 2010).... This section, then, stays entities from doing something to obtain possession of or to exercise control over the estate's property. It does not cover "the act of passively holding onto an asset," *Thompson*, 566 F.3d at 703, nor does it impose an affirmative obligation to turn over property to the estate.[16]

The difficulty with *Cowen*'s approach to the language is that a creditor does more than "passively hold" a seized vehicle by refusing to return it; the creditor actively prevents the debtor from regaining possession by keeping the vehicle locked or guarded. Only if the creditor were truly passive, allowing the debtor free access to the vehicle, would there be no exercise of control. In at least one bankruptcy decision, the minority interpretation is supported with an alternative argument that "property of the estate" does not include all the rights of property ownership, but only the rights to which the debtor was entitled when the bankruptcy case was filed. If the debtor had no right to possess seized property before the bankruptcy case was filed, the argument continues, the right of possession would not become property of the estate, and the creditor would not "exercise control over property of the estate" by preventing the debtor from obtaining the property.[17]

Cowen does not make this argument, so it avoids addressing the difficulty with the argument presented by § 542(a). While a chapter 13 debtor would not have had the right to possess seized property before the bankruptcy filing, § 542(a) conveys that right as soon as the bankruptcy case is filed. *Thompson* makes the point that § 542(a) "draw[s] back into the estate a right of possession that is claimed by a lien creditor pursuant to a prepetition seizure."[18] So, by depriving the debtor of the right to possess property that § 542(a) accords, a creditor would clearly exercise control over "estate property," violating § 362(a)(3).

10 Section 542(a) provides, in relevant part "[A]n entity ... in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 ... shall deliver to the trustee ... such property ... unless such property is of inconsequential value or benefit to the estate."

11 For example, *In re Hall*, 502 B.R. at 654-64, sets out a lengthy argument that § 542(a) continues a pre-Bankruptcy Code practice requiring trustees and debtors in possession to obtain turnover of estate property by moving for a court order. Pre-Code practice might inform the interpretation of ambiguous statutory Code provision language, but it may not be used to contradict the Code's language. *See Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 10, 120 S. Ct. 1942, 1949 (2000) ("[W]hile pre-Code practice 'informs our understanding of the language of the Code,' it cannot overcome that language. It is a tool of construction, not an extratextual supplement.") (citation omitted).

12 S. Rep. No. 95-989, 95th Cong., 2d Sess. 84 (1978); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977) ("Subsection (a) of this section requires anyone holding property of the estate on the date of the filing of the petition, or property that the trustee may use, sell, or lease under section 363, to deliver it to the trustee.").

13 *See, e.g., In re Knaus*, 889 F.2d at 775 ("The duty to turn over the property is not contingent upon ... any order of the bankruptcy court...."); *Thompson*, 566 F.3d at 704 (under § 542(a) "turnover of a seized asset is compulsory").

14 *Cowen*, 849 F.3d at 950.

15 *Thompson*, 566 F.3d at 702.

16 *Cowen*, 849 F.3d at 949.

17 *Hall*, 502 B.R. at 667-69.

18 *Thompson*, 566 F.3d at 704 (quoting *In re Sharon*, 234 B.R. at 683).

Bankruptcy Policy

The policies underlying §§ 362(a)(3) and 542(a), as *Thompson* explains, are to "allow the debtor to reorganize and repay the majority of his debts without having to liquidate his assets" and so let the debtor "retain the beneficial use of productive assets."[19] For chapter 13 debtors, enforcing this policy by applying the automatic stay to seized vehicles is particularly important. Chapter 13 debtors often need their vehicles to get to work or care for their children, but they typically have limited financial resources, so they would often lack the additional funds needed to obtain alternative transportation while a motion to enforce turnover was being considered by the court. Requiring a motion to be granted before the debtor can obtain the return of a seized vehicle would often make bankruptcy unable to address the debtor's financial distress.[20]

For creditors, on the other hand, complying with § 362(a)(3) imposes no extraordinary burden. The major concern raised by the minority decisions is that the creditor might be required to return a vehicle without a court order providing adequate protection. However, this situation is not significantly different from that faced by any creditor whose collateral is not adequately protected while a chapter 13 case is pending.[21]

The remedy is for the creditor to seek a court order for relief from the automatic stay, which (if the creditor is threatened with immediate and irreparable loss) can be obtained without notice to the debtor.[22] The most troubling situation for a creditor is a request for the return of a repossessed vehicle that is uninsured.[23] However, a loss of insurance (caused by the debtor's failure to pay premiums) can also occur during a case, and again, the remedy is stay relief. Creditors who have repossessed an uninsured vehicle before filing have an additional alternative: to retain the vehicle and respond to any motion for enforcement of the automatic stay with a request for stay annulment, which would retroactively validate the vehicle retention.[24] There appear to be no published decisions imposing sanctions for a creditor's refusal to return an uninsured vehicle, and there is ample indication that no such turnover would be ordered.[25]

Conclusion

Each of the arguments discussed herein will likely be addressed in the Seventh Circuit's decision in the pending appeal, and that decision might have a major effect on chapter 13 practice. abi

19 *Id.* at 705.

20 *Id.* at 707 ("If a debtor's car remains in the hands of a creditor, it could hamper the debtor from either attending or finding work, which is crucial for garnering the funds necessary to pay off his debts.").

21 *See In re Yates*, 332 B.R. at 5 ("As a practical matter, there is little difference between a creditor who obtains property of the estate before bankruptcy is filed, or after bankruptcy is filed.").

22 Fed. R. Civ. P. 4001(a)(2), providing for *ex parte* stay relief under § 362(d).

23 *See Hall*, 502 B.R. at 660 ("If immediate turnover were required, an accident might result in the collateral being destroyed, with no insurance proceeds recovered, and the lien being rendered worthless.").

24 Annulment is one of the forms of stay relief authorized by § 362(d), and its effect of retroactive validation is well recognized. *See, e.g., In re Siciliano*, 13 F.3d 748, 751 (3d Cir. 1994) ("[I]nclusion of the word 'annulling' in the statute ... indicates a legislative intent to apply certain types of relief retroactively and validate proceedings that would otherwise be void *ab initio*.").

25 While adopting the majority interpretation of § 362(a)(3), one court bluntly stated that it "takes the lack of insurance seriously and will not permit a debtor to obtain or retain possession of a vehicle that is not adequately insured." *Stephens v. Guaranteed Auto Inc. (In re Stephens)*, 495 B.R. 608, 615 (Bankr. N.D. Ga. 2013). Another court, though otherwise accepting the minority interpretation of § 362(a)(3), upheld the district's practice of finding a violation of the automatic stay by a creditor that refuses to return a seized vehicle, but only after the debtor produces proof of insurance. *In re Denby-Peterson*, 576 B.R. 66, 81-82 (Bankr. D.N.J. 2017).