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2021 Bankruptcy Battleground West

We Give a Split! Overview of Circuit Splits on Current Issues

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WE GIVE A SPLIT!

Overview of Circuit Splits on Current Issues



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CITY OF CHICAGO V. FULTON:

STAY PUT, DO NOT ACT: SUPREME COURT HOLDS THAT POSTPETITION RETENTION OF PROPERTY OF THE ESTATE DOES NOT VIOLATE SECTION 362(A)(3) OF THE BANKRUPTCY CODE

Background

- Series of cases in which the City of Chicago impounded vehicles for various motor vehicle infractions. Motorists filed chapter 13 bankruptcy petitions in an effort to retrieve their vehicles. The Seventh Circuit held that the City's retention of their vehicles constituted an "exercise of control" that violated section 362(a)(3). *In re Fulton*, 926 F.3d 916 (7th Cir. 2019)
- Supreme Court granted *certiorari* to address growing split amongst Circuit Courts
 - **Majority Position:** Passive retention of property constitutes an "exercise of control"
 - Creditor must return property to the debtor upon receiving notice of the bankruptcy or risk sanctions for violating the automatic stay
 - Followed by the Second, Seventh, Eighth, Ninth, and Eleventh Circuits
 - **Minority Position:** Only affirmative acts to gain possession of, or to exercise control over, property of the estate violates section 362(a)(3) of the Bankruptcy Code
 - Creditor may retain property until the bankruptcy court determines whether the debtor has a right to turnover, creditor may assert defenses to turnover and seek adequate protection
 - Followed by the Third, Tenth and D.C. Circuits

Background

- Oral arguments took place on October 13, 2020
- Key amici briefs included
 - joint brief by the ACLU/CATO Institute,
 - briefs by bankruptcy law professors, and
 - brief by the National Association of Chapter 13 trustees
- Opinion entered on January 14, 2021
 - Unanimous decision by Justice Alito (8-0)
 - Concurrence by Justice Sotomayor
- **Holding**
 - The mere retention of property after the filing of a bankruptcy petition does not violate section 362(a)(3) of the Bankruptcy Code

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The Supreme Court's Analysis

- **Plain language of section 362**
 - Section 362(a)(3): Automatic stay applies to “**any act . . . to exercise control** over property of the estate.”
 - The Court consulted dictionaries and case law concluding that “taken together, the most natural reading of these terms—‘stay,’ ‘act,’ and ‘exercise control’—is that §362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed.”
 - Some ambiguity in section 362(a)(3) in that omissions can qualify as “acts” in certain contexts and “control” can mean “to have power over”
- **Harmonizing sections 362 and 542**
 - Section 542(a): Creditors “in possession, custody, or control, during the case . . . **shall deliver** to the trustee, and account for, such property . . .”
 - Reading 362(a)(3) to require affirmative turnover would render section 542 superfluous and the provisions contradictory
- **Review of the legislative history**
 - 1984 Code Amendments added a new prohibition on acts “to exercise control over property of the estate” to section 362(a)(3)
 - The Court reasoned it is unlikely that Congress meant to impose a new turnover obligation by addition of this language alone where no turnover obligation had previously existed

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Justice Sotomayor Concurrence

- **Narrow reading**
 - Emphasizes that the Court's ruling was limited section 362(a)(3) and does not decide whether other code provisions, such as sections 362(a)(4) or (a)(6) may require automatic turnover
 - Section 362(a)(4) stays "any act to create, perfect, or enforce any lien against property of the estate"
 - Section 362(a)(6) stays "any act to collect, assess, or recover a claim against [a] debtor"
 - Decision also fails to address how bankruptcy courts should enforce a creditors' separate obligation to "deliver" estate property to a trustee under section 542(a)
- **Policy implications**
 - Acknowledges the importance of the debtor's ability to obtain a fresh start and continue to earn income and that "regardless of whether the City's policy of refusing to return impounded vehicles satisfies the letter of the Code, it hardly comports with its spirit"
- **Procedural Concerns**
 - The Federal Rules of Bankruptcy Procedure require an adversary proceeding for turnover actions, which delays vehicle turnover to consumer debtors
 - Advisory Committee on Rules of Bankruptcy Procedure could consider amendments to expedite adversary proceedings for turnover or allow debtors to request turnover by motion
 - Congress could provide a statutory fix

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Practical Implications after *Fulton*

- **Action required by debtor**
 - Debtor or trustee must commence adversary proceeding to assert rights in and request turnover of property
 - Creditors may assert defenses to turnover before the bankruptcy court
- **Consumer Context**
 - Additional administrative and financial burden for the estate (limiting funds for unsecured creditors) if trustee is tasked with seeking turnover
 - Policy concerns if delayed timing threatens a debtor's ability to earn income and receive a fresh start
 - Alleviates burden on secured creditor to immediately (i) surrender possession or (ii) file motion for relief from stay for collateral collected prepetition

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Potential Alternatives for Debtors

- Applicability of other automatic stay provisions to protect individual debtors with more limited implications
 - Section 362(a)(4) stays “any act to create, perfect, or enforce any lien against property of the estate”
 - Section 362(a)(6) stays “any act to collect, assess, or recover a claim against [a] debtor”
- Amendments to Bankruptcy Court Local Rules
 - Courts may create a form summons and adversary complaint for consumer debtor vehicle turnover
 - Expedited procedural rules for turnover adversary proceedings
 - Local rules may be tailored to address local policies with respect to vehicle foreclosure
- Amendments to Bankruptcy Code expressly providing that retaining possession of estate property violates the automatic stay and incorporation of mechanisms to protect status quo for creditors (i.e., proof of insurance, etc.)
- Amendments to the Bankruptcy Rules to permit turnover by motion instead of adversary proceeding

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DEBT RECHARACTERIZATION

Debt Recharacterization

- Recharacterization of debt into equity for purposes of bankruptcy priority and distributions
 - Arises in circumstances comparable to those giving rise to equitable subordination under section 510(c)(1) of the Bankruptcy Code
 - Typically – but not always – arises in the context of insider loans to a debtor
- Policy considerations
 - Encourage rehabilitation of distressed entities by respecting last-resort debt or protect existing creditors from potential unscrupulousness of late-in-time lenders?
 - Stability/predictability for debtors and lenders

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Current Law – Test 1

- Majority Rule – Multi-Factor Tests under Federal law
 - Third, Fourth, Sixth, and Tenth Circuits
 - Statutory basis is section 105(a)
 - Derived from tax law classifications of debt vs. equity
 - Phrasing of tests and number of factors vary from court to court, but substance of tests is similar/identical
 - Multi-factor tests tend to focus on both formalities and circumstances of loans
 - E.g., characterization of debt in instruments, payment schedule, fixed maturity date, security vs. capitalization of debtor, availability of alternative financing

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Current Law – Test 2

- Minority Rule – Looks to State law
 - Fifth and Ninth Circuits
 - Statutory basis is section 502(b); court is obligated to determine what a claim is and whether a right to payment exists by reference to state law
 - Recent development, with cases decided in 2011, 2013
 - Reaction to perceived imprecision of the majority's multi-factor tests
 - Looks either to state statutory or decisional law, depending on the current evolution of relevant state's law

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Current Law – Test 3

- Outlier Rule: “No-Commercial-Lender-Would-Have-Done-This”
 - Applies only in the Eleventh Circuit
 - Pre-dates most majority rule cases and minority law cases
 - Per se rule: Court identifies whether a commercial lender would have made the loan in question; if not, loan should be treated as equity
 - Maximizes predictability and protection of existing creditors' positions, but effectively eliminates respect for last-minute financing

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Pros And Cons of the Various Approaches

- Majority Rule (Multi-Factor Tests)
 - Maximizes courts' power to employ recharacterization as a remedy
 - But maximizes lender uncertainty – difficult to predict in advance how a court will apply this test
 - Puts a lot (maybe too much) weight on section 105(a)
- Minority Rule (Look to State Law)
 - Consistent with S. Ct. precedent that creditors' substantive rights should be determined with reference to state law
 - May increase predictability for lenders and availability of rescue capital
 - Limits courts' ability to fashion remedies

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Practice Implications

- Know your jurisdiction – minority rule decisions appear to be more friendly to last-resort financing than majority rule jurisdictions
- Hearing preparation – hearings in courts applying majority rule multi-factor tests likely to be more fact and evidence-intensive than minority rule state law approach
- Observe loan formalities, particularly where lenders are insiders or may become insiders
- Loan percentages should not match equity percentages
- Be careful about convertibility

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APPROPRIATE RATE OF INTEREST TO “UNIMPAIRED” GENERAL UNSECURED CREDITORS

11 U.S.C. § 1124

- Section 1124 of the Bankruptcy Code provides, in relevant part, that “. . . a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—
- leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest.
- 11 U.S.C. § 1124(1).
- Impairment, for purposes of Section 1124(1), only occurs where the plan itself alters the creditors rights. *In re PG&E Corp.*, 610 B.R. 308, 315 (Bankr. N.D. Cal. 2019). Where alteration of the creditors’ rights is the Bankruptcy Code itself, and not of the plan, the creditors are not “impaired” for purposes of Section 1124(1). *Id.*
- It is settled law that where a chapter 11 debtor is solvent, the debtor generally must pay postpetition interest to its general unsecured creditors. *In re Cardelucci*, 285 F.3d 1231, 1234 (9th Cir. 2002). However, the Federal Courts of Appeal are split as to whether the Federal Judgment Rate or the parties’ contract rate applies in such situations.

Ninth Circuit – Federal Judgment Rate

- *In re Cucker Interactive, LLC*, 622 B.R. 67 (Bankr. S.D. Cal. 2020) – Debtor asserted that unsecured creditors are deemed “unimpaired” if claim paid in full plus interest at the federal judgment rate. Creditors objected, asserting that they are entitled to contract rate to be “unimpaired”.
- Judge Adler rejected the creditors’ position, relying on *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), where the Ninth Circuit held that in cases involving solvent debtors, unsecured creditors are entitled to postpetition interest at the federal judgment rate, not at contractual or state statutory rates. *Id.* at 1234. In so holding, the Ninth Circuit observed that application of the lower federal judgment rate did not violate an unsecured creditor’s substantive due process rights [*id.* at 1236] and that utilization of federal judgment rate for all claims was rationally related to legitimate interests in efficiency, fairness, predictability, and uniformity within bankruptcy system. *Id.*
- *PG&E* was also instructive, where Judge Montali “read *Cardelucci* expansively and ultimately adopted its holding as applying to all unsecured creditors in a solvent-debtor case.” *In re PG&E Corp.*, 610 B.R. at 310. The *PG&E* Court explained that limiting an unsecured claim to postpetition interest at the Federal Judgment Rate is a function of the Bankruptcy Code and not the plan. *Id.* at 315-16.

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First, Fifth and Sixth Circuits – “Solvent Debtor Exception”

- “Solvent Debtor Exception” enforces state law rights of unsecured creditors in a solvent case, including the right to receive post-petition interest at their contract rate. *In re Ultra Petroleum Corp.*, 943 F.3d 758 (9th Cir. 2019); *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006); *Debentureholders Protective Comm. Of Cont’l Inv. Corp v. Cont’l Inc. Corp.*, 679 F.2d 264, 269 (1st Cir. 1982) (recognizing that the solvent-debt exception requires a court to enforce the parties’ state law contractual rights, even for unsecured creditors).
- In *Ultra Petroleum*, Judge Isgur concluded that the “solvent-debtor exception” applies and held that where claims of unsecured creditors are “unimpaired”, they must receive postpetition interest at their contractual rate, or otherwise be given the opportunity to vote on the plan. *In re Ultra Petroleum Corp.*, No. 16-32202 et al., 2020 WL 6276712, 21-22 (Bankr. S.D. Tex. Oct. 26, 2020). The Court explained that the underlying purpose of the exception is that the debtor must repay its debts in full when it has the means to do so. *Id.* at 22. Thus, when a debtor is solvent, “. . . a bankruptcy court’s rule is merely to enforce the contractual rights of the parties.” *Id.* at 21 (quoting *In re Dow Corning*, 456 F.3d at 679).

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Practical Considerations

- Assume thousands of unsecured creditors with different contracts and different rights. What would be the administrative costs (time and money) to obtain, analyze and reconcile thousands of agreements to determine appropriate repayment terms?
- Judge Adler, as well as the *Cardelucci* court, concluded that the application of the “solvent-debtor exception” would pose an administrative threat to the bankruptcy court’s administrative efficiency in larger cases. See *In re Cardelucci*, 285 F.3d at 1236 (recognizing that even on occasions when a debtor may receive a windfall, the uniform approach of applying the Federal Judgment Rate is a more efficient and fair and equitable outcome than applying each creditors’ contractual rate or the applicable state law judgment rate, which varies state-by-state).
- Application of federal law (9th Circuit) vs. state law (1st, 5th and 6th Circuits).

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EXPLORING THE INTERSECTION BETWEEN THE MEDICARE ACT AND THE BANKRUPTCY CODE:

- Jurisdiction issues / circuit splits; and
- Medicare provider agreement - contract or a license?

Jurisdiction Issues / Circuit Splits

THE MEDICARE ACT: 42 U.S.C. § 405(H)

- (h) Finality of Commissioner's decision

The findings and decision of the Commissioner of Social Security after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under **section 1331** or **1346 of title 28** to recover on any claim **arising under** this subchapter.

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Competing Views on Bankruptcy Court Jurisdiction

BANKRUPTCY JURISDICTION BARRED BY § 405(H)

- Omission of 28 U.S.C. § 1334 is product of codification error
- Jurisdiction will allow providers to bypass 5-level medical appeals process
- Lack of expertise in handling Medicare disputes
- Whether a claim “arises under” Medicare Act is broadly interpreted

BANKRUPTCY JURISDICTION NOT BARRED BY § 405(H)

- Plain meaning rule applies to amendments to § 405(h)
- Breathing spell needed to prevent cessation of Medicare payments
- Bankruptcy courts are well-equipped to efficiently handle matters concerning the bankruptcy estate
- Does not “arise under” Medicare Act

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Codification Error vs. Plain Meaning Rule: Which Statutory Canon of Construction Will Prevail?

- *Florida Agency for Health Care Administration v. Bayou Shores SNF LLC (In re Bayou Shores SNF, LLC)*, 828 F.3d 1297 (11th Cir. 2016)

Diversity
Jurisdiction?

- *Bodimetric Health Servs., Inc. v. Aetna Life & Cas.*, 903 F.2d 480 (7th Cir. 1990)
- *Midland Psychiatric Assocs., Inc. v. United States*, 145 F.3d 1000 (8th Cir. 1998)



- *Sullivan v. Town & Country Home Nursing Services, Inc. (In re Town & Country Home Nursing Services, Inc.)*, 963 F.2d 1146 (9th Cir. 1991)
- *University Medical Center, Inc. v. Sullivan (In re Univ. Med. Ctr., Inc.)*, 973 F.2d 1065 (3d Cir. 1992)
- *Benjamin v. United States (In re Benjamin)*, 932 F.3d 298 (5th Cir. 2019)

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True Health Diagnostics LLC: Lessons Learned

BACKGROUND:

- Laboratory provider of diagnostic and disease management solutions
- 5/30/17: Notice of suspension of Medicare payments (100% - 35% - 100%) based on allegations of fraud
- 7/2/19: True Health seeks TRO and PI in E.D. Texas; CMS issues overpayment determinations; TRO issued but PI denied and case dismissed for lack of SMJ
- 7/30/19: True Health files BK, initiates AP to enforce automatic stay

DISCUSSION:

- *University Medical Center*, 965 F.3d 1065, 1073-74 (3d Cir. 1992) – “where there is an independent basis for bankruptcy. . . jurisdiction, exhaustion of administrative remedies . . . is not required.”
- Issue not about pre-petition fraud suspension and overpayment determination, but whether withholding post-petition payments for post-petition services based on alleged pre-petition overpayments violates automatic stay
- Post-petition reimbursements are estate property; police power exception does not apply

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Health Insurance Benefit Agreement, aka “Medicare Provider Agreement”

CONTRACT OR A LICENSE?

- Agreement contains three material terms: (1) Provider agrees to comply with Social Security Act and applicable regulations; (2) Agreement is binding on provider and the Secretary; and (3) In the event of transfer of ownership, Agreement is assigned to new owner.
- In bankruptcy courts, gov’t argues that Agreement is a contract. Outside of bankruptcy, it argues that it simply creates statutory rights. Why?
- Most bankruptcy courts adopt gov’t position without litigation. See, e.g., *In re Bayou Shores*, 525 B.R. at 168; and *In re Vitalsigns Homecare, Inc.*, 396 B.R. 232, 239 (Bankr. D. Mass. 2008). Outside of bankruptcy, courts have characterized Agreements as statutory licenses. See, e.g., *Harper-Grace Hospitals v. Schweiker*, 708 F.2d 199, 201 (6th Cir. 1983); *PAMC, Ltd. v. Sebelius*, 747 F.3d 1214 (9th Cir. 2014)
- Recent cases of *Verity Health System of California, Inc.* and *BDK Health Management* have followed non-bankruptcy court precedent.

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EQUITABLE MOOTNESS

Equitable Mootness

- Permits an appellate court to exercise its discretion to decline to review the underlying merits of an appeal because a plan has been substantially consummated
- Judge-fashioned remedy
- Unique to chapter 11 cases after plan confirmation

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Equitable Mootness

- No circuit has expressly rejected the doctrine in its entirety, but there have been notable concurring and dissenting circuit opinions criticizing equitable mootness. See *e.g. In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996) (Alito, J. dissenting); *In re One2One Communications, LLC*, 805 F.3d 428 (3d Cir. 2015) (Krause, J., concurring); *In re City of Detroit, Michigan*, 838 F.3d 792 (6th Cir. 2016) (Nelson Moore, J., dissenting)

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Criticisms of Equitable Mootness Doctrine

- Highly discretionary
- Unconstitutional (limits Article III court supervision over bankruptcy court decisions)
- Lack of efficacy (fails to promote finality, increases delay and opportunism, and prevents development of appellate case law on confirmation issues)
- Lack of uniform application

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Equitable Mootness Tests

- Substantially similar tests have been adopted by the Second, Third, Fifth, Sixth, Ninth, Tenth and Eleventh Circuits
- Common factors include:
 - Whether the plan has been substantially consummated
 - Whether the appealing party sought to stay the order pending appeal and post a *supersedeas* bond
 - Whether granting the relief requested would significantly harm other parties who justifiably relied on the plan
 - Whether the relief requested would affect the success of the plan and the availability of effective relief
 - The public policy of affording finality to the bankruptcy court orders
- The circuits differ with respect to the weight placed on these factors

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Factors Applied: Substantial Consummation and Presumption of Equitable Mootness

- In the Second Circuit, once a plan has been substantially consummated, an appeal is presumed to be equitably moot
 - *In re Charter Communications, Inc.*, 691 F.3d 476, 482 (2d Cir. 2012) (“[A]n appeal is presumed equitably moot where the debtor’s plan of reorganization has been substantially consummated.” The presumption of equitable mootness can only be overcome where all five of the “*Chateaugay* factors” are present)
- The Ninth Circuit has rejected the presumption
 - *In re Transwest Resort Properties, Inc.*, 801 F.3d 1161, 1169 (9th Cir. 2015) (Rejecting the presumption, stating “Our circuit’s articulation of the equitable mootness test, however, has never included such a presumption”)

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Factors Applied: Stay Pending Appeal and Posting of a Supersedeas Bond

- The circuit courts differ as to the requirement to seek a stay pending appeal
 - *In re Thorpe Insulation Co.*, 677 F.3d 869, 881 (9th Cir. 2012) (“A failure to *seek* a stay can render an appeal equitably moot. However, failure to *obtain* a stay does not require a conclusion of equitable mootness where parties use due diligence in seeking the stay”) (emphasis added)
 - *Matter of UNR Industries, Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (“[R]equesting a stay is not a mandatory step comparable to filing a timely notice of appeal. The significance of an application for a stay lies in the opportunity it affords to hold things in stasis, to prevent reliance on the plan of reorganization while the appeal proceeds”)
- Differences among circuits in approach to bond requirement
 - *In re Tribune Media Co.*, 799 F.3d 272, 281 (3d Cir. 2015) (appellant’s failure to post a supersedeas bond weighs in favor of equitable mootness)
 - *In re Mortgages Ltd.*, 771 F.3d 1211, 1216 (9th Cir. 2014) (appellant has a duty to seek a stay even if it believes it cannot obtain a bond)

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Factors Applied: Protection of Participating or Sophisticated Third Parties vs. Innocent Bystanders

- The Third Circuit has held that equitable mootness should particularly protect reliance by third party investors on the terms of a confirmed plan
 - *In re Continental Airlines*, 91 F.3d 553, 562 (3d Cir. 1996) (holding that investors who participated in reorganization are “in particular” protected by equitable mootness)
- In contrast, the Fifth Circuit has reasoned that reversal on appeal is a foreseeable risk to sophisticated investors (and therefore sophisticated parties are not the parties equitable mootness is intended to protect)
 - *In re Pacific Lumber Co.*, 584 F.3d 229, 244 (5th Cir. 2009) (refusing to apply equitable mootness when “appellate consequences were foreseeable to [appellants] as sophisticated investors. . .”)
- The Ninth Circuit has focused on whether a party participated in the confirmation process, instead of evaluating a party’s sophistication
 - *In re Transwest Resort Properties, Inc.*, 801 F.3d 1161, 1169 (9th Cir. 2016) (holding that those parties present in the confirmation hearings are not the “innocent third parties” equitable mootness seeks to protect)

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Factors Applied: Availability of Effective Relief

- Differing approaches by the circuit courts in their view of a bankruptcy court’s ability to fashion effective relief
 - *In re Tribune Media Co.*, 799 F.3d 272, 280–81 (3d Cir. 2015) (“Though it is within the power of an appellate court to order the Settlement severed from the Plan and keep the rest of the Plan in place—thereby not attempting to “unscramble the eggs,” or turning a court into a “Humpty Dumpty repairman,” or any other ovoid metaphor—allowing the relief the appeal seeks would effectively undermine the Settlement (along with the transactions entered in reliance on it) and, as a result, recall the entire Plan for a redo.”)
 - *In re Thorpe Insulation Co.*, 677 F.3d 869, 883 (9th Cir. 2012) (“There are several ways here that Appellants could get some relief without completely upsetting the plan. First, Appellees challenge the sufficiency of plan funding. The district court, on appeal, could require Appellees to contribute more to the trust. [...] Second, Appellants could receive relief from the bankruptcy court if it amends the plan to make clear that the trust distribution procedures are not binding on direct suits filed against Appellants [...] Third, the bankruptcy court could allow Appellants to present evidence and argue for modification of the trust distribution procedure. Fourth, the Appellants would receive relief by placing the trust under new governance if the bankruptcy court credits their argument that the trust is in the hands of biased parties.”)
 - *Blixseth v. Credit Suisse*, 961 F.3d 1074, 1081 (9th Cir. 2020) (“[E]quitable mootness involves the capacity of courts, not parties, to fashion a remedy”)

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Standard of Review Applied

- Divide among circuits as to the appropriate standard of review applied to a district court or bankruptcy appellate panel's determination that an appealed claim is equitably moot
 - *In re Continental Airlines*, 91 F.3d 553, 560 (3d Cir. 1996) (applying abuse of discretion standard)
 - *In re United Producers, Inc.*, 526 F.3d 942, 946 (6th Cir. 2008) (applying de novo review)
- The Sixth Circuit in *United Producers* reasoned that de novo review should apply because a court of appeal, district court (acting in its appellate capacity) or bankruptcy appellate panel are equally well positioned to determine whether an appeal is equitably moot

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Suggested Revisions to the Application of the Doctrine

- Limit application to complex reorganizations
- Place greater weight on appellants attempt to obtain a stay and willingness to post a *supersedeas* bond
- Narrow analysis of “significant harm” to “third parties”
- Reconsider standard of review of equitable mootness dismissals from “abuse of discretion” to “plenary”
- Incorporate a review of the merits of the appellate challenge to determine if legally meritorious or compelling
 - *In re One2One Communications, LLC*, 805 F.3d 428, 454 (3d Cir. 2015) (Krause, J., concurring); *In re Tribune Media Co.*, 799 F.3d 272, 290 n.2 (3d Cir. 2015) (Ambro J., concurring)

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TILL

Till v. SCS Credit Corp. 541 U.S. 465 (2004)

- 11 U.S.C. § 1325(a)(5)(B), does not mention the term “discount rate” or the word “interest.” Rather, it simply requires bankruptcy courts to ensure that the property to be distributed to a particular secured creditor over the life of a bankruptcy plan has a total “value, as of the effective date of the plan,” that equals or exceeds the value of the creditor’s allowed secured claim—in this case, \$4,000. §1325(a)(5)(B)(ii).
- Supreme Court rejects the coerced loan, presumptive contract rate, and cost of funds approaches.
 - Each of these approaches is complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor’s payments have the required present value.
- “W[e] think Congress would favor an approach that is familiar in the financial community and that minimizes the need for expensive evidentiary proceedings.” *Till* at 475.

Till v. SCS Credit Corp. 541 U.S. 465 (2004)

- Thus, Supreme Court determines that the “Formula Approach” is the proper approach to be utilized.
 - “[T]he formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary proceedings.” *Till* at 479.
 - Start with the Prime Rate and “[b]ecause bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly.” *Till* at 479.
- “The formula approach, which begins with a concededly low estimate of the appropriate interest rate and requires the creditor to present evidence supporting a higher rate, places the evidentiary burden on the more knowledgeable party, thereby facilitating more accurate calculation of the appropriate interest rate.” *Till* at 484.

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Till v. SCS Credit Corp. 541 U.S. 465 (2004)

Since a “cramdown” loan is disputed by the creditor, by definition, a creditor forced to accept such a loan would prefer instead to foreclose.¹⁴ *Till* at 476-77.

¹⁴This fact helps to explain why there is no readily apparent Chapter 13 “cram down market rate of interest”: Because every cramdown loan is imposed by a court over the objection of the secured creditor, there is no free market of willing cramdown lenders. Interestingly, the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. See, e.g., Balmoral Financial Corporation, <http://www.balmoral.com/bdip.htm> (all Internet materials as visited Mar. 4, 2004, and available in Clerk of Court’s case file) (advertising debtor in possession lending); Debtor in Possession Financing: 1st National Assistance Finance Association DIP Division, <http://www.loanmallusa.com/dip.htm> (offering “to tailor a financing program TTT to your business’ needs and TTT to work closely with your bankruptcy counsel”). Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce. In the Chapter 13 context, by contrast, the absence of any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure.

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In re Prussia Assocs. 322 B.R. 572, 585, 589
(Bankr.E.D.Pa.2005)

- “ ‘*Till* is instructive, but it is not controlling, insofar as mandating the use of the ‘formula’ approach described in *Till* in every Chapter 11 case.” *Prussia Assocs.* at 585.
- “[*Till*’s] dicta implies that the Bankruptcy Court in such circumstances (i.e., efficient markets) should exercise discretion in evaluating an appropriate cramdown interest rate by considering the availability of market financing”. *Prussia Assocs.* at 589.

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In re American Home Patient, Inc. 420 F.3d 559 (6th Cir. 2005)

Bankruptcy Court applied the coerced loan approach, reaching a “cramdown” interest rate of 6.785% while the lender asserted an appropriate rate of 12.16%. Lender appealed.

- The market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the *Till* plurality.
- Although the efficient market analysis is appropriate in this case, the lenders focused on a new financing transaction, which the Bankruptcy Court found inapplicable since the reorganization plan did not contemplate new financing, but rather restructure of the current debt. The lenders, therefore, did not sustain their burden.
- In addition, the Bankruptcy Court found that the lender’s proposed rate would provide a huge windfall to the lenders. If a bankruptcy court “determines that the likelihood of default is so high as to necessitate an ‘eye-popping’ interest rate, the plan probably should not be confirmed.” *American Home Patient, Inc.* at 569. The Bankruptcy Court found that the lender’s proposed rate takes the loan into such “eye-popping” category.
- While the 6th Circuit recognized the application of efficient markets, in this case, the underlying order was affirmed.

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In The Matter of MPM Silicones, LLC 874 F.3d 787 (2nd Cir. 2017)

- To determine appropriate Chapter 11 “cramdown” rate of interest to ensure that objecting secured class receives stream of payments under proposed plan with present value that is at least equal to amount of class members’ allowed secured claims, bankruptcy court should engage in two-stage process and first determine whether there exists efficient market for loans of type that secured creditors will be required to make under plan; only if there is no efficient market for such loans should courts proceed to second stage of process and use “formula” or prime-plus approach to calculate appropriate “cramdown” rate by starting with largely risk-free interest rate and applying appropriate risk adjustments
- Courts have held that markets for financing are ‘efficient’ where, for example, “they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan.” *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324, 337 (5th Cir. 2013).

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COLLATERAL DESCRIPTIONS

Circuit Split on the Sufficiency of Collateral Descriptions in UCC Financing Statements

UCC FINANCING STATEMENT
PULLDOWN INSTRUCTIONS

A. NAME AS PROVIDED IN CONTACT AT FILING OFFICE

B. EMAIL CONTACT AT FILING OFFICE

C. DEDICATED PULLDOWN KEY TO: (Name and Address)

Print **Reset**

THE WHITE SPACE IS FOR PULLDOWN OFFICE USE ONLY.

D. DEBITOR'S NAME: Please enter your Debtor name (first, last, middle, full name, do not omit, or abbreviate any part of the Debtor's name). If any part of the Debtor's name is not in the State's records, do not enter it. Instead, enter "N/A" and complete the Individual Debtor information in section 3 of this Financing Statement. Submit on Form 991-001.

1. DEBITOR'S NAME

11 FIRST NAME	12 LAST NAME	13 MIDDLE NAME	14 SUFFIX

E. CREDITORS' NAME: Please enter your Creditor name (first, last, middle, full name, do not omit, or abbreviate any part of the Debtor's name). If any part of the Debtor's name is not in the State's records, do not enter it. Instead, enter "N/A" and complete the Individual Debtor information in section 3 of this Financing Statement. Submit on Form 991-001.

2. CREDITORS' NAME

21 FIRST NAME	22 LAST NAME	23 MIDDLE NAME	24 SUFFIX

F. SECURED PARTY NAME: As provided, a secured party or secured party's assignee. Please enter your Secured Party name(s) in the following order:

3. SECURED PARTY NAME

31 FIRST NAME	32 LAST NAME	33 MIDDLE NAME	34 SUFFIX

G. SECURED PARTY ADDRESS:

35 STREET ADDRESS	36 CITY	37 STATE	38 ZIP CODE

H. SECURED PARTY PHONE:

39 AREA CODE	40 PHONE NUMBER

I. COLLATERAL: The financing statement covers the following collateral:

“all collateral described in the security agreement”

- *First Midwest Bank v. Reinbold (In re 180 Equipment LLC)*, 938 F.3d 866 (7th Cir. 2019) – plain reading of UCC §§ 9-504, 9-108(b)(6) (“any other method, if the identity of the collateral is objectively determinable”) supports conclusion that financing statement may reference parties’ security agreement
- *Altair Global Credit Opportunities Fund (A) LLC v. Financial Oversight and Management Board for Puerto Rico (In re Financial Oversight and Management Board for Puerto Rico)*, 914 F.3d 694, 711-712 (1st Cir. Jan. 30, 2019) – financing statement is insufficient if simply describes collateral by reference to document not found in filing office.

ABI – Bankruptcy Battleground West – 2021

We Give a Split! Overview of Circuit Splits on Current Issues
Tuesday, March 9, 2:00-3:45 p.m. PT

SPEAKERS

Hon. William Lafferty, U.S. Bankruptcy Judge, N.D. CA
Amir Gamliel, Perkins Coie, LLP
David Golubchik, Levene Neale Bender Yoo & Brill LLP
Kenneth Kansa, Sidley Austin, LLP
Jordana Renert, Arent Fox, LLP

WRITTEN MATERIALS

Automatic Stay

Automatic Stay 1 – City of Chicago v. Fulton Supreme Court Decision
Automatic Stay 2 – Fulton Petitioner’s Brief
Automatic Stay 3 – Fulton Respondent’s Brief
Automatic Stay 4 – Fulton - 7th Circuit Decision
Automatic Stay 5 – Denby-Peterson 3rd Circuit Decision

Equitable Mootness

Equitable Mootness 1 – In re Charter Commc'ns, Inc., 691 F.3d 476 (2d Cir. 2012)
Equitable Mootness 2 – In re One2One Commc'ns, LLC, 805 F.3d 428 (3d Cir. 2015)
Equitable Mootness 3 – In re Thorpe Insulation Co., 677 F.3d 869 (9th Cir. 2012)
Equitable Mootness 4 - In re Transwest Resort Prop's, Inc., 801 F.3d 1161, 1164 (9th Cir. 2015)

Debt Recharacterization

Debt Recharac. 1 - In re Province Grande Olde Liberty, LLC, 655 F. App'x 971 (4th Cir. 2016)
Debt Recharac. 2- In re Fitness Holdings Int'l, Inc., 714 F.3d 1141 (9th Cir. 2013).

Interest Rates

Interest Rate 1 - Till v. SCS Credit Corp.
Interest Rate 2 - In re PG and E Corp.
Interest Rate 3 - In re Ultra Petroleum Corp.
Interest Rate 4 - In re Cuker Interactive LLC

Medicare Act – Bankruptcy Code

Medicare Act 1 – In re Bayou Shores SNF, LLC, 828 F.3d 1297 (11th Cir.2016)
Medicare Act 2 - In re Benjamin, 932 F.3d 293 (5th Cir.2019)

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

CITY OF CHICAGO, ILLINOIS *v.* FULTON ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR
THE SEVENTH CIRCUIT

No. 19–357. Argued October 13, 2020—Decided January 14, 2021

The filing of a petition under the Bankruptcy Code automatically “creates an estate” that, with some exceptions, comprises “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U. S. C. §541(a). Section 541 is intended to include within the estate any property made available by other provisions of the Bankruptcy Code. Section 542 is one such provision, as it provides that an entity in possession of property of the bankruptcy estate “shall deliver to the trustee, and account for” that property. The filing of a petition also automatically “operates as a stay, applicable to all entities,” of efforts to collect prepetition debts outside the bankruptcy forum, §362(a), including “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,” §362(a)(3). Here, each respondent filed a bankruptcy petition and requested that the city of Chicago (City) return his or her vehicle, which had been impounded for failure to pay fines for motor vehicle infractions. In each case, the City’s refusal was held by a bankruptcy court to violate the automatic stay. The Seventh Circuit affirmed, concluding that by retaining possession of the vehicles the City had acted “to exercise control over” respondents’ property in violation of §362(a)(3).

Held: The mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code. Under that provision, the filing of a bankruptcy petition operates as a “stay” of “any act” to “exercise control” over the property of the estate. Taken together, the most natural reading of these terms is that §362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was

Syllabus

filed. Respondents' alternative reading would create at least two serious problems. First, reading §362(a)(3) to cover mere retention of property would render §542's central command—that an entity in possession of certain estate property “shall deliver to the trustee . . . such property”—largely superfluous, even though §542 appears to be the provision governing the turnover of estate property. Second, respondents' reading would render the commands of §362(a)(3) and §542 contradictory. Section 542 carves out exceptions to the turnover command. Under respondents' reading, an entity would be required to turn over property under §362(a)(3) even if that property were exempt from turnover under §542. The history of the Bankruptcy Code confirms the better reading. The Code originally included both §362(a)(3) and §542(a), but the former provision lacked the phrase “or to exercise control over property of the estate.” When that phrase was later added by amendment, Congress made no mention of transforming §362(a)(3) into an affirmative turnover obligation. It is unlikely that Congress would have made such an important change simply by adding the phrase “exercise control,” rather than by adding a cross-reference to §542(a) or some other indication that it was so transforming §362(a)(3). Pp. 3–7.

926 F. 3d 916, vacated and remanded.

ALITO, J., delivered the opinion of the Court, in which all other Members joined, except BARRETT, J., who took no part in the consideration or decision of the case. SOTOMAYOR, J., filed a concurring opinion.

Cite as: 592 U. S. ____ (2021)

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Opinion of the Court

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

 No. 19–357

CITY OF CHICAGO, ILLINOIS, PETITIONER *v.*
 ROBBIN L. FULTON, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
 APPEALS FOR THE SEVENTH CIRCUIT

[January 14, 2021]

JUSTICE ALITO delivered the opinion of the Court.

When a debtor files a petition for bankruptcy, the Bankruptcy Code protects the debtor’s interests by imposing an automatic stay on efforts to collect prepetition debts outside the bankruptcy forum. *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 589 U. S. ___, ___–___ (2020) (slip op., at 6–7). Those prohibited efforts include “any act . . . to exercise control over property” of the bankruptcy estate. 11 U. S. C. §362(a)(3). The question in this case is whether an entity violates that prohibition by retaining possession of a debtor’s property after a bankruptcy petition is filed. We hold that mere retention of property does not violate §362(a)(3).

I

Under the Bankruptcy Code, the filing of a bankruptcy petition has certain immediate consequences. For one thing, a petition “creates an estate” that, with some exceptions, comprises “all legal or equitable interests of the debtor in property as of the commencement of the case.” §541(a)(1). Section 541 “is intended to include in the estate

Opinion of the Court

any property made available to the estate by other provisions of the Bankruptcy Code.” *United States v. Whiting Pools, Inc.*, 462 U. S. 198, 205 (1983). One such provision, §542, is important for present purposes. Titled “Turnover of property to the estate,” §542 provides, with just a few exceptions, that an entity (other than a custodian) in possession of property of the bankruptcy estate “shall deliver to the trustee, and account for” that property.

A second automatic consequence of the filing of a bankruptcy petition is that, with certain exceptions, the petition “operates as a stay, applicable to all entities,” of efforts to collect from the debtor outside of the bankruptcy forum. §362(a). The automatic stay serves the debtor’s interests by protecting the estate from dismemberment, and it also benefits creditors as a group by preventing individual creditors from pursuing their own interests to the detriment of the others. Under the Code, an individual injured by any willful violation of the stay “shall recover actual damages, including costs and attorneys’ fees, and in appropriate circumstances, may recover punitive damages.” §362(k)(1).

Among the many collection efforts prohibited by the stay is “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.*” §362(a)(3) (emphasis added). The prohibition against exercising control over estate property is the subject of the present dispute.

In the case before us, the city of Chicago (City) impounded each respondent’s vehicle for failure to pay fines for motor vehicle infractions. Each respondent filed a Chapter 13 bankruptcy petition and requested that the City return his or her vehicle. The City refused, and in each case a bankruptcy court held that the City’s refusal violated the automatic stay. The Court of Appeals affirmed all of the judgments in a consolidated opinion. *In re Fulton*, 926 F. 3d 916 (CA7 2019). The court concluded that “by retaining possession of the debtors’ vehicles after they declared

Opinion of the Court

bankruptcy,” the City had acted “to exercise control over” respondents’ property in violation of §362(a)(3). *Id.*, at 924–925. We granted certiorari to resolve a split in the Courts of Appeals over whether an entity that retains possession of the property of a bankruptcy estate violates §362(a)(3).¹ 589 U. S. ____ (2019). We now vacate the judgment below.

II

The language used in §362(a)(3) suggests that merely retaining possession of estate property does not violate the automatic stay. Under that provision, the filing of a bankruptcy petition operates as a “stay” of “any act” to “exercise control” over the property of the estate. Taken together, the most natural reading of these terms—“stay,” “act,” and “exercise control”—is that §362(a)(3) prohibits affirmative acts that would disturb the status quo of estate property as of the time when the bankruptcy petition was filed.

Taking the provision’s operative words in turn, the term “stay” is commonly used to describe an order that “suspend[s] judicial alteration of the status quo.” *Nken v. Holder*, 556 U. S. 418, 429 (2009) (brackets in original; internal quotation marks omitted). An “act” is “[s]omething done or performed . . . ; a deed.” Black’s Law Dictionary 30 (11th ed. 2019); see also Webster’s New International Dictionary 25 (2d ed. 1934) (“that which is done,” “the exercise of power,” “a deed”). To “exercise” in the sense relevant here means “to bring into play” or “make effective in action.” Webster’s Third New International Dictionary 795 (1993). And to “exercise” something like control is “to put in practice or carry out in action.” Webster’s New International

¹ Compare *In re Fulton*, 926 F. 3d 916, 924 (CA7 2019), *In re Weber*, 719 F. 3d 72, 81 (CA2 2013), *In re Del Mission Ltd.*, 98 F. 3d 1147, 1151–1152 (CA9 1996), and *In re Knaus*, 889 F. 2d 773, 774–775 (CA8 1989), with *In re Denby-Peterson*, 941 F. 3d 115, 132 (CA3 2019), and *In re Cowen*, 849 F. 3d 943, 950 (CA10 2017).

Opinion of the Court

Dictionary, at 892. The suggestion conveyed by the combination of these terms is that §362(a)(3) halts any affirmative act that would alter the status quo as of the time of the filing of a bankruptcy petition.

We do not maintain that these terms definitively rule out the alternative interpretation adopted by the court below and advocated by respondents. As respondents point out, omissions can qualify as “acts” in certain contexts, and the term “control” can mean “to have power over.” *Thompson v. General Motors Acceptance Corp.*, 566 F. 3d 699, 702 (CA7 2009) (quoting Merriam-Webster’s Collegiate Dictionary 272 (11th ed. 2003)). But saying that a person engages in an “act” to “exercise” his or her power over a thing communicates more than merely “having” that power. Thus the language of §362(a)(3) implies that something more than merely retaining power is required to violate the disputed provision.

Any ambiguity in the text of §362(a)(3) is resolved decidedly in the City’s favor by the existence of a separate provision, §542, that expressly governs the turnover of estate property. Section 542(a), with two exceptions, provides as follows:

“[A]n entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.”

The exceptions to §542(a) shield (1) transfers of estate property made from one entity to another in good faith without notice or knowledge of the bankruptcy petition and (2) good-faith transfers to satisfy certain life insurance obligations.

Opinion of the Court

See §§542(c), (d). Reading §362(a)(3) to cover mere retention of property, as respondents advocate, would create at least two serious problems.

First, it would render the central command of §542 largely superfluous. “The canon against surplusage is strongest when an interpretation would render superfluous another part of the same statutory scheme.” *Yates v. United States*, 574 U. S. 528, 543 (2015) (plurality opinion; internal quotation marks and brackets omitted). Reading “any act . . . to exercise control” in §362(a)(3) to include merely retaining possession of a debtor’s property would make that section a blanket turnover provision. But as noted, §542 expressly governs “[t]urnover of property to the estate,” and subsection (a) describes the broad range of property that an entity “shall deliver to the trustee.” That mandate would be surplusage if §362(a)(3) already required an entity affirmatively to relinquish control of the debtor’s property at the moment a bankruptcy petition is filed.

Respondents and their *amici* contend that §542(a) would still perform some work by specifying the party to whom the property in question must be turned over and by requiring that an entity “account for . . . the value of” the debtor’s property if the property is damaged or lost. But that is a small amount of work for a large amount of text in a section that appears to be the Code provision that is designed to govern the turnover of estate property. Under this alternative interpretation, §362(a)(3), not §542, would be the chief provision governing turnover—even though §362(a)(3) says nothing expressly on that question. And §542 would be reduced to a footnote—even though it appears on its face to be the governing provision. The better account of the two provisions is that §362(a)(3) prohibits collection efforts outside the bankruptcy proceeding that would change the status quo, while §542(a) works within the bankruptcy process to draw far-flung estate property back into the hands of the debtor or trustee.

Opinion of the Court

Second, respondents' reading would render the commands of §362(a)(3) and §542 contradictory. Section 542 carves out exceptions to the turnover command, and §542(a) by its terms does not mandate turnover of property that is "of inconsequential value or benefit to the estate." Under respondents' reading, in cases where those exceptions to turnover under §542 would apply, §362(a)(3) would command turnover all the same. But it would be "an odd construction" of §362(a)(3) to require a creditor to do immediately what §542 specifically excuses. *Citizens Bank of Md. v. Strumpf*, 516 U. S. 16, 20 (1995). Respondents would have us resolve the conflicting commands by engrafting §542's exceptions onto §362(a)(3), but there is no textual basis for doing so.

The history of the Bankruptcy Code confirms what its text and structure convey. Both §362(a)(3) and §542(a) were included in the original Bankruptcy Code in 1978. See Bankruptcy Reform Act of 1978, 92 Stat. 2570, 2595. At the time, §362(a)(3) applied the stay only to "any act to obtain possession of property of the estate or of property from the estate." *Id.*, at 2570. The phrase "or to exercise control over property of the estate" was not added until 1984. Bankruptcy Amendments and Federal Judgeship Act of 1984, 98 Stat. 371.

Respondents do not seriously dispute that §362(a)(3) imposed no turnover obligation prior to the 1984 amendment. But transforming the stay in §362 into an affirmative turnover obligation would have constituted an important change. And it would have been odd for Congress to accomplish that change by simply adding the phrase "exercise control," a phrase that does not naturally comprehend the mere retention of property and that does not admit of the exceptions set out in §542. Had Congress wanted to make §362(a)(3) an enforcement arm of sorts for §542(a), the least one would expect would be a cross-reference to the latter provision, but Congress did not include such a cross-

Opinion of the Court

reference or provide any other indication that it was transforming §362(a)(3). The better account of the statutory history is that the 1984 amendment, by adding the phrase regarding the exercise of control, simply extended the stay to acts that would change the status quo with respect to intangible property and acts that would change the status quo with respect to tangible property without “obtain[ing]” such property.

* * *

Though the parties debate the issue at some length, we need not decide how the turnover obligation in §542 operates. Nor do we settle the meaning of other subsections of §362(a).² We hold only that mere retention of estate property after the filing of a bankruptcy petition does not violate §362(a)(3) of the Bankruptcy Code. The judgment of the Court of Appeals is vacated, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE BARRETT took no part in the consideration or decision of this case.

²In respondent Shannon’s case, the Bankruptcy Court determined that by retaining Shannon’s vehicle and demanding payment, the City also had violated §§362(a)(4) and (a)(6). Shannon presented those theories to the Court of Appeals, but the court did not reach them. 926 F. 3d, at 926, n. 1. Neither do we.

SOTOMAYOR, J., concurring

SUPREME COURT OF THE UNITED STATES

No. 19–357

CITY OF CHICAGO, ILLINOIS, PETITIONER *v.*
ROBBIN L. FULTON, ET AL.ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE SEVENTH CIRCUIT

[January 14, 2021]

JUSTICE SOTOMAYOR, concurring.

Section 362(a)(3) of the Bankruptcy Code provides that the filing of a bankruptcy petition “operates as a stay” of “any act . . . to exercise control over property of the [bankruptcy] estate.” 11 U. S. C. §362(a)(3). I join the Court’s opinion because I agree that, as used in §362(a)(3), the phrase “exercise control over” does not cover a creditor’s passive retention of property lawfully seized prebankruptcy. Hence, when a creditor has taken possession of a debtor’s property, §362(a)(3) does not require the creditor to return the property upon the filing of a bankruptcy petition.

I write separately to emphasize that the Court has not decided whether and when §362(a)’s other provisions may require a creditor to return a debtor’s property. Those provisions stay, among other things, “any act to create, perfect, or enforce any lien against property of the estate” and “any act to collect, assess, or recover a claim against [a] debtor” that arose prior to bankruptcy proceedings. §§362(a)(4), (6); see, e.g., *In re Kuehn*, 563 F. 3d 289, 294 (CA7 2009) (holding that a university’s refusal to provide a transcript to a student-debtor “was an act to collect a debt” that violated the automatic stay). Nor has the Court addressed how bankruptcy courts should go about enforcing creditors’ separate obligation to “deliver” estate property to the trustee or debtor under §542(a). The City’s conduct may very well

SOTOMAYOR, J., concurring

violate one or both of these other provisions. The Court does not decide one way or the other.

Regardless of whether the City's policy of refusing to return impounded vehicles satisfies the letter of the Code, it hardly comports with its spirit. "The principal purpose of the Bankruptcy Code is to grant a "fresh start"" to debtors. *Marrama v. Citizens Bank of Mass.*, 549 U. S. 365, 367 (2007) (quoting *Grogan v. Garner*, 498 U. S. 279, 286 (1991)). When a debtor files for Chapter 13 bankruptcy, as respondents did here, "the debtor retains possession of his property" and works toward completing a court-approved repayment plan. 549 U. S., at 367. For a Chapter 13 bankruptcy to succeed, therefore, the debtor must continue earning an income so he can pay his creditors. Indeed, Chapter 13 bankruptcy is available only to "individual[s] with regular income." 11 U. S. C. §109(e).

For many, having a car is essential to maintaining employment. Take, for example, respondent George Peake. Before the City seized his car, Peake relied on his 200,000-mile 2007 Lincoln MKZ to travel 45 miles each day from his home on the South Side of Chicago to his job in Joliet, Illinois. In June 2018, when the City impounded Peake's car for unpaid parking and red-light tickets, the vehicle was worth just around \$4,300 (and was already serving as collateral for a roughly \$7,300 debt). Without his car, Peake had to pay for rides to Joliet. He filed for bankruptcy, hoping to recover his vehicle and repay his \$5,393.27 debt to the City through a Chapter 13 plan. The City, however, refused to return the car until either Peake paid \$1,250 upfront or after the court confirmed Peake's bankruptcy plan. As a result, Peake's car remained in the City's possession for months. By denying Peake access to the vehicle he needed to commute to work, the City jeopardized Peake's ability to make payments to *all* his creditors, the City included. Surely, Peake's vehicle would have been more valuable in the hands of its owner than parked in the City's

SOTOMAYOR, J., concurring

impound lot.¹

Peake's situation is far too common.² Drivers in low-income communities across the country face similar vicious cycles: A driver is assessed a fine she cannot immediately pay; the balance balloons as late fees accrue; the local government seizes the driver's vehicle, adding impounding and storage fees to the growing debt; and the driver, now without reliable transportation to and from work, finds it all but impossible to repay her debt and recover her vehicle. See Brief for American Civil Liberties Union et al. as *Amici Curiae* 11–16, 31–32. Such drivers may turn to Chapter 13 bankruptcy for a “fresh start.” *Marrama*, 549 U. S., at 367 (internal quotation marks omitted).³ But without their vehicles, many debtors quickly find themselves unable to make their Chapter 13 payments. The cycle thus continues, disproportionately burdening communities of color, see Brief for American Civil Liberties Union et al. as *Amici Curiae* 17, and interfering not only with debtors' ability to earn an income and pay their creditors but also with their access to childcare, groceries, medical appointments, and other necessities.

Although the Court today holds that §362(a)(3) does not

¹ Even though §362(a)(3) does not require turnover, whether and when the City may sell impounded cars is an entirely different matter. See, e.g., *In re Cowen*, 849 F. 3d 943, 950 (CA10 2017) (“It’s not hard to come up with examples of . . . ‘acts’ that ‘exercise control’ over, but do not ‘obtain possession of,’ the estate’s property, e.g., a creditor in possession who improperly sells property belonging to the estate”).

² See, e.g., Ramos, Chicago Seized and Sold Nearly 50,000 Cars Over Tickets Since 2011, Sticking Owners With Debt, WBEZ News (Jan. 7, 2019) (online source archived at www.supremecourt.gov).

³ The 10-year period from 2007 to 2017, for instance, saw a tenfold increase in the number of Chicagoans filing Chapter 13 bankruptcies that involved debt to the City. See Sanchez & Kambhampati, Driven Into Debt: How Chicago Ticket Debt Sends Black Motorists Into Bankruptcy, ProPublica Illinois (Feb. 27, 2018) (online source archived at www.supremecourt.gov).

SOTOMAYOR, J., concurring

require creditors to turn over impounded vehicles, bankruptcy courts are not powerless to facilitate the return of debtors' vehicles to their owners. Most obviously, the Court leaves open the possibility of relief under §542(a). That section requires any "entity," subject to some exceptions, to turn over "property" belonging to the bankruptcy estate. 11 U. S. C. §542(a). The debtor, in turn, must be able to provide the creditor with "adequate protection" of its interest in the returned property, §363(e); for example, the debtor may need to demonstrate that her car is sufficiently insured. In this way, §542(a) maximizes value for all parties involved in a bankruptcy: The debtor is able to use her asset, which makes it easier to earn an income; the debtor's unsecured creditors, in turn, receive timely payments from the debtor; and the debtor's secured creditor, for its part, receives "adequate protection [to] replace the protection afforded by possession." *United States v. Whiting Pools, Inc.*, 462 U. S. 198, 207 (1983). Secured creditors cannot opt out of this arrangement. As even the City acknowledges, §542(a) "impose[s] a duty of turnover that is mandatory when the statute's conditions . . . are met." Brief for Petitioner 37.

The trouble with §542(a), however, is that turnover proceedings can be quite slow. The Federal Rules of Bankruptcy Procedure treat most "proceeding[s] to recover . . . property" as "adversary proceedings." Rule 7001(1). Such actions are, in simplified terms, "essentially full civil lawsuits carried out under the umbrella of [a] bankruptcy case." *Bullard v. Blue Hills Bank*, 575 U. S. 496, 505 (2015). Because adversary proceedings require more process, they take more time. Of the turnover proceedings filed after July 2019 and concluding before June 2020, the average case was pending for over 100 days. See Administrative Office of the United States Courts, Time Intervals in Months From Filing to Closing of Adversary Proceedings Filed Under 11 U. S. C. §542 for the 12-Month Period Ending June

SOTOMAYOR, J., concurring

30, 2020, Washington, DC: Sept. 25, 2020.

One hundred days is a long time to wait for a creditor to return your car, especially when you need that car to get to work so you can earn an income and make your bankruptcy-plan payments. To address this problem, some courts have adopted strategies to hurry things along. At least one bankruptcy court has held that §542(a)'s turnover obligation is automatic even absent a court order. See *In re Larimer*, 27 B. R. 514, 516 (Idaho 1983). Other courts apparently will permit debtors to seek turnover by simple motion, in lieu of filing a full adversary proceeding, at least where the creditor has received adequate notice. See Tr. of Oral Arg. 81 (counsel for the City stating that “[i]n most bankruptcy courts, if a creditor responds to a motion [for turnover] by” arguing that the debtor should have instituted an adversary proceeding, the bankruptcy judge will ask whether the creditor received “actual notice”); Brief for United States as *Amicus Curiae* 32 (reporting that “some courts have granted [turnover] orders based solely on a motion”); but see, e.g., *In re Denby-Peterson*, 941 F. 3d 115, 128–131 (CA3 2019) (holding that debtors must seek turnover through adversary proceedings). Similarly, even when a turnover request does take the form of an adversary proceeding, bankruptcy courts may find it prudent to expedite proceedings or order preliminary relief requiring temporary turnover. See, e.g., *In re Reid*, 423 B. R. 726, 727–728 (Bkrtcy. Ct. ED Pa. 2010); see generally 10 Collier on Bankruptcy ¶ 7065.02 (16th ed. 2019).

Ultimately, however, any gap left by the Court’s ruling today is best addressed by rule drafters and policymakers, not bankruptcy judges. It is up to the Advisory Committee on Rules of Bankruptcy Procedure to consider amendments to the Rules that ensure prompt resolution of debtors’ requests for turnover under §542(a), especially where debtors’ vehicles are concerned. Congress, too, could offer a statu-

SOTOMAYOR, J., concurring

tory fix, either by ensuring that expedited review is available for §542(a) proceedings seeking turnover of a vehicle or by enacting entirely new statutory mechanisms that require creditors to return cars to debtors in a timely manner.

Nothing in today's opinion forecloses these alternative solutions. With that understanding, I concur.

No. 19-357

IN THE
Supreme Court of the United States

CITY OF CHICAGO,

Petitioner,

v.

ROBBIN L. FULTON, JASON S. HOWARD,
GEORGE PEAKE, AND TIMOTHY SHANNON,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR PETITIONER

MARK A. FLESSNER
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QUESTION PRESENTED

Whether an entity that is passively retaining possession of property in which a bankruptcy estate has an interest has an affirmative obligation under the Bankruptcy Code's automatic stay, 11 U.S.C. § 362, to return that property to the debtor or trustee immediately upon the filing of the bankruptcy petition.

PARTIES TO THE PROCEEDING

Petitioner is the City of Chicago.

Respondents are Robbin L. Fulton, Jason S. Howard, George Peake and Timothy Shannon.

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IN THE
Supreme Court of the United States

No. 19-357

CITY OF CHICAGO,

Petitioner,

v.

ROBBIN L. FULTON, JASON S. HOWARD, GEORGE PEAKE,
AND TIMOTHY SHANNON,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR PETITIONER

INTRODUCTION

Under the Bankruptcy Code, the filing of a bankruptcy petition freezes the relationship between a debtor and the debtor’s creditors that existed on the petition date. The petition itself operates, without the need for a court order, as an automatic “stay” of further acts to enforce creditors’ claims, including “any act to obtain possession of ... or to exercise control over property of the estate.” 11 U.S.C. § 362(a)(3). Violations of the automatic stay can result in actual and punitive damages. *Id.* § 362(k)(1). Separately, the Code’s turnover provision requires a creditor who has possession of estate property on the petition date—for instance, a

creditor who has lawfully repossessed property but not yet sold it—to turn that property over if it is of consequential value to the estate, the trustee can use it during the bankruptcy case, and the creditor receives adequate protection of its rights. *Id.* § 542(a); *see id.* § 363. The question presented here is whether the automatic stay *by itself* requires creditors to turn over lawfully repossessed property—even if the creditor may assert a valid defense to turnover under the turnover provision—or face a claim for damages. The answer is no: That reading of the Bankruptcy Code contravenes its plain text, turns the function of the automatic stay on its head, renders the actual turnover provision surplusage, and deprives creditors of crucial protections the Code affords them.

Each of the Debtors here repeatedly violated the City of Chicago’s traffic laws. When the Debtors failed to pay the resulting fines, the City impounded their vehicles, giving the City a possessory lien on the vehicles securing its claim for the delinquent fines. Each of the Debtors responded by filing for Chapter 13 bankruptcy. In each case, the bankruptcy court held that the automatic stay affirmatively required the City to return the Debtors’ vehicles without the need for any turnover proceedings. The Seventh Circuit affirmed. It reasoned that, by retaining possession of the vehicles lawfully impounded before bankruptcy, the City was engaging in an “act ... to exercise control” over estate property, in violation of the stay.

That is wrong. As its name suggests, the automatic stay prevents any further collection activity after the petition is filed. It is a negative injunction that preserves the status quo pending further order of the bankruptcy court. But it does not impose an affirmative obligation on creditors to turn over property of the

estate lawfully repossessed or impounded before the bankruptcy filing.

A creditor's obligation to turn over property in its possession is set out not in the automatic stay provision, § 362, but in the turnover provision, § 542(a). Unlike the automatic stay, § 542(a) does not itself operate as an injunction. A creditor that fails to turn over estate property can be sued under § 542(a), and it may respond by raising statutory defenses. For instance, the creditor might contend that the debtor actually has no ownership interest in the property; that the property's value to the estate is inconsequential, as might be the case if the property is worth less than a secured creditor's claim; or that the debtor cannot provide the creditor with adequate protection of the creditor's interest in the property. If the debtor prevails, a bankruptcy court can order the creditor to turn over the property—an order that bankruptcy courts have ample authority to enforce. *See* 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."). Reading § 362 to impose an affirmative requirement to turn over estate property would render § 542(a) superfluous and deprive the creditor of the ability to assert the defenses and receive the process § 542 contemplates before it must surrender property lawfully in its possession.

All agree that, before 1984, this is how the Code operated: The automatic stay barred creditors who had not repossessed the debtor's property from doing so, but it did not require creditors who had repossessed property before the bankruptcy to return it immediately or face sanctions. Turnover was governed by the turnover provision, and a creditor was entitled to a judicial process in which it could assert defenses to turn-

over. Counsel for the Debtors has acknowledged as much. See Wedoff, *The Automatic Stay Under § 362(a)(3)—One More Time*, 38 Bankr. L. Letter No. 7, at 2 (July 2018).

The contrary reading now advanced by the Seventh Circuit and the Debtors rests entirely on a 1984 amendment to the automatic stay provision, which added “any act . . . to exercise control over property of the estate” to the list of actions the automatic stay prohibits. 11 U.S.C. § 362(a)(3). But that amendment did not change the basic function of the automatic stay, reflected in its text: to “stay” post-petition acts that would alter the status quo, not to require such acts. “Stay means stay, not go.” *In re Cowen*, 849 F.3d 943, 949 (10th Cir. 2017).

Nor is there any other basis for concluding that the 1984 amendment worked a sea change on long-settled bankruptcy practice. The amendment originated in a bill described as making “[t]echnical” and “[c]larify[ing]” changes to the Bankruptcy Code. H.R. Rep. No. 96-1195, at 1, 52 (1980). Indeed, the House Report stated that “[e]very effort” was made “to maintain existing policy intact.” *Id.* at 2. This Court has repeatedly held that the Bankruptcy Code should not be read to alter prior bankruptcy practice in the absence of a clear signal that Congress so intended. *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998). To say the least, there is no such clear signal here.

The Seventh Circuit’s appeal to bankruptcy policy is likewise unavailing. The question in this case is not whether a debtor should have a way to obtain possession of a car that belongs to the estate. Section 542(a) provides that relief, in appropriate circumstances. The only question is whether the debtor should be required

to follow the procedure § 542(a) contemplates, with its attendant protections for creditors' interests, or whether—as the Seventh Circuit held—debtors may conduct an end-run around those procedures and compel turnover immediately, on pain of sanctions, by relying on the more general terms of § 362. Ordinary principles of statutory construction—and common sense—foreclose the Seventh Circuit's approach.

OPINIONS BELOW

The Seventh Circuit's opinion (Pet. App. 1a-27a) is reported at 926 F.3d 916. The decision resolved a consolidated direct appeal from four judgments entered by bankruptcy courts in separate cases. The bankruptcy court decision in *In re Howard* (Pet. App. 29a-41a) is reported at 584 B.R. 252. The bankruptcy court decision in *In re Peake* (Pet. App. 63a-100a) is reported at 588 B.R. 811. The bankruptcy court decision in *In re Shannon* (Pet. App. 101a-147a) is reported at 590 B.R. 467. The bankruptcy court decision in *In re Fulton* (Pet. App. 43a-62a) is reported at 2018 WL 2570109.

JURISDICTION

The Seventh Circuit entered judgment on June 19, 2019. Pet. App. 1a. Petitioner filed a timely petition for certiorari on September 17, 2019, which this Court granted on December 18, 2019. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The statutory addendum reproduces 11 U.S.C. §§ 361, 362, 363, 541, and 542 and Federal Rule of Bankruptcy Procedure 7001.

STATEMENT

A. Statutory Background

1. *Property of the estate.* The filing of a bankruptcy case creates a bankruptcy “estate,” 11 U.S.C. § 541(a), which includes “all legal or equitable interests of the debtor in property as of the commencement of the case,” *id.* § 541(a)(1). In a Chapter 7 case, the trustee marshals and liquidates all non-exempt estate property and distributes the value realized to creditors. *Id.* §§ 522(b)(1), 704(a)(1). In a Chapter 11, 12, or 13 case, the debtor typically retains possession of property of the estate and enjoys some rights to use or dispose of that property while the debtor formulates and seeks court approval for a plan to repay creditors. *Id.* §§ 363(b)-(c), 1107, 1203, 1207, 1303, 1306.

2. *The turnover power.* Sometimes, at the outset of a bankruptcy case, a debtor may have a “legal or equitable interest[],” 11 U.S.C. § 541(a)(1), in property that is in the lawful possession of a creditor or a third party. For example, a secured creditor may have repossessed its collateral from the debtor but not yet sold or foreclosed on it. Or, as in this case, a municipality may have impounded a debtor’s vehicle due to unpaid fines for traffic-law violations. In either situation, the creditor has lawful possession of the collateral, but since the sale or foreclosure process is not complete, the debtor retains an interest in the collateral, which is property of the bankruptcy estate.

Section 542 of the Bankruptcy Code, commonly referred to as the “turnover provision,” addresses this circumstance. As relevant here, it provides that an entity in possession of property that the trustee or debtor may use, sell, or lease during the bankruptcy case “shall deliver to the trustee, and account for, such property or

the value of such property.” 11 U.S.C. § 542(a); *see United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 (1983).

The turnover obligation is not absolute. Turnover is not required, for example, if the property at issue is of “inconsequential value or benefit to the estate.” 11 U.S.C. § 542(a). Likewise, an entity in possession of estate property that lacks actual notice or knowledge of the bankruptcy may transfer the property in good faith to another party, without being required to account to the trustee for the property or its value. *Id.* § 542(c); *Whiting Pools*, 462 U.S. at 206 n.12.

The turnover obligation may also be disputed on legal or factual grounds requiring resolution by the bankruptcy court. For instance, the entity in possession of the property in question may contend that the debtor did not have an interest in the property when the bankruptcy case was filed. If so, the property could not be used, sold, or leased by the trustee and is thus not subject to turnover.

The Bankruptcy Rules require the trustee to bring an action seeking to compel turnover of property as an adversary proceeding—the equivalent of a separate lawsuit within the bankruptcy case, with the formal notice required for a lawsuit—rather than as a more informal contested matter initiated by motion. Fed. R. Bankr. P. 7001 (“a proceeding to recover ... property” from a non-debtor is an adversary proceeding); *id.* 7003, 7004 (requiring summons and complaint to initiate adversary proceeding); *see Bullard v. Blue Hills Bank*, 135 S. Ct. 1686, 1694 (2015) (distinguishing adversary proceedings from contested matters).

3. *Adequate protection.* While § 542 requires parties to turn over property in which the estate has an in-

terest to the trustee or debtor, the Bankruptcy Code does not place a creditor's collateral at the debtor's disposal without affording the creditor some protection. Section 542(a) provides that turnover is required only if the trustee may use, sell, or lease the property under § 363 of the Code. 11 U.S.C. § 542(a); *Whiting Pools*, 462 U.S. at 202-203, 205-206 & n.12. Section 363 provides, in turn, that any entity with an interest in property that the debtor proposes to use, sell, or lease is entitled to "adequate protection" of its interest in the property. 11 U.S.C. § 363(e). Indeed, if a debtor is unable to give a secured creditor adequate protection, the court must prohibit the debtor from using the collateral. *Id.* (court "shall prohibit or condition" use of property as "necessary to provide adequate protection").

Adequate protection is designed to ensure that a secured creditor retains its interest in collateral without bearing the risk that the debtor's use of the collateral during the bankruptcy might diminish the collateral's value and impair the creditor's security interest. *See, e.g., 3 Collier on Bankruptcy* ¶ 361.02 (16th ed. 2019). Adequate protection may take various forms. The bankruptcy court might, for example, order the debtor to make periodic cash payments to the secured creditor to compensate the creditor for any depreciation in the value of its collateral. 11 U.S.C. § 361(1); *3 Collier on Bankruptcy* ¶ 361.03[2]. In a consumer bankruptcy case in which the creditor's collateral is a vehicle that the debtor wants to keep driving during the bankruptcy case, adequate protection may require the debtor to secure insurance coverage sufficient to compensate the creditor if an accident or other damage to the vehicle diminishes its value. *See In re Denby-Peterson*, 576 B.R. 66, 81-82 (Bankr. D.N.J. 2017), *aff'd*, 595 B.R. 184 (D.N.J. 2018), *aff'd*, 941 F.3d 115 (3d Cir. 2019).

4. *The automatic stay.* Finally, the automatic stay protects the bankruptcy estate during the bankruptcy case. 11 U.S.C. § 362(a). It is “automatic” because the bankruptcy petition itself “operates as a stay” of certain actions by creditors without the need for a court order. *Id.*

The automatic stay serves to “maintain the status quo and prevent dismemberment of the estate” while the bankruptcy case is pending. Slip Op. 6, *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, No. 18-938 (U.S. Jan. 14, 2020). It halts the race to the courthouse that may have precipitated the bankruptcy case and prevents creditors from seizing estate assets to satisfy their individual claims, enabling an orderly and fair division of the estate’s value among all creditors. *See* S. Rep. No. 95-989, at 50 (1978); H.R. Rep. No. 95-595, at 341 (1977); *United States v. Inslaw, Inc.*, 932 F.2d 1467, 1473 (D.C. Cir. 1991). The stay also grants the debtor a breathing spell from creditors’ collection efforts and an opportunity to formulate a repayment plan. *See In re VistaCare Grp., LLC*, 678 F.3d 218, 231 (3d Cir. 2012).

Most of the automatic stay’s commands are addressed to prepetition creditors, barring them from taking any further action to collect on their claims against the debtor. For example, the automatic stay bars the commencement or continuance of any proceeding against the debtor that was or could have been commenced prior to the petition date, as well as any effort to collect on a prepetition claim or enforce a prepetition lien. 11 U.S.C. § 362(a)(1), (4)-(6). That aspect of the stay lasts until the debtor is granted (or denied) a discharge of prepetition claims or the bankruptcy case is terminated. *Id.* § 362(c)(2).

The automatic stay also bars both prepetition and postpetition creditors from seizing estate property to satisfy their claims. For example, § 362(a)(3)—the provision at issue here—prohibits “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.” 11 U.S.C. § 362(a)(3). That aspect of the stay remains in effect “until such property is no longer property of the estate.” *Id.* § 362(c)(1).

The bankruptcy court may lift the stay for cause, including lack of adequate protection of a secured creditor’s interest in its collateral. 11 U.S.C. § 362(d)(1); *Ritzen*, Slip Op. at 7.

Violations of the automatic stay can give rise to a right to compensatory and—in the case of a “willful violation”—punitive damages. 11 U.S.C. § 362(k)(1) (“[A]n individual injured by any willful violation of [the automatic] stay ... shall recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages.”); *see also Taggart v. Lorenzen*, 139 S. Ct. 1795, 1803-1804 (2019).

B. Factual And Procedural Background

1. In each of the cases below, the City of Chicago impounded the Debtor’s car based on unpaid penalties and fines imposed for violations of the City’s laws. City ordinances provide that, for the “purpose of enforcing” its traffic regulations, the City may impound vehicles and hold them until fines and penalties are satisfied. Municipal Code of Chicago, Ill. § 9-100-120(a). Under § 9-100-120, a vehicle may be immobilized if the owner has three or more unpaid violations; 24 hours after immobilization, the vehicle is subject to impoundment. *Id.* § 9-100-120(b), (c). The City has a possessory lien on

impounded vehicles. *Id.* § 9-92-080(f). If impounded vehicles are not claimed within specified time periods, the City may sell or dispose of the vehicles. *Id.* § 9-100-120(f); 625 Ill. Comp. Stat. 5/4-208(a).

In response to the impoundments, each of the Debtors commenced a Chapter 13 bankruptcy case in the U.S. Bankruptcy Court for the Northern District of Illinois and sought the return of his or her car.

Debtor Robbin Fulton's car was impounded in December 2017 because Fulton was discovered to be driving on a suspended license. Pet. App. 4a. The following month, Fulton filed a Chapter 13 petition (commencing her third bankruptcy case). *Id.*; Bankr. N.D. Ill. No. 18-02860, Dkt. 6. At the time of the bankruptcy filing, Fulton owed the City of Chicago \$11,831.20 in connection with 54 separate outstanding violations. Pet. App. 4a; Bankr. N.D. Ill. No. 18-02860, Claims Register 1-3. Fulton demanded the return of her car; when the City responded that the Code did not mandate immediate turnover of the car, she sought sanctions for violation of the automatic stay. Pet. App. 4a-5a. Relying on *Thompson v. Gen. Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), the bankruptcy court concluded that the City's failure to return the car violated the automatic stay. Pet. App. 44a-46a, 49a-51a. In *Thompson*, the Seventh Circuit had held that "passively holding onto an asset ... violates section 362(a)(3)," 566 F.3d at 703, and that "the Bankruptcy Code's provisions ... require that a creditor immediately return a seized asset in which a debtor has an equity interest to the debtor's estate upon his filing of Chapter 13 bankruptcy," *id.* at

700. The bankruptcy court accordingly ordered the City to return Fulton’s car. Pet. App. 5a.¹

Debtor Jason Scott Howard’s car was impounded in August 2017. Pet. App. 7a. Howard had incurred 66 unpaid parking, automated red-light, and speeding tickets and accumulated an outstanding balance of \$17,110.80. *Id.*; Bankr. N.D. Ill. No. 17-25141, Claims Register 1-1. Two weeks later, on August 22, 2017, Howard filed a Chapter 13 petition—his third bankruptcy filing in a period of just over 12 months. Pet. App. 7a, 29a-30a. Because of Howard’s prior petitions, the automatic stay did not come into effect when the case was filed. 11 U.S.C. § 362(c)(4)(A). But the bankruptcy court granted Howard’s motion to impose the stay upon confirmation of his plan. Pet. App. 7a, 29-30a. The bankruptcy court thereafter *sua sponte* ordered the City to show cause why it was not violating the automatic stay by retaining Howard’s car. *Id.* 7a, 31a. Ultimately, on April 19, 2018, the bankruptcy court held that the City had violated the automatic stay by “fail[ing] to return the vehicle as required by the *Thompson* ruling since this case was filed on August 22, 2017.” *Id.* 40a-41a. It imposed sanctions upon the City of fifty dollars per day. *Id.* 41a.²

Debtor George Peake’s vehicle was immobilized and subsequently impounded in June 2018 because Peake had failed to pay fines associated with 21 violations of the Chicago Municipal Code. Pet. App. 6a, 64a;

¹ By order dated August 28, 2019, Fulton’s bankruptcy case was dismissed on the trustee’s motion for failure to make plan payments. Bankr. N.D. Ill. No. 18-02860, Dkt. 121.

² By order dated May 21, 2018, Howard’s bankruptcy case was dismissed on the trustee’s motion for failure to make plan payments. Bankr. N.D. Ill. No. 17-25141, Dkt. 87.

Bankr. N.D. Ill. No. 18-16544, Dkt. 16-4, Ex. D. A week later, Peake filed a Chapter 13 bankruptcy petition. Pet. App. 6a. The City asserted a claim in Peake's bankruptcy case for \$5,393.27. *Id.* Peake sought turn-over of the car and sanctions against the City. *Id.* The bankruptcy court found that the City's retention of the vehicle after the bankruptcy filing violated the automatic stay under *Thompson* and ordered the car returned. *Id.* 6a, 64a-67a, 100a. The court imposed sanctions of "\$100 per day from August 17 through August 22 and \$500 per day thereafter until the City returned [the] vehicle." *Id.* 6a.

Debtor Timothy Shannon's vehicle was impounded in January 2018 because of unpaid parking tickets and three speeding violations, and because Shannon drove the car on a suspended license. Pet. App. 5a, 146a. The following month, Shannon filed a Chapter 13 bankruptcy petition. *Id.* 5a. As of the petition date, Shannon had incurred fines payable to the City of Chicago for 26 separate violations of its Municipal Code. *Id.* 146a; Bankr. N.D. Ill. No. 18-04116, Dkt. 33-2, Ex. B. In June 2018, Shannon moved for sanctions, alleging that the City's failure to return his car to him violated the automatic stay. Pet. App. 5a-6a. The bankruptcy court held that the City violated § 362(a)(3) under *Thompson* and granted Shannon's motion, ordering the return of his vehicle. *Id.* 6a, 109a-113a, 155a.

2. In each of the four cases, the court of appeals granted the City's petition for direct appeal from the bankruptcy court pursuant to 28 U.S.C. § 158(d). All

four cases were consolidated on appeal. The court of appeals affirmed the bankruptcy courts' judgments.³

Adhering to circuit precedent under *Thompson*, the court of appeals held that the passive retention of property in which the estate has an interest is an “act to ... exercise control” over the property, in violation of the automatic stay. Pet. App. 8a-10a, 12a (citing *Thompson*, 566 F.3d at 700, 702). In the court of appeals' view, the automatic stay operates as a mandatory injunction affirmatively requiring the City to turn over a debtor's vehicle immediately upon the filing of a bankruptcy petition. The debtor need not bring an action for turnover under § 542(a) or provide adequate protection of the City's security interest; the City must give the car back to the debtor before it can seek a judicial determination of its turnover obligation or adequate protection of its interest. Pet. App. 10a. The City therefore “violated the automatic stay pursuant to

³ Contrary to the court of appeals' suggestion, the City's failure to turn over the vehicles to the Debtors immediately upon their bankruptcy filings did not reflect a belief that it was entitled to “ignore the Bankruptcy Code[]” or the court's interpretation of it. Pet. App. 2a. Although the Seventh Circuit resolved the question presented here in *Thompson*, 566 F.3d 699, the City was not a party to *Thompson*, and it was required to litigate the issue in the lower courts to preserve it for this Court's review. See, e.g., *City of Springfield v. Kibbe*, 480 U.S. 257, 259 (1987) (per curiam) (Court “ordinarily will not decide questions not raised or litigated in the lower courts”). Moreover, lower courts within the Seventh Circuit had held that the City's retention of a debtor's vehicle was authorized by the exception to the automatic stay set forth in 11 U.S.C. § 362(b)(3). See *In re Avila*, 566 B.R. 558 (Bankr. N.D. Ill. 2017); *City of Chicago v. Kennedy*, 2018 WL 2087453 (N.D. Ill. May 4, 2018). The Seventh Circuit ultimately rejected that argument (Pet. App. 17a-27a), and that aspect of its decision is not presented for review here.

§ 362(a)(3) by retaining possession of the debtors' vehicles after they declared bankruptcy." *Id.* 12a.

SUMMARY OF ARGUMENT

I. The text, purpose and history of the automatic stay all confirm that it is a "stay," a negative injunction that halts collection activity and preserves the status quo. Section 362(a)(3) "stay[s]" post-petition "acts" to exercise control over property of the estate; it does not require creditors to take affirmative steps to undo lawful actions taken pre-petition. That reading accords with the automatic stay's purpose: to stop creditors' debt-collection efforts and preserve the status quo existing on the petition date, thereby ensuring that the estate is not dismembered by creditors seeking to collect their individual claims against the debtor while the bankruptcy case is pending.

The history of the automatic-stay provision confirms that reading. The parties agree that long-settled bankruptcy law permitted a creditor to retain possession of repossessed or impounded property pending the outcome of a turnover proceeding. And the 1984 addition of language staying acts to "exercise control" over estate property merely clarified that creditors were stayed from taking acts to "control" intangible property just as they were stayed from taking acts to "obtain possession" of tangible property. There is no basis for reading the 1984 amendment as overturning well-established bankruptcy law.

II. The Bankruptcy Code contains a separate statutory provision that permits the debtor or trustee to marshal property of the estate—§ 542(a)'s turnover authority. Reading the automatic stay to require creditors to turn over property in which the estate has an

interest immediately upon the petition date or face sanctions would render § 542(a) surplusage. And it would nullify the protections the Bankruptcy Code's turnover process affords creditors, including the ability to raise defenses to turnover and obtain adequate protection of their interests in the property before relinquishing possession. Indeed, this Court has already held, in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), that § 362(a)(3) should not be read to eviscerate the protections afforded creditors under a closely analogous turnover provision in § 542(b). The same logic compels reversal here.

III. The general Bankruptcy Code policy promoting reorganization or a debtor's "fresh start" does not justify reading into § 362(a)(3) an affirmative turnover obligation that its text and purpose do not support. Dispensing with the need to file turnover proceedings might be better for debtors, but that provides no basis for disregarding the statutory requirements that Congress provided to protect creditors' interests in property when debtors seek to avail themselves of the Bankruptcy Code's benefits.

ARGUMENT

I. A CREDITOR DOES NOT VIOLATE THE AUTOMATIC STAY BY RETAINING POSSESSION OF PROPERTY LAWFULLY OBTAINED BEFORE BANKRUPTCY

The court of appeals' holding that a creditor violates the automatic stay by passively retaining property lawfully repossessed or impounded before bankruptcy contravenes the text and context of the Bankruptcy Code's automatic stay provisions. A "stay" *bars* parties from taking action that alters the status quo; it does not *require* them to take such action. And the automatic

stay, in particular, is designed to freeze in place the positions of the debtor and creditors as of the day the bankruptcy petition is filed.

The parties agree that, before 1984, that was just what § 362(a)(3) did: A creditor who lawfully obtained possession of its collateral from the debtor before bankruptcy was not required by the automatic stay to hand the collateral back without any process or protection for the creditor's interest in the collateral. Rather, the automatic stay simply barred creditors who had *not* obtained possession of their collateral before bankruptcy from attempting to do so in bankruptcy. The Debtors' contention that technical amendments adding the phrase "exercise control" somehow upended the basic function of the automatic stay, turning it from a stay into a mandatory injunction, finds no support in the Bankruptcy Code's text, its history, or common sense.

A. Section 362(a)(3)'s Plain Text Stays Acts That Alter The Status Quo As Of The Petition Date; It Does Not Require Such Acts

We "begin[] with the language of the statute itself." *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989). The Bankruptcy Code provides that "a [bankruptcy] petition ... operates as a stay" of "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." 11 U.S.C. § 362(a)(3).

In concluding that the City had violated this provision by retaining possession of the Debtors' cars, the Seventh Circuit focused almost entirely on the words "exercise control." Pet. App. 8a-9a; *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699, 702 (7th Cir. 2009). The court looked to a dictionary definition of

“control”—“to exercise restraining or directing influence over” or “to have power over”—and reasoned that “[h]olding onto an asset [and] refusing to return it” fit within the definition. *Thompson*, 566 F.3d at 702.

That analysis might make sense if the Bankruptcy Code provided that “creditors may not exercise control over property of the estate.” But it does not. Rather, it carefully provides that a petition “operates as a *stay*” of “any *act* to obtain possession of ... or to exercise control over property of the estate.” 11 U.S.C. § 362(a)(3). Those words are key in determining the scope of the automatic stay. And because the Bankruptcy Code does not define “stay” or “act,” they have their ordinary meaning. *See, e.g., Hamilton v. Lanning*, 560 U.S. 505, 513 (2010).

In both legal parlance and ordinary English, “stay” means the “halting” or “bringing to a stop” of a proceeding or activity. *See In re Denby-Peterson*, 941 F.3d 115, 125 (3d Cir. 2019); *Black’s Law Dictionary* 1709 (11th ed. 2019) (defining “stay” as “[t]he postponement or halting of a proceeding”); *Webster’s Third New International Dictionary* 2231 (1993) (defining the noun “stay” as “a bringing to a stop,” “the action of halting,” and “the state of being stopped”). Indeed, that is precisely how this Court and Congress have previously described the automatic stay. *See* Slip Op. 6, *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, No. 18-938 (U.S. Jan. 14, 2020) (the stay “halts efforts to collect prepetition debts”); H.R. Rep. No. 95-595, at 340 (the automatic stay “stops all collection efforts, all harassment, and all foreclosure actions”).

The word “stay” is most commonly used in the law to mean a court’s temporary suspension of proceedings or of the effectiveness of an order or judgment under

review. *See Nken v. Holder*, 556 U.S. 418, 428-429 (2009). The automatic stay is different only in that it stays parties as well as courts from acting, and thus functions as a prohibitory injunction. *See id.* (distinguishing a “stay” of proceedings from an “injunction,” while acknowledging that a stay and a prohibitory injunction can have the same “practical effect”). But the essential function of a “stay” is the same in both contexts: It temporarily “suspends ... alteration of the status quo” by “preventing some action before the legality of that action has been conclusively determined.” *Id.* A stay freezes the parties’ positions during judicial proceedings so that the parties’ rights and obligations can be determined. It does not “alter[] the legal status quo” as a mandatory injunction would. *Id.* at 429.⁴

⁴ The distinction between prohibitory and mandatory injunctions—that is, between ordering parties not to act and ordering them to act—is well established. Simply put, “[p]rohibitory injunctions maintain the status quo pending resolution of the case; mandatory injunctions alter it.” *North Am. Soccer League, LLC v. U.S. Soccer Fed’n, Inc.*, 883 F.3d 32, 36 (2d Cir. 2018); *see also, e.g., Meghriq v. KFC Western, Inc.*, 516 U.S. 479, 484 (1996) (construing federal environmental statute to authorize issuance of either a “mandatory injunction, *i.e.*, one that orders a responsible party to ‘take action’ by attending to the cleanup ... of toxic waste, or a prohibitory injunction, *i.e.*, one that ‘restrains’ a responsible party from further violating [the statute]” (quoting 42 U.S.C. § 6972(a)(1)(B)); *Ex parte Young*, 209 U.S. 123, 159 (1908) (permitting a negative injunction against state official that imposes “no affirmative action of any nature” but simply prohibits official “from doing an act which he had no legal right to do”); *Marlyn Nutraceuticals, Inc. v. Mucos Pharma GmbH & Co.*, 571 F.3d 873, 878-879 (9th Cir. 2009) (“A prohibitory injunction prohibits a party from taking action” and “freezes the positions of the parties”; a “mandatory injunction orders a responsible party to take action” and “goes well beyond simply maintaining the status quo” (internal quotation marks omitted)).

“‘Act’, in turn, commonly means to ‘take action’ or ‘do something.’” *In re Cowen*, 849 F.3d 943, 949 (10th Cir. 2017) (quoting *New Oxford American Dictionary* 15 (3d ed. 2010)). “[P]assively holding on to an asset” that the creditor already had in its possession on the petition date is not an “act” in everyday speech or within the meaning of § 362(a)(3). *Id.*; *Denby-Peterson*, 941 F.3d at 125. “[T]he distinction between doing something and doing nothing [was] not ... lost” on Congress—a body of “‘practical statesmen,’ not metaphysical philosophers”—when it drafted the Bankruptcy Code. *National Fed’n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 555 (2012) (Roberts, C.J., opinion).

The surrounding text in § 362(a)(3) makes clear that “act” in § 362(a)(3) has its ordinary meaning and does not encompass the failure to act. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997) (interpreting statutory language requires examination of “the specific context in which th[e] language is used”). Section 362(a)(3) operates as a “stay” of an “act.” And, again, a “stay” “prevent[s]” a future act that would “alter[] the status quo.” *Nken*, 556 U.S. at 429 (emphasis added). But retaining property lawfully repossessed prepetition *preserves* the status quo. Accordingly, even on the Debtors’ view that passive possession can be characterized as an “act,” it is not the type of act that can sensibly be subject to a “stay.”

Section 362(a)(3)’s “stay” of “any act ... to exercise control over property of the estate” thus bars creditors “from *doing* something” after the petition date “to exercise control over the estate’s property.” *Cowen*, 849 F.3d at 949. It stops a creditor from taking a “post-petition affirmative act” that would improve the position the creditor held on the petition date, *Denby-Peterson*, 941 F.3d at 125-126, such as an act “to repos-

sess or liquidate collateral” or “to terminate a lease,” *Ritzen*, Slip Op. at 10. See *United States v. Inslaw, Inc.*, 932 F.2d 1467, 1474 (D.C. Cir. 1991) (“The automatic stay ... serves as a restraint only on acts to gain possession or control over property of the estate. Nowhere in its language is there a hint that it creates an affirmative duty[.]”). The Seventh Circuit’s and the Debtors’ contrary reading—under which the automatic stay *requires* a creditor to take an act that *worsens* the position it had on the petition date—contravenes the plain text of the statute.

B. The Debtors’ Interpretation Turns The Role Of The Automatic Stay On Its Head

As this Court has recognized, the automatic stay plays a critical role in the bankruptcy process: It “maintains the status quo and prevents dismemberment of the estate’ during the pendency of the bankruptcy case.” *Ritzen*, Slip Op. at 6; see also *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1804 (2019) (the automatic stay “aims to prevent damaging disruptions to the administration of a bankruptcy case in the short run”). The Debtors’ interpretation of § 362(a)(3) as requiring creditors to *change* the status quo cannot be reconciled with that core function of the automatic stay or with basic bankruptcy principles.

Bankruptcy is designed to marshal the debtor’s assets and address the debtor’s liabilities in a single centralized proceeding, ensuring that the estate’s value can be maximized and divided among the debtor’s creditors in an orderly and fair manner. Because that process takes time, bankruptcy needs a “mechanism to preserve the status quo while we sort out the affairs of the debtor. This is the purpose of § 362 and the automatic stay.” Baird, *Elements of Bankruptcy* 195 (6th

ed. 2014). Accordingly, once a bankruptcy petition is filed, the automatic stay halts creditors from taking any further action to collect their claims or liquidate property of the estate, thereby “effect[ing] an immediate freeze of the *status quo*.” *Hillis Motors, Inc. v. Hawaii Auto. Dealers’ Ass’n*, 997 F.2d 581, 585 (9th Cir. 1993); see also *Checkers Drive-In Rests., Inc. v. Commissioner of Patents & Trademarks*, 51 F.3d 1078, 1083 (D.C. Cir. 1995) (“Congress included section 362(a) in the Bankruptcy Code to ensure the preservation of the status quo between a debtor and its creditors.”).⁵

As the Senate Report on the legislation that resulted in the 1978 Bankruptcy Code explained: “[The automatic stay] gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions.” S. Rep. No. 95-989, at 54. “The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor’s property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors.” *Id.* at 49. The stay prevents that harm by freezing in place the state of affairs as of the commencement of the bankruptcy case, permitting “an orderly ... procedure under which all creditors are treated equally.” *Id.*; H.R. Rep. No. 95-595, at 340 (same); Brubaker, *Turnover, Adequate Protection and the Automatic Stay: A Reply to Judge Wedoff*, 38 Bankr. L. Letter No. 11, at 9 (Nov. 2018) (*Turnover Part III*).

⁵ *Accord In re Dukes*, 909 F.3d 1306, 1321 (11th Cir. 2018); *Hillis Motors, Inc. v. Hawaii Auto. Dealers’ Ass’n*, 997 F.2d 581, 585 (9th Cir. 1993); *In re Larson*, 979 F.2d 625, 627 (8th Cir. 1992); *ICC v. Holmes Transp., Inc.*, 931 F.2d 984, 987 (1st Cir. 1991); *In re Morton*, 866 F.2d 561, 564 (2d Cir. 1989).

Section 362(a)(3), in particular, protects the estate that is created when a bankruptcy petition is filed, which includes “all legal or equitable interests of the debtor in property” as of the petition date, 11 U.S.C. § 541(a)(1). Once the petition has been filed, the estate has been created, and the automatic stay takes effect, both prepetition and postpetition creditors are stayed from seizing estate property, placing a lien on it, or otherwise attempting to use it to satisfy or secure their claims. Section 362(a)(3) thus “prevent[s] dismemberment of the estate” and ensures that “[a]ny distribution of property must be by the trustee after he has had an opportunity to familiarize himself with the various rights and interests involved.” S. Rep. No. 95-989, at 50; *see also* H.R. Rep. No. 95-595, at 341 (same). In other words, § 362(a)(3) “preserv[es] the bankrupt’s estate pending orderly distribution by a trustee” and “make[s] sure that creditors do not destroy the bankrupt estate in their scramble for relief.” *Checkers*, 51 F.3d at 1082; *see also* 2 *Norton Bankr. L. & Prac.* § 43:7 (3d ed. 2019) (same).

But neither the filing of a bankruptcy petition nor the automatic stay that accompanies it expands a debtor’s rights vis-à-vis creditors beyond what the debtor had before the bankruptcy filing. It is a core bankruptcy principle that “[t]he estate cannot possess anything more than the debtor itself did outside bankruptcy.” *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1663 (2019). “Whatever ‘limitations on the debtor’s property apply outside of bankruptcy apply inside of bankruptcy as well. A debtor’s property does not shrink by happenstance of bankruptcy, but it does not expand, either.’” *Id.* (quoting Baird, *Elements of Bankruptcy* 97 (brackets omitted)).

Accordingly, if a creditor lawfully repossesses or impounds its collateral before bankruptcy—so that the creditor, not the debtor, had the lawful right to possession of the property on the petition date—the automatic stay cannot render the creditor’s possession of the collateral unlawful. The stay preserves the status quo by preventing a creditor from taking any postpetition act, such as repossessing or foreclosing on property, that would better the creditor’s position compared to what it had on the petition date. But the stay emphatically does not require a creditor to take affirmative action to undo its lawful exercise of its rights before bankruptcy, thereby changing the status quo and worsening the position it had on the petition date. “The automatic stay ... serves as a restraint only on acts to gain possession or control over property of the estate.” *Inslaw*, 932 F.2d at 1474. Moreover, it “applies only to acts taken *after* the petition is filed.” *Id.* “Nowhere in its language is there a hint that it creates an affirmative duty to remedy past acts.” *Id.*

As discussed further below, *see infra* Part II, there is a way for the estate to recover collateral that a secured creditor lawfully repossessed prepetition, if the debtor can use, sell, or lease that property during the bankruptcy case. The debtor can bring suit under § 542, the Bankruptcy Code’s turnover provision, and in some circumstances can compel the creditor to surrender the collateral. Likewise, a trustee can bring certain other property transferred before bankruptcy into the estate by bringing suit to invalidate a preferential payment or fraudulent conveyance. *See* 11 U.S.C. §§ 544, 547, 548. But all of these provisions for bringing property into the estate are subject to strict procedural and substantive limitations, designed to protect creditors’ interests in such property. *See id.* §§ 542(a), (c)-

(d), 544(b), 547(b)-(c), 548(a), (c); *Mission*, 139 S. Ct. at 1663. And achieving the objectives of these provisions is outside the ambit of the automatic stay, which functions to preserve the debtor's rights as of the filing of the petition, not to expand them.

C. The Automatic Stay's History Confirms That § 362(a)(3) Does Not Compel Creditors To Turn Over Lawfully Repossessed Property

The history of the automatic stay provision is also instructive in determining the scope of present-day § 362(a)(3). The parties agree that for decades, before and after the enactment of the Bankruptcy Code, the stay did *not* require creditors to return property that was repossessed prepetition. Debtors contend that changed in 1984, when Congress amended § 362(a)(3) to stay not only “any act to obtain possession of property of the estate,” but also “any act ... *to exercise control* over property of the estate.” The addition of the “exercise control” language, they argue, fundamentally changed the automatic stay, turning it from a status-quo-preserving bar on future seizures of property into a mandatory injunction requiring creditors to surrender property already lawfully in their possession, without any process and on pain of sanctions. But the long-established function of the automatic stay, and the lack of any indication that Congress believed the 1984 amendment worked such a significant change, refute the Debtors' interpretation.

Well before enactment of the Bankruptcy Code, pre-Code law recognized bankruptcy courts' power to enter stays of lawsuits and other creditor actions to “main[tain] ... the status quo” during bankruptcy proceedings. *Continental Ill. Nat'l Bank & Tr. Co. v. Chicago, Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 675-679

(1935) (upholding injunction entered under the Bankruptcy Act of 1898 restraining creditors from selling collateral during reorganization efforts). During the 1970s, the scope of the bankruptcy stay was broadened and the Federal Rules of Bankruptcy Procedure made it “automatic” in many instances, taking effect when a petition was filed without the need for a court order. See Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. Mich. J. L. Reform 175, 177-178, 182-184 (1978). But the purpose of the stay remained the same: “to maintain the status quo ... by restraining other proceedings which would impede the reorganization effort by bringing about the liquidation of the debtor’s property.” *In re Stanndco Developers, Inc.*, 534 F.2d 1050, 1052 & n.3 (2d Cir. 1976); see also *In re Decker*, 465 F.2d 294, 296-297 (3d Cir. 1972) (“[T]he stays authorized by [the Bankruptcy Act] are in the nature of temporary injunctions designed to maintain the status quo.”); 14 *Collier on Bankruptcy* ¶ 11-44.02 (14th ed.) (explaining that the automatic stay “protects the debtor against harassment and possible impairment of the ... rehabilitation process by adverse disposition of its property before the necessary steps can be taken to obtain ... relief”).

In 1978, the new Bankruptcy Code codified and expanded the existing automatic stay. As originally enacted, § 362(a)(3) of the Code stayed “any act to obtain possession of property of the estate or of property from the estate.” Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 362, 92 Stat. 2549, 2570. That version of § 362(a)(3), barring only postpetition “act[s] to obtain possession” of estate property, undisputedly did not require creditors who lawfully obtained possession of estate property prepetition to surrender that property.

Thus, under the Bankruptcy Code as enacted in 1978, nothing in § 362 could be construed to impose a turnover obligation. And it was generally understood that while § 542 of the Code empowered a debtor or trustee to seek turnover of property that the estate could use, sell or lease, creditors were not required to turn over such property as soon as the petition was filed or face sanctions. Rather, “turnover could be refused and the creditor could raise defenses to turnover before being required to relinquish possession.” *In re Hall*, 502 B.R. 650, 664 (Bankr. D.D.C. 2014); Brubaker, *Turnover Part III*, 38 Bankr. L. Letter No. 11 at 2-3. As the Debtors’ counsel has put it, “if a creditor was unwilling to return collateral, the debtor would have to seek a court order requiring turnover under § 542(a), and in response the creditor could request adequate protection under § 363(e).” Wedoff, *The Automatic Stay Under § 362(a)(3)—One More Time*, 38 Bankr. L. Letter No. 7 at 2 (July 2018).

In 1984, Congress enacted a number of technical and clarifying amendments to the Code. One such amendment added to § 362(a)(3) the language on which the Debtors rely, barring “any act to ... exercise control over property of the estate.” Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 441(a)(2), 98 Stat. 333, 371. The Debtors contend, and the Seventh Circuit held, that the 1984 amendment effected a sea change in long-settled law, requiring creditors to turn over collateral in their possession to the debtor or trustee immediately upon the filing of the bankruptcy case or else face sanctions. Pet. App. 10a; *Thompson*, 566 F.3d at 702-703. That argument fails.

As this Court has repeatedly held, it “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.” *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998); *see also, e.g., Hall v. United States*, 566 U.S. 506, 518 (2012) (holding 2005 Bankruptcy Code amendment did not “disrupt settled Chapter 13 practices”); *Hamilton*, 560 U.S. at 515-517 (same) (“pre-[amendment] bankruptcy practice is telling”; “we would expect that, had Congress intended” a substantive change, “Congress would have said so expressly”); *Travelers Cas. & Sur. Co. of Am. v. Pacific Gas & Elec. Co.*, 549 U.S. 443, 453-454 (2007) (holding Bankruptcy Code provision did not overturn pre-Code law).

No such clear indication—indeed, no indication at all—is present here. To the contrary, there is ample evidence that the 1984 amendments to § 362 were intended to be clarifying rather than substantive. The “exercise control” language originated in a bill entitled “An Act to Correct Technical Errors, Clarify and Make Minor Substantive Changes to Public Law 95-598 (the Bankruptcy Reform Act of 1978).” H.R. Rep. No. 96-1195, at 1, 52 (1980); Brubaker, *Turnover Part III*, 38 Bankr. L. Letter No. 11 at 5-6. The original House Report explained that the bill made changes where “the treatment of a subject in the Bankruptcy Reform Act was found to be incomplete; or [] there was overlooked some minor yet relevant matter.” H.R. Rep. No. 96-1195, at 2. Substantively, however, “[e]very effort” was made “to maintain existing policy intact.” *Id.* The legislative history specifically addressing the changes to § 362(a)(3) was cursory, doing little more than repeating the language of the amendment. *Id.* at 10.

Just as in *Cohen*, which also addressed one of the technical amendments in the 1984 Act, “the change to

the language” of §362(a)(3) “in no way signals an intention” to alter established law in the dramatic way the Debtors claim. 523 U.S. at 221. Had Congress intended, in the face of decades of contrary practice, to require a creditor to turn over property in its possession as soon as a bankruptcy case was filed—regardless of the creditor’s defenses or the debtor’s ability to provide adequate protection—“one would expect Congress to have made [its intent] unmistakably clear.” *Id.* at 222.

What is even more implausible is that, according to the Debtors, Congress instituted this new turnover requirement not by amending the *turnover* provisions of the Bankruptcy Code but by amending the *automatic stay*, a provision that before 1984 was uniformly understood to have nothing to do with turnover. And this sweeping change was made not through a clear statement of the secured creditor’s new duty to turn over estate property immediately, but instead through an oblique reference to “exercising control” over such property. That is simply not credible. “If Congress had meant to add an affirmative obligation—to the automatic *stay* provision no less, as opposed to the *turnover* provision—to turn over property belonging to the estate, it would have done so explicitly.” *Cowen*, 849 F.3d at 950.

In addition, the Debtors’ reading—under which possessing property of the estate is an “act to exercise control” over that property—would effectively render the “obtain possession” language surplusage, in violation of basic canons of statutory interpretation. *See, e.g., Duncan v. Walker*, 533 U.S. 167, 174 (2001). That would be especially odd here, where the stay of acts to obtain possession of estate property is the core of the statutory provision and the “exercise control” language is a later addition. *See id.* (“We are especially unwill-

ing” to treat a statutory term as surplusage “when the term occupies so pivotal a place in the statutory scheme[.]”). If “acts to exercise control” include merely being in possession of property, why include the “obtain possession” language at all, since affirmative actions to take possession of property would already be covered by the “exercise control” language?

There is a much more natural explanation for the addition of the “exercise control” language to § 362(a)(3). The legislative history of the original provision enacted in 1978—along with the rapid development of commercial law governing intangible property rights—explains why § 362(a)(3) needed clarification. That provision, the 1978 Senate Report explained, was intended to protect “property over which the estate has *control or possession*.” S. Rep. No. 95-959, at 50 (1977) (emphasis added). As originally enacted, however, § 362(a)(3) stayed only acts to obtain “possession,” without mentioning “control.” The 1984 amendment corrected that apparent oversight, clarifying that § 362(a)(3) stays acts to exercise “control” over property even where the creditor does not obtain “possession” of it.

That clarification ensured that the stay protects property of the estate from dismemberment by postpetition acts that improve a creditor’s position vis-a-vis estate property but are not readily characterized as “obtaining possession” of property. For instance, “a creditor in possession who improperly sells property belonging to the estate” could not easily be described as “obtaining possession” of property—the creditor has already obtained possession before bankruptcy—but it is certainly exercising control over that property. *Cowen*, 849 F.3d at 950. Likewise, intangible property rights—such as causes of action, contract rights, and

intellectual property—cannot be physically “possessed.” The addition of the “exercise control” language ensured that the stay prevents creditors from taking similar actions against such intangible interests. *Id.*; see also Brubaker, *Turnover Part III*, 38 Bankr. L. Letter No. 11 at 4-5 & nn.23-28 (§ 362(a)(3)’s language “suggests a distinction between physical ‘possession’ of things capable of physical possession ... and ‘control’ of intangible property not capable of physical possession”).⁶

Indeed, § 362(a)(3)’s stay of acts to “exercise control” over property of the estate has been held to protect a wide range of intangible interests from actions that might otherwise fall outside the reach of the bar on acts to “obtain possession” of estate property. See, e.g., *In re Prudential Lines Inc.*, 928 F.2d 565, 574 (2d Cir. 1991) (action to eliminate debtor’s tax benefits); *Hillis Motors*, 997 F.2d at 585-586, 590 (action to dissolve debtor’s corporate charter); *In re Securities Investor Protection Corp.*, 460 B.R. 106, 114 (Bankr. S.D.N.Y.

⁶ At the time the relevant language was enacted in 1978 and 1984, it was widely recognized that the concept of “possession” had become inadequate to address many forms of intangible rights that were becoming increasingly common. See, e.g., Coogan, *Article 9—An Agenda for the Next Decade*, 87 Yale L.J. 1012, 1045-1046 (1978) (noting that growth of intangible rights in commercial affairs was “jeopardiz[ing] old customs ... depend[ent] on ‘possession[,]’ an idea that presupposes the existence of something tangible to possess”); 1 Gilmore, *Security Interests in Personal Property* § 14.1, at 439 (1965) (“[P]ossession is a meaningless concept when applied to an intangible claim.”). Commercial practices that had emerged to provide the functional equivalent of “possession” for intangible rights were ultimately codified in the 1990s revisions to the Uniform Commercial Code, which explicitly distinguishes between “possession” of tangible property and “control” of certain intangible rights. See, e.g., U.C.C. §§ 9-313, 9-314; *id.* § 9-105 cmt. 2; *id.* § 9-603 Reporter’s Note (Oct. 1992 draft).

2011) (action to usurp estate's cause of action); *In re Albion Disposal, Inc.*, 217 B.R. 394, 407-408 (W.D.N.Y. 1997) (action to terminate debtor's contract rights); *In re Nat'l Cattle Cong., Inc.*, 179 B.R. 588, 597 (Bankr. N.D. Iowa 1995) (action to revoke debtor's gaming license).

In contrast to the Debtors' interpretation, that reading of § 362(a)(3) makes sense of the entire provision, giving distinct meanings to "obtain possession" and "exercise control." It explains Congress's treatment of the amendment as a clarification rather than a significant change. And it comports with the universal understanding of the automatic stay and turnover provisions for many years before 1984, consistent with this Court's admonition that the Bankruptcy Code should not lightly be read to overturn past practice.

II. THE DEBTORS' INTERPRETATION OF § 362(a)(3) WOULD RENDER THE TURNOVER PROVISION SUPERFLUOUS AND DEPRIVE SECURED CREDITORS OF CRITICAL STATUTORY PROTECTIONS

The Seventh Circuit's conclusion is also at odds with the Bankruptcy Code's express inclusion of a provision dealing with the turnover of estate property, 11 U.S.C. § 542. That provision carefully balances the interest in facilitating the reorganization of a corporate debtor or promoting an individual debtor's fresh start with the non-bankruptcy rights and entitlements of creditors. The Seventh Circuit's construction of the automatic stay would sweep aside and render superfluous the careful balance Congress struck in enacting § 542(a).

A. Section 542 Contemplates A Procedure Under Which Creditors May Raise Statutory Defenses To Turnover

Section 542(a) of the Bankruptcy Code permits a debtor to seek turnover of property lawfully obtained by a secured creditor before the petition date. But turnover is not required in all circumstances. Rather, § 542 contains express statutory defenses. For instance, a creditor is not obligated to turn over property where “such property is of inconsequential value or benefit to the estate.” 11 U.S.C. § 542(a).

Furthermore, as this Court recognized in *United States v. Whiting Pools, Inc.*, one of the “explicit limitations on the reach of § 542(a)” is “that the property be usable under § 363.” 462 U.S. 198, 206 & n.12 (1983); 11 U.S.C. § 542(a) (requiring turnover only if the property is “property that the trustee may use, sell, or lease under section 363” of the Bankruptcy Code). And the trustee cannot use property under § 363 unless the creditor is provided “adequate protection” of its interest in the property as a condition to relinquishing possession.

Specifically, § 363 provides that “on request of an entity that has an interest in property ... proposed to be used, sold, or leased, by the trustee, the court ... shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.” 11 U.S.C. § 363(e). Under this provision, “[a]t the secured creditor’s insistence, the bankruptcy court must place such limits or conditions on the trustee’s power to sell, use, or lease property as are necessary to protect the creditor.” *Whiting Pools*, 462 U.S. at 204. Thus, a secured creditor is not obligated to turn over property that the trustee proposes to use under § 363

unless, as a condition to turnover, the creditor obtains adequate protection of its interest in the property. *Hall*, 502 B.R. at 659-660; Brubaker, *Turnover, Adequate Protection, and The Automatic Stay (Part II): Who Is ‘Exercising Control’ Over What?*, 33 Bankr. L. Letter No. 9, at 4-5 (Sept. 2013) (*Turnover Part II*).

Accordingly, if the trustee or debtor demands return of the property in a turnover action, a creditor may respond by raising statutory defenses and asserting its right to receive “adequate protection.” 11 U.S.C. §§ 542(a), 363(e); *Denby-Peterson*, 941 F.3d at 128-131; *Hall*, 502 B.R. at 659-661; Brubaker, *Turnover Part II*, 33 Bankr. L. Letter No. 9, at 4-5. In the case of a vehicle in which the creditor holds a security interest, adequate protection may include a requirement that the debtor obtain appropriate insurance. If the value of a creditor’s security interest may diminish as a result of the debtor’s use of the property, adequate protection may also include cash payments to compensate a secured creditor for that diminution of value. 11 U.S.C. § 361(1).

In these ways, the Bankruptcy Code is careful to compensate the secured creditor for the loss of its possessory interest when the creditor is required to turn over possession of its collateral. Instead of possession, the secured creditor is entitled to adequate protection of all of its interests in property in which the estate also has an interest. *Whiting Pools*, 462 U.S. at 207 (“The Bankruptcy Code provides secured creditors various rights, including the right to adequate protection, and these rights replace the protection afforded by possession.”); see also Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part I): Origins and Evolution of the Turnover Power*, 33 Bankr. L. Letter No. 8, at 6 (Aug. 2013) (*Turnover Part I*).

In substance, § 542(a) of the Code therefore contemplates a trade. The secured creditor gives up possession, while the estate is required to provide adequate protection that fairly compensates the secured creditor for the loss of possession. A consequence of this structural protection for the rights of creditors is that a secured creditor's obligation to turn over estate property can become judicially enforceable only following a turnover proceeding. That proceeding will not only allow the bankruptcy court to rule on the debtor's entitlement to the property, but will also ensure that the secured creditor receives the adequate protection to which it is entitled in return for relinquishing possession of its collateral. Requiring such property to be turned over immediately after the bankruptcy petition is filed, by contrast, creates the risk that the secured creditor's collateral will be destroyed or damaged before the debtor has taken the necessary steps to protect the secured creditor's interest—an outcome that would frustrate the very purpose of adequate protection. *Hall*, 502 B.R. at 660-661; Brubaker, *Turnover Part II*, 33 Bankr. L. Letter No. 9, at 6-7.

In nonetheless mandating that very outcome, the rule adopted by the Seventh Circuit makes a hash of the Bankruptcy Code's structural protections for secured creditors and disregards established principles of statutory construction. If § 362(a)(3) itself requires immediate turnover of property in which the estate has an interest, § 542's turnover provision would be superfluous. *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 562 (1990) ("express[ing] a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment"). And if § 362(a)(3) requires a creditor to turn over property immediately after a bankruptcy filing or

face sanctions, §§ 542(a)'s and 363(e)'s carefully designed protections for creditors to assert defenses to turnover and secure adequate protection for their property rights before relinquishing possession would become meaningless. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988) (“Statutory construction ... is a holistic endeavor” in which a provision’s “meaning[] ... [should be] compatible with the rest of the law”); *id.* at 371-375 (rejecting reading of § 362 that “contradict[ed] the carefully drawn disposition of” other “provisions ... dealing with the rights of secured creditors”); *see also Mission*, 139 S. Ct. at 1663 (rejecting reading of Code’s executory-contract provision that would permit debtor effectively to “avoid” a pre-bankruptcy transfer of property under the contract free of the limitations on achieving that result under the Code’s “avoidance” provisions).

B. While Section 542 Imposes A Mandatory Duty To Turn Over, It Does Not Operate As An Injunction

Courts that have adopted the approach urged by the Debtors rely in part on the notion that § 542 is “self-executing,” compelling the creditor to turn over property “without condition or any further action” by the trustee or debtor to “commence a [turnover] proceeding or obtain a court order.” *In re Weber*, 719 F.3d 72, 79 (2d Cir. 2013); *In re Del Mission Ltd.*, 98 F.3d 1147, 1151 (9th Cir. 1996); *In re Knaus*, 889 F.2d 773, 775 (8th Cir. 1989). Because, on this view, a secured creditor’s “duty to turn over the property” “arises upon the filing of the bankruptcy petition,” these courts have concluded that § 542 works in conjunction with § 362(a)(3) to provide that a creditor’s “failure to fulfill this duty ... constitutes a prohibited attempt to exer-

cise control over property of the estate.” *Knaus*, 889 F.2d at 775; Pet. App. 10a-12a.

That is wrong. “Even if the turnover provision were ‘self-executing,’ ... there is still no textual link between § 542 and § 362.” *Cowen*, 849 F.3d at 950.

Moreover, § 542 is not “self-executing.” Courts adopting a contrary view cite § 542’s language providing that a creditor “shall” deliver property in which the estate has an interest to the trustee. Pet. App.11a; *Thompson*, 566 F.3d at 704; *Del Mission*, 98 F.3d at 1151. But those courts disregard the rest of the statutory language placing “explicit limitations on the reach of § 542(a).” *Whiting Pools*, 462 U.S. at 206 & n.12. “[O]n its face, the turnover provision includes numerous explicit conditions that must be satisfied before a property is subject to turnover.” *Denby-Peterson*, 941 F.3d at 129. Those requirements make it evident that the turnover provision cannot be “self-effectuating,” but “[i]nstead[] ... is effectuated by virtue of judicial action.” *Id.* at 130. And “[i]t is only after the bankruptcy court determines whether those requirements are met that the debtor’s right to turnover is triggered.” *Id.* at 128; *Hall*, 502 B.R. at 655-664; Brubaker, *Turnover Part II*, 33 Bankr. L. Letter No. 9, at 4-5; Brubaker, *Turnover Part I*, 33 Bankr. L. Letter No. 8, at 4-6.

Thus, while § 542 does impose a duty of turnover that is mandatory when the statute’s conditions for turnover are met, that duty is enforced like any other statutory obligation, through a judicial proceeding to obtain a court order directing compliance. If the court concludes that an order directing turnover is warranted, and the creditor refuses to comply, the court may exercise the ordinary power of civil contempt to enforce its order. 11 U.S.C. § 105(a) (“The court may is-

sue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”); *Taggart*, 139 S. Ct. at 1801 (“Under traditional principles of equity practice, courts have long imposed civil contempt sanctions to ‘coerce the defendant into compliance’ with [the court’s] injunction”); *Cowen*, 849 F.3d at 950.⁷

Indeed, statutes are not ordinarily construed as injunctive commands punishable by contempt. For example, the Freedom of Information Act (“FOIA”) provides, similarly to § 542(a), that government agencies “shall” make public specified information, subject to statutory exceptions. 5 U.S.C. § 552(a). But agencies are entitled to assert defenses to disclosure and may withhold information pending a court order determining whether disclosure is required. *See, e.g., U.S. Dep’t of Justice v. Tax Analysis*, 492 U.S. 136, 142 (1989); *Kissinger v. Reporters Comm. for Freedom of the Press*, 45 U.S. 136, 150 (1980).

When Congress intends a statute to operate as an injunction, it uses explicit injunctive language making that intent clear, as with the automatic stay. *See, e.g.,* 11 U.S.C. § 362(a) (petition “operates as a stay”); *see also id.* § 524(a)(2) (bankruptcy discharge “operates as an injunction”); *Taggart*, 139 S. Ct. at 1801 (“the statutes specifying that a discharge order ‘operates as an injunction’ ... bring with them the ‘old soil’ that has

⁷ *See also, e.g., International Union v. Bagwell*, 512 U.S. 821, 826-834 (1994) (discussing history of contempt power); *Ex parte Robinson*, 86 U.S. (19 Wall.) 505, 510-511 (1874) (“The power to punish for contempts is inherent in all courts” and “essential ... to the enforcement of the judgments, orders, and writs of the courts[.]”).

long governed how courts enforce injunctions”).⁸ But unlike the automatic stay, § 542(a) contains no such language. *Hall*, 502 B.R. at 656 (“§ 542(a) does not operate as a statutory injunction.”).

The Debtors contend that Congress could have inserted the phrase “after entry of a court order” in § 542(a) if it did not intend § 542(a) to be “self-executing.” Opp. 17-18. But the same could be said of many Code provisions. Section 548 provides that “[t]he trustee may avoid” certain pre-bankruptcy transfers as fraudulent transfers, with no mention of any requirement for a court order. 11 U.S.C. § 548(a)(1); *see also*, *e.g.*, §§ 544, 545, 547(b), 549(a). Yet a creditor is not obligated to turn over to the trustee immediately upon demand any property that the trustee seeks to avoid as a fraudulent transfer, in the absence of a judicial proceeding and order determining that the property was fraudulently transferred and must be returned.

Indeed, there is ample evidence in the legislative history confirming that Congress did not intend § 542(a) to be “self-executing.” In the same 1984 legislation that added § 362(a)(3)’s “exercise control” language, Congress enacted 28 U.S.C. § 157, which gave bankruptcy judges authority to “hear and determine ... core proceedings arising under title 11,” including “orders to turn over property of the estate.” *Id.* § 157(b)(1), (b)(2)(E); Pub. L. No. 98-353, § 104, 98 Stat.

⁸ *See also, e.g.* 15 U.S.C. § 8306(b)(4) (“filing of a petition” for certain relief under Wall Street Transparency and Accountability Act “shall operate as a stay of the order”); 18 U.S.C. § 3626(b), (e)(2) (“motion made” under Prison Litigation Reform Act to terminate prospective relief regarding prison conditions “shall operate as a stay” of such relief); 27 U.S.C. § 204(h) (“commencement of proceedings” under Federal Alcohol Administration Act “shall ... operate as a stay of the Secretary’s order”).

333, 336. The House Report for the original 1978 legislation similarly stated that the “[p]rocedure for determining whether an entity must turnover [sic] property of the estate” “will be dealt with by the Rules of Bankruptcy Procedure.” H.R. Rep. No. 95-595, at 293, 297 (1977). The Bankruptcy Rules provide that a turnover action must proceed by way of an adversary proceeding commenced by a complaint, Fed. R. Bankr. P. 7001(1), (7), which provides a creditor with the opportunity to assert defenses and its right to adequate protection.

Furthermore, as this Court recognized in *Whiting Pools*, § 542(a) codified “judicial precedent predating the Bankruptcy Code” under which “the bankruptcy court could order the turnover of collateral in the hands of a secured creditor.” 462 U.S. at 207-208 & n.16 (citing *Reconstruction Fin. Corp. v. Kaplan*, 185 F.2d 791, 796 (1st Cir. 1950)). Under that pre-Code precedent, turnover was a judicially developed procedure, derived from the bankruptcy court’s equitable power to protect its jurisdiction over the debtor’s property, in which the trustee or debtor-in-possession could petition the court for a turnover order. *Kaplan*, 185 F.2d at 794-797; see also *Maggio v. Zeitz*, 333 U.S. 56, 61-64 (1948); McGovern, *Aspects of the Turnover Proceeding in Bankruptcy*, 9 Fordham L. Rev. 313, 313-317 (1940).

Turnover under pre-Code law thus was not a “self-effectuating” obligation arising upon the bankruptcy filing, but rather relief obtained through a turnover order. *Denby-Peterson*, 941 F.3d at 130 n.77; *Hall*, 502 B.R. at 655-657; Brubaker, *Turnover Part I*, 33 Bankr. L. Letter No. 8, at 2-4; 2 *Collier on Bankruptcy* ¶¶ 23.10[1]-[4] (14th ed.). And as this Court observed in discussing § 542’s codification of the turnover power, “[n]othing in the legislative history evinces a congressional intent to depart from that practice.” *Whiting*

Pools, 462 U.S. at 208; *id.* at 207 & n.16; *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 150-155 (2d Cir. 1982) (analyzing legislative history and concluding “§ 542 ... was intended to codify *RFC v. Kaplan*”), *aff’d*, 462 U.S. 198 (1983). Section 542 thus “simply provides an express statutory basis for a bankruptcy court to enter an injunctive order compelling turnover of identified property in the possession of a third party.” Brubaker, *Turnover Part I*, 33 Bankr. L. Letter No. 8, at 4.

The Debtors accordingly misread *Whiting Pools* in contending that it holds § 542(a) to be “self-executing.” Opp. 20. In rejecting the argument that secured creditors are exempted from § 542(a)’s reach, the Court never suggested that the statute requires secured creditors to turn over property *immediately upon the filing*, in the absence of a court order. To the contrary, consistent with its discussion of § 542(a)’s historical roots, *Whiting Pools* stated that “[t]he issue before us is whether § 542(a) ... authorized the Bankruptcy Court to subject the IRS to a *turnover order* with respect to the seized property.” 462 U.S. at 199 (emphasis added); *see also id.* at 201-202 & n.7 (noting bankruptcy court conditioned turnover on the provision of adequate protection).

Accordingly, § 542(a) is not “self-executing.” It entitles creditors to assert defenses to turnover and to secure adequate protection of their interests in their collateral before being ordered to surrender it. The Seventh Circuit’s rule reading § 362(a)(3) to require turnover immediately upon the bankruptcy filing does serious damage to that statutory scheme.

C. Reading Section 362(a)(3) To Compel Immediate Turnover Of Property Is Inconsistent With This Court's Decision In *Strumpf*

The Seventh Circuit's decision is also inconsistent with this Court's decision in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995).

In *Strumpf*, this Court considered the interplay between the automatic stay and § 542(b) of the Bankruptcy Code. The question was whether a bank that places an administrative freeze on funds in a debtor's bank account during the bankruptcy case, to preserve the bank's ability to set off the bank's claim against the debtor against the funds in the account, violates the automatic stay. *See* 516 U.S. at 17. The Court held that such an administrative freeze did not violate the automatic stay. *Id.* at 21.

As the Court explained, the automatic stay does prohibit a creditor from effecting a setoff of mutually owing obligations. *See Strumpf*, 516 U.S. at 19; *see* 11 U.S.C. § 362(a)(7) (staying "the setoff of any debt owing to the debtor that arose before the commencement of the [bankruptcy] case ... against any claim against the debtor"). A creditor that would be entitled to setoff under common law outside bankruptcy must thus obtain relief from the stay to effect such a setoff once the debtor has sought bankruptcy protection.

The bank in *Strumpf* froze the debtor's bank account to permit it to seek stay relief so that it could exercise its setoff rights. The debtor argued that freezing the account was itself a stay violation, and that the bank was under an affirmative obligation to pay the funds in the account to the debtor immediately under § 542(b). That provision, which is very similar to § 542(a), requires an entity that owes a debt that is

property of the estate to pay that debt to the trustee. *See Strumpf*, 516 U.S. at 20; *see* 11 U.S.C. § 542(b).

Like § 542(a), however, § 542(b) permits the third party to assert certain defenses to payment. Specifically, § 542(b) provides that the trustee's right to demand payment does not apply "to the extent" that the party owing money to the estate is entitled to assert setoff as a defense to the estate's claim. This Court accordingly held that reading the automatic stay to require immediate payment of any debt to the estate would "eviscerate" the statutory exceptions to the duty to pay such debts. *Strumpf*, 516 U.S. at 20.

So too here. *Strumpf* refused to "give § 362(a)(3) ... an interpretation that would proscribe what § 542(b)'s exception ... [was] plainly intended to permit." 516 U.S. at 21 (quotation marks and original brackets omitted). Likewise, § 362(a)(3) should not be interpreted to proscribe what § 542(a) would otherwise permit: a creditor's assertion of defenses to turnover and its right to adequate protection before it surrenders its collateral. The Seventh Circuit's contrary reading of § 362(a)(3) similarly "eviscerate[s]" the statutory protections associated with the turnover obligation.

III. THE "POLICY CONSIDERATIONS" UNDERLYING THE SEVENTH CIRCUIT'S RULE ARE UNPERSUASIVE

As the Tenth Circuit noted in *Cowen*, the "majority rule" adopted by the Seventh Circuit seems driven more by "policy considerations" than by faithful adherence to the statutory text. 849 F.3d at 949-950. Of course, where—as here—the text of the statute is plain, there is no reason for a court to pass judgment on the wisdom of Congress's policy choices. But, in any

event, these “policy considerations” are unpersuasive even on their own terms.

There is no dispute that a trustee or debtor in possession is entitled to recover property in which the estate has an interest, such as a repossessed or impounded car, absent a valid defense to turnover. The question presented here is only *when* turnover must occur: immediately upon the filing of the bankruptcy petition, or after resolution of any disputes and the provision of adequate protection in a turnover proceeding under § 542(a). Indeed, the Debtors have acknowledged as much, asserting that “[w]hat is at stake here ... is whether [debtors] must incur filing costs and legal fees to obtain court orders requiring creditors” to turn over property, or whether they may be excused from that obligation because that would promote bankruptcy’s “fresh start” policy. Opp. 6.

Reading §§ 362 and 542 in accordance with their text and purpose does not threaten debtors’ ability to reorganize or obtain a fresh start. Debtors must simply file turnover proceedings—which courts can and frequently do hear on short notice and decide expeditiously—and can recover their property promptly thereafter. In cases in which the debtor’s right to turnover is clear and the debtor can provide adequate protection, the creditor is likely simply to turn over the property without the need for a hearing. And while it may be true that it would be better for debtors if they were relieved of the obligation to file such proceedings (and creditors were thereby stripped of their statutory protections), that does not by itself mean the Bankruptcy Code provides for it. As this Court explained in *Mission*, while the “Code of course aims to make reorganizations possible[] ... it does not permit anything and everything that might advance that goal.” 139 S. Ct. at 1665.

CONCLUSION

The judgment of the Seventh Circuit should be reversed.

Respectfully submitted.

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STATUTORY ADDENDUM

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STATUTORY ADDENDUM

11 U.S.C. § 361

§ 361. Adequate protection

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

- (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
- (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
- (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

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11 U.S.C. § 362**§ 362. Automatic stay**

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
- (3) 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;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

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(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a)—

(A) of the commencement or continuation of a civil action or proceeding—

(i) for the establishment of paternity;

(ii) for the establishment or modification of an order for domestic support obligations;

(iii) concerning child custody or visitation;

(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or

(v) regarding domestic violence;

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(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law, as specified in section 466(a)(16) of the Social Security Act;

(E) of the reporting of overdue support owed by a parent to any consumer reporting agency as specified in section 466(a)(7) of the Social Security Act;

(F) of the interception of a tax refund, as specified in sections 464 and 466(a)(3) of the Social Security Act or under an analogous State law; or

(G) of the enforcement of a medical obligation, as specified under title IV of the Social Security Act;

(3) under subsection (a) of this section, of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

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(4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction, opened for signature on January 13, 1993, to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power;

[(5) Repealed. Pub.L. 105-277, Div. I, Title VI, § 603(1), Oct. 21, 1998, 112 Stat. 2681-886]

(6) under subsection (a) of this section, of the exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency of any contractual right (as defined in section 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any commodity contract, forward contract or securities contract, or of any contractual right (as defined in section 555 or 556) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such contracts, including any master agreement for such contracts;

(7) under subsection (a) of this section, of the exercise by a repo participant or financial participant of any contractual right (as defined in section 559) under any security agreement or arrangement or oth-

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er credit enhancement forming a part of or related to any repurchase agreement, or of any contractual right (as defined in section 559) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements;

(8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;

(9) under subsection (a), of—

(A) an audit by a governmental unit to determine tax liability;

(B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;

(C) a demand for tax returns; or

(D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment (but any tax lien that would otherwise attach to property of the estate by reason of such an assessment shall not take effect unless such tax is a debt of the debtor that will not be discharged in the case and such property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor).

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(10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property;

(11) under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument;

(12) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Transportation under section 31325 of title 46 (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage, or a security interest in or relating to a vessel or vessel under construction, held by the Secretary of Transportation under chapter 537 of title 46 or section 109(h) of title 49, or under applicable State law;

(13) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Commerce under section 31325 of title 46 (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage in a vessel or a mortgage, deed of

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trust, or other security interest in a fishing facility held by the Secretary of Commerce under chapter 537 of title 46;

(14) under subsection (a) of this section, of any action by an accrediting agency regarding the accreditation status of the debtor as an educational institution;

(15) under subsection (a) of this section, of any action by a State licensing body regarding the licensure of the debtor as an educational institution;

(16) under subsection (a) of this section, of any action by a guaranty agency, as defined in section 435(j) of the Higher Education Act of 1965 or the Secretary of Education regarding the eligibility of the debtor to participate in programs authorized under such Act;

(17) under subsection (a) of this section, of the exercise by a swap participant or financial participant of any contractual right (as defined in section 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined in section 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements;

(18) under subsection (a) of the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit, if such tax or assessment comes due after the date of the filing of the petition;

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(19) under subsection (a), of withholding of income from a debtor's wages and collection of amounts withheld, under the debtor's agreement authorizing that withholding and collection for the benefit of a pension, profit-sharing, stock bonus, or other plan established under section 401, 403, 408, 408A, 414, 457, or 501(c) of the Internal Revenue Code of 1986, that is sponsored by the employer of the debtor, or an affiliate, successor, or predecessor of such employer—

(A) to the extent that the amounts withheld and collected are used solely for payments relating to a loan from a plan under section 408(b)(1) of the Employee Retirement Income Security Act of 1974 or is subject to section 72(p) of the Internal Revenue Code of 1986; or

(B) a loan from a thrift savings plan permitted under subchapter III of chapter 84 of title 5, that satisfies the requirements of section 8433(g) of such title;

but nothing in this paragraph may be construed to provide that any loan made under a governmental plan under section 414(d), or a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or a debt under this title;

(20) under subsection (a), of any act to enforce any lien against or security interest in real property following entry of the order under subsection (d)(4) as to such real property in any prior case under this title, for a period of 2 years after the date of the entry of such an order, except that the debtor, in a subsequent case under this title, may move for relief from such order based upon changed circum-

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stances or for other good cause shown, after notice and a hearing;

(21) under subsection (a), of any act to enforce any lien against or security interest in real property—

(A) if the debtor is ineligible under section 109(g) to be a debtor in a case under this title; or

(B) if the case under this title was filed in violation of a bankruptcy court order in a prior case under this title prohibiting the debtor from being a debtor in another case under this title;

(22) subject to subsection (l), under subsection (a)(3), of the continuation of any eviction, unlawful detainer action, or similar proceeding by a lessor against a debtor involving residential property in which the debtor resides as a tenant under a lease or rental agreement and with respect to which the lessor has obtained before the date of the filing of the bankruptcy petition, a judgment for possession of such property against the debtor;

(23) subject to subsection (m), under subsection (a)(3), of an eviction action that seeks possession of the residential property in which the debtor resides as a tenant under a lease or rental agreement based on endangerment of such property or the illegal use of controlled substances on such property, but only if the lessor files with the court, and serves upon the debtor, a certification under penalty of perjury that such an eviction action has been filed, or that the debtor, during the 30-day period preceding the date of the filing of the certification, has endangered property or illegally used or allowed to be used a controlled substance on the property;

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(24) under subsection (a), of any transfer that is not avoidable under section 544 and that is not avoidable under section 549;

(25) under subsection (a), of—

(A) the commencement or continuation of an investigation or action by a securities self regulatory organization to enforce such organization's regulatory power;

(B) the enforcement of an order or decision, other than for monetary sanctions, obtained in an action by such securities self regulatory organization to enforce such organization's regulatory power; or

(C) any act taken by such securities self regulatory organization to delist, delete, or refuse to permit quotation of any stock that does not meet applicable regulatory requirements;

(26) under subsection (a), of the setoff under applicable nonbankruptcy law of an income tax refund, by a governmental unit, with respect to a taxable period that ended before the date of the order for relief against an income tax liability for a taxable period that also ended before the date of the order for relief, except that in any case in which the setoff of an income tax refund is not permitted under applicable nonbankruptcy law because of a pending action to determine the amount or legality of a tax liability, the governmental unit may hold the refund pending the resolution of the action, unless the court, on the motion of the trustee and after notice and a hearing, grants the taxing authority adequate protection (within the meaning of section 361) for

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the secured claim of such authority in the setoff under section 506(a);

(27) under subsection (a) of this section, of the exercise by a master netting agreement participant of any contractual right (as defined in section 555, 556, 559, or 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any master netting agreement, or of any contractual right (as defined in section 555, 556, 559, or 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such master netting agreements to the extent that such participant is eligible to exercise such rights under paragraph (6), (7), or (17) for each individual contract covered by the master netting agreement in issue; and

(28) under subsection (a), of the exclusion by the Secretary of Health and Human Services of the debtor from participation in the medicare program or any other Federal health care program (as defined in section 1128B(f) of the Social Security Act pursuant to title XI or XVIII of such Act).

The provisions of paragraphs (12) and (13) of this subsection shall apply with respect to any such petition filed on or before December 31, 1989.

(c) Except as provided in subsections (d), (e), (f), and (h) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate;

(2) the stay of any other act under subsection (a) of this section continues until the earliest of—

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- (A) the time the case is closed;
 - (B) the time the case is dismissed; or
 - (C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied;
- (3) if a single or joint case is filed by or against a debtor who is an individual in a case under chapter 7, 11, or 13, and if a single or joint case of the debtor was pending within the preceding 1-year period but was dismissed, other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b)—
- (A) the stay under subsection (a) with respect to any action taken with respect to a debt or property securing such debt or with respect to any lease shall terminate with respect to the debtor on the 30th day after the filing of the later case;
 - (B) on the motion of a party in interest for continuation of the automatic stay and upon notice and a hearing, the court may extend the stay in particular cases as to any or all creditors (subject to such conditions or limitations as the court may then impose) after notice and a hearing completed before the expiration of the 30-day period only if the party in interest demonstrates that the filing of the later case is in good faith as to the creditors to be stayed; and
 - (C) for purposes of subparagraph (B), a case is presumptively filed not in good faith (but such presumption may be rebutted by clear and convincing evidence to the contrary)—

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(i) as to all creditors, if—

(I) more than 1 previous case under any of chapters 7, 11, and 13 in which the individual was a debtor was pending within the preceding 1-year period;

(II) a previous case under any of chapters 7, 11, and 13 in which the individual was a debtor was dismissed within such 1-year period, after the debtor failed to—

(aa) file or amend the petition or other documents as required by this title or the court without substantial excuse (but mere inadvertence or negligence shall not be a substantial excuse unless the dismissal was caused by the negligence of the debtor's attorney);

(bb) provide adequate protection as ordered by the court; or

(cc) perform the terms of a plan confirmed by the court; or

(III) there has not been a substantial change in the financial or personal affairs of the debtor since the dismissal of the next most previous case under chapter 7, 11, or 13 or any other reason to conclude that the later case will be concluded—

(aa) if a case under chapter 7, with a discharge; or

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(bb) if a case under chapter 11 or 13, with a confirmed plan that will be fully performed; and

(ii) as to any creditor that commenced an action under subsection (d) in a previous case in which the individual was a debtor if, as of the date of dismissal of such case, that action was still pending or had been resolved by terminating, conditioning, or limiting the stay as to actions of such creditor; and

(4)(A)(i) if a single or joint case is filed by or against a debtor who is an individual under this title, and if 2 or more single or joint cases of the debtor were pending within the previous year but were dismissed, other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b), the stay under subsection (a) shall not go into effect upon the filing of the later case; and

(ii) on request of a party in interest, the court shall promptly enter an order confirming that no stay is in effect;

(B) if, within 30 days after the filing of the later case, a party in interest requests the court may order the stay to take effect in the case as to any or all creditors (subject to such conditions or limitations as the court may impose), after notice and a hearing, only if the party in interest demonstrates that the filing of the later case is in good faith as to the creditors to be stayed;

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(C) a stay imposed under subparagraph (B) shall be effective on the date of the entry of the order allowing the stay to go into effect; and

(D) for purposes of subparagraph (B), a case is presumptively filed not in good faith (but such presumption may be rebutted by clear and convincing evidence to the contrary)—

(i) as to all creditors if—

(I) 2 or more previous cases under this title in which the individual was a debtor were pending within the 1-year period;

(II) a previous case under this title in which the individual was a debtor was dismissed within the time period stated in this paragraph after the debtor failed to file or amend the petition or other documents as **required** by this title or the court without substantial excuse (but mere inadvertence or negligence shall not be substantial excuse unless the dismissal was caused by the negligence of the debtor's attorney), failed to provide adequate protection as ordered by the court, or failed to perform the terms of a plan confirmed by the court; or

(III) there has not been a substantial change in the financial or personal affairs of the debtor since the dismissal of the next most previous case under this title, or any other reason to conclude that the later case will not be concluded, if a case under chapter 7, with a discharge, and if a case under chapter 11 or 13, with a confirmed plan that will be fully performed; or

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(ii) as to any creditor that commenced an action under subsection (d) in a previous case in which the individual was a debtor if, as of the date of dismissal of such case, such action was still pending or had been resolved by terminating, conditioning, or limiting the stay as to such action of such creditor.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization;

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later—

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(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments that—

(i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and

(ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; or

(4) with respect to a stay of an act against real property under subsection (a), by a creditor whose claim is secured by an interest in such real property, if the court finds that the filing of the petition was part of a scheme to delay, hinder, or defraud creditors that involved either—

(A) transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or

(B) multiple bankruptcy filings affecting such real property.

If recorded in compliance with applicable State laws governing notices of interests or liens in real property,

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an order entered under paragraph (4) shall be binding in any other case under this title purporting to affect such real property filed not later than 2 years after the date of the entry of such order by the court, except that a debtor in a subsequent case under this title may move for relief from such order based upon changed circumstances or for good cause shown, after notice and a hearing. Any Federal, State, or local governmental unit that accepts notices of interests or liens in real property shall accept any certified copy of an order described in this subsection for indexing and recording.

(e)(1) Thirty days after a request under subsection (d) of this section for relief from the stay of any act against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination under subsection (d) of this section. A hearing under this subsection may be a preliminary hearing, or may be consolidated with the final hearing under subsection (d) of this section. The court shall order such stay continued in effect pending the conclusion of the final hearing under subsection (d) of this section if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing. If the hearing under this subsection is a preliminary hearing, then such final hearing shall be concluded not later than thirty days after the conclusion of such preliminary hearing, unless the 30-day period is extended with the consent of the parties in interest or for a specific time which the court finds is required by compelling circumstances.

(2) Notwithstanding paragraph (1), in a case under chapter 7, 11, or 13 in which the debtor is an individual,

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the stay under subsection (a) shall terminate on the date that is 60 days after a request is made by a party in interest under subsection (d), unless—

(A) a final decision is rendered by the court during the 60-day period beginning on the date of the request; or

(B) such 60-day period is extended—

(i) by agreement of all parties in interest; or

(ii) by the court for such specific period of time as the court finds is required for good cause, as described in findings made by the court.

(f) Upon request of a party in interest, the court, with or without a hearing, shall grant such relief from the stay provided under subsection (a) of this section as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) or (e) of this section.

(g) In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section—

(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and

(2) the party opposing such relief has the burden of proof on all other issues.

(h)(1) In a case in which the debtor is an individual, the stay provided by subsection (a) is terminated with respect to personal property of the estate or of the debtor securing in whole or in part a claim, or subject to an unexpired lease, and such personal property shall no long-

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er be property of the estate if the debtor fails within the applicable time set by section 521(a)(2)—

(A) to file timely any statement of intention required under section 521(a)(2) with respect to such personal property or to indicate in such statement that the debtor will either surrender such personal property or retain it and, if retaining such personal property, either redeem such personal property pursuant to section 722, enter into an agreement of the kind specified in section 524(c) applicable to the debt secured by such personal property, or assume such unexpired lease pursuant to section 365(p) if the trustee does not do so, as applicable; and

(B) to take timely the action specified in such statement, as it may be amended before expiration of the period for taking action, unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms.

(2) Paragraph (1) does not apply if the court determines, on the motion of the trustee filed before the expiration of the applicable time set by section 521(a)(2), after notice and a hearing, that such personal property is of consequential value or benefit to the estate, and orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee. If the court does not so determine, the stay provided by subsection (a) shall terminate upon the conclusion of the hearing on the motion.

(i) If a case commenced under chapter 7, 11, or 13 is dismissed due to the creation of a debt repayment plan, for purposes of subsection (c)(3), any subsequent case

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commenced by the debtor under any such chapter shall not be presumed to be filed not in good faith.

(j) On request of a party in interest, the court shall issue an order under subsection (c) confirming that the automatic stay has been terminated.

(k)(1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

(2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

(l)(1) Except as otherwise provided in this subsection, subsection (b)(22) shall apply on the date that is 30 days after the date on which the bankruptcy petition is filed, if the debtor files with the petition and serves upon the lessor a certification under penalty of perjury that—

(A) under nonbankruptcy law applicable in the jurisdiction, there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession, after that judgment for possession was entered; and

(B) the debtor (or an adult dependent of the debtor) has deposited with the clerk of the court, any rent that would become due during the 30-day period after the filing of the bankruptcy petition.

(2) If, within the 30-day period after the filing of the bankruptcy petition, the debtor (or an adult dependent

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of the debtor) complies with paragraph (1) and files with the court and serves upon the lessor a further certification under penalty of perjury that the debtor (or an adult dependent of the debtor) has cured, under nonbankruptcy law applicable in the jurisdiction, the entire monetary default that gave rise to the judgment under which possession is sought by the lessor, subsection (b)(22) shall not apply, unless ordered to apply by the court under paragraph (3).

(3)(A) If the lessor files an objection to any certification filed by the debtor under paragraph (1) or (2), and serves such objection upon the debtor, the court shall hold a hearing within 10 days after the filing and service of such objection to determine if the certification filed by the debtor under paragraph (1) or (2) is true.

(B) If the court upholds the objection of the lessor filed under subparagraph (A)—

(i) subsection (b)(22) shall apply immediately and relief from the stay provided under subsection (a)(3) shall not be required to enable the lessor to complete the process to recover full possession of the property; and

(ii) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the court's order upholding the lessor's objection.

(4) If a debtor, in accordance with paragraph (5), indicates on the petition that there was a judgment for possession of the residential rental property in which the debtor resides and does not file a certification under paragraph (1) or (2)—

(A) subsection (b)(22) shall apply immediately upon failure to file such certification, and relief from the stay provided under subsection (a)(3) shall not be

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required to enable the lessor to complete the process to recover full possession of the property; and

(B) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the docket indicating the absence of a filed certification and the applicability of the exception to the stay under subsection (b)(22).

(5)(A) Where a judgment for possession of residential property in which the debtor resides as a tenant under a lease or rental agreement has been obtained by the lessor, the debtor shall so indicate on the bankruptcy petition and shall provide the name and address of the lessor that obtained that pre-petition judgment on the petition and on any certification filed under this subsection.

(B) The form of certification filed with the petition, as specified in this subsection, shall provide for the debtor to certify, and the debtor shall certify—

(i) whether a judgment for possession of residential rental housing in which the debtor resides has been obtained against the debtor before the date of the filing of the petition; and

(ii) whether the debtor is claiming under paragraph (1) that under nonbankruptcy law applicable in the jurisdiction, there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession, after that judgment of possession was entered, and has made the appropriate deposit with the court.

(C) The standard forms (electronic and otherwise) used in a bankruptcy proceeding shall be amended to reflect the requirements of this subsection.

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(D) The clerk of the court shall arrange for the prompt transmittal of the rent deposited in accordance with paragraph (1)(B) to the lessor.

(m)(1) Except as otherwise provided in this subsection, subsection (b)(23) shall apply on the date that is 15 days after the date on which the lessor files and serves a certification described in subsection (b)(23).

(2)(A) If the debtor files with the court an objection to the truth or legal sufficiency of the certification described in subsection (b)(23) and serves such objection upon the lessor, subsection (b)(23) shall not apply, unless ordered to apply by the court under this subsection.

(B) If the debtor files and serves the objection under subparagraph (A), the court shall hold a hearing within 10 days after the filing and service of such objection to determine if the situation giving rise to the lessor's certification under paragraph (1) existed or has been remedied.

(C) If the debtor can demonstrate to the satisfaction of the court that the situation giving rise to the lessor's certification under paragraph (1) did not exist or has been remedied, the stay provided under subsection (a)(3) shall remain in effect until the termination of the stay under this section.

(D) If the debtor cannot demonstrate to the satisfaction of the court that the situation giving rise to the lessor's certification under paragraph (1) did not exist or has been remedied—

(i) relief from the stay provided under subsection (a)(3) shall not be required to enable the lessor to proceed with the eviction; and

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(ii) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the court's order upholding the lessor's certification.

(3) If the debtor fails to file, within 15 days, an objection under paragraph (2)(A)—

(A) subsection (b)(23) shall apply immediately upon such failure and relief from the stay provided under subsection (a)(3) shall not be required to enable the lessor to complete the process to recover full possession of the property; and

(B) the clerk of the court shall immediately serve upon the lessor and the debtor a certified copy of the docket indicating such failure.

(n)(1) Except as provided in paragraph (2), subsection (a) does not apply in a case in which the debtor—

(A) is a debtor in a small business case pending at the time the petition is filed;

(B) was a debtor in a small business case that was dismissed for any reason by an order that became final in the 2-year period ending on the date of the order for relief entered with respect to the petition;

(C) was a debtor in a small business case in which a plan was confirmed in the 2-year period ending on the date of the order for relief entered with respect to the petition; or

(D) is an entity that has acquired substantially all of the assets or business of a small business debtor described in subparagraph (A), (B), or (C), unless such entity establishes by a preponderance of the evidence that such entity acquired substantially all of the assets or business of such small business

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debtor in good faith and not for the purpose of evading this paragraph.

(2) Paragraph (1) does not apply—

(A) to an involuntary case involving no collusion by the debtor with creditors; or

(B) to the filing of a petition if—

(i) the debtor proves by a preponderance of the evidence that the filing of the petition resulted from circumstances beyond the control of the debtor not foreseeable at the time the case then pending was filed; and

(ii) it is more likely than not that the court will confirm a feasible plan, but not a liquidating plan, within a reasonable period of time.

(o) The exercise of rights not subject to the stay arising under subsection (a) pursuant to paragraph (6), (7), (17), or (27) of subsection (b) shall not be stayed by any order of a court or administrative agency in any proceeding under this title.

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11 U.S.C. § 363**§ 363. Use, sale, or lease of property**

(a) In this section, “cash collateral” means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

(b)(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—

(A) such sale or such lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

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(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable non-bankruptcy law.

(2) If notification is required under subsection (a) of section 7A of the Clayton Act in the case of a transaction under this subsection, then—

(A) notwithstanding subsection (a) of such section, the notification required by such subsection to be given by the debtor shall be given by the trustee; and

(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the 15th day after the date of the receipt, by the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, of the notification required under such subsection (a), unless such waiting period is extended—

(i) pursuant to subsection (e)(2) of such section, in the same manner as such subsection (e)(2) applies to a cash tender offer;

(ii) pursuant to subsection (g)(2) of such section; or

(iii) by the court after notice and a hearing.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course

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of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section—

(1) in the case of a debtor that is a corporation or trust that is not a moneyed business, commercial corporation, or trust, only in accordance with non-bankruptcy law applicable to the transfer of prop-

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erty by a debtor that is such a corporation or trust;
and

(2) only to the extent not inconsistent with any relief granted under subsection (c), (d), (e), or (f) of section 362.

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

(g) Notwithstanding subsection (f) of this section, the trustee may sell property under subsection (b) or (c) of

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this section free and clear of any vested or contingent right in the nature of dower or curtesy.

(h) Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

(i) Before the consummation of a sale of property to which subsection (g) or (h) of this section applies, or of property of the estate that was community property of the debtor and the debtor's spouse immediately before the commencement of the case, the debtor's spouse, or a co-owner of such property, as the case may be, may purchase such property at the price at which such sale is to be consummated.

(j) After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the

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debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

(l) Subject to the provisions of section 365, the trustee may use, sell, or lease property under subsection (b) or (c) of this section, or a plan under chapter 11, 12, or 13 of this title may provide for the use, sale, or lease of property, notwithstanding any provision in a contract, a lease, or applicable law that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title concerning the debtor, or on the appointment of or the taking possession by a trustee in a case under this title or a custodian, and that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in such property.

(m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

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(n) The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

(o) Notwithstanding subsection (f), if a person purchases any interest in a consumer credit transaction that is subject to the Truth in Lending Act or any interest in a consumer credit contract (as defined in section 433.1 of title 16 of the Code of Federal Regulations (January 1, 2004), as amended from time to time), and if such interest is purchased through a sale under this section, then such person shall remain subject to all claims and defenses that are related to such consumer credit transaction or such consumer credit contract, to the same extent as such person would be subject to such claims and defenses of the consumer had such interest been purchased at a sale not under this section.

(p) In any hearing under this section—

- (1) the trustee has the burden of proof on the issue of adequate protection; and
- (2) the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest.

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11 U.S.C. § 541**§ 541. Property of the estate**

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes

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entitled to acquire within 180 days after such date—

- (A) by bequest, devise, or inheritance;
- (B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or
- (C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

- (1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;
- (2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case;
- (3) any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.), or any accreditation status or State licensure of the debtor as an educational institution;

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(4) any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—

(A)(i) the debtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement or any written agreement directly related to a farmout agreement; and

(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 544(a)(3) of this title; or

(B)(i) the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and

(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 542 of this title;

(5) funds placed in an education individual retirement account (as defined in section 530(b)(1) of the Internal Revenue Code of 1986) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of such account was a child, stepchild, grandchild, or step-grandchild of the debtor for the taxable year for which funds were placed in such account;

(B) only to the extent that such funds—

(i) are not pledged or promised to any entity in connection with any extension of credit; and

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(ii) are not excess contributions (as described in section 4973(e) of the Internal Revenue Code of 1986); and

(C) in the case of funds placed in all such accounts having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed \$6,825¹;

(6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;

(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(6) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and

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(C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed \$6,825¹;

(7) any amount—

(A) withheld by an employer from the wages of employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions—

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(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title;

(8) subject to subchapter III of chapter 5, any interest of the debtor in property where the debtor pledged or sold tangible personal property (other than securities or written or printed evidences of indebtedness or title) as collateral for a loan or advance of money given by a person licensed under law to make such loans or advances, where—

(A) the tangible personal property is in the possession of the pledgee or transferee;

(B) the debtor has no obligation to repay the money, redeem the collateral, or buy back the property at a stipulated price; and

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(C) neither the debtor nor the trustee have exercised any right to redeem provided under the contract or State law, in a timely manner as provided under State law and section 108(b);

(9) any interest in cash or cash equivalents that constitute proceeds of a sale by the debtor of a money order that is made—

(A) on or after the date that is 14 days prior to the date on which the petition is filed; and

(B) under an agreement with a money order issuer that prohibits the commingling of such proceeds with property of the debtor (notwithstanding that, contrary to the agreement, the proceeds may have been commingled with property of the debtor),

unless the money order issuer had not taken action, prior to the filing of the petition, to require compliance with the prohibition; or

(10) funds placed in an account of a qualified ABLE program (as defined in section 529A(b) of the Internal Revenue Code of 1986) not later than 365 days before the date of the filing of the petition in a case under this title, but—

(A) only if the designated beneficiary of such account was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were placed in such account;

(B) only to the extent that such funds—

(i) are not pledged or promised to any entity in connection with any extension of credit; and

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(ii) are not excess contributions (as described in section 4973(h) of the Internal Revenue Code of 1986); and

(C) in the case of funds placed in all such accounts having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed \$6,825¹.

Paragraph (4) shall not be construed to exclude from the estate any consideration the debtor retains, receives, or is entitled to receive for transferring an interest in liquid or gaseous hydrocarbons pursuant to a farmout agreement.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

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(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

(e) In determining whether any of the relationships specified in paragraph (5)(A) or (6)(A) of subsection (b) exists, a legally adopted child of an individual (and a child who is a member of an individual's household, if placed with such individual by an authorized placement agency for legal adoption by such individual), or a foster child of an individual (if such child has as the child's principal place of abode the home of the debtor and is a member of the debtor's household) shall be treated as a child of such individual by blood.

(f) Notwithstanding any other provision of this title, property that is held by a debtor that is a corporation described in section 501(c)(3) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title.

¹ Dollar amount as adjusted by the Judicial Conference of the United States. See Adjustment of Dollar Amounts notes set out under this section and 11 U.S.C.A. § 104.

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11 U.S.C. § 542**§ 542. Turnover of property to the estate**

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

(b) Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

(c) Except as provided in section 362(a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith and other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

(d) A life insurance company may transfer property of the estate or property of the debtor to such company in good faith, with the same effect with respect to such company as if the case under this title concerning the debtor had not been commenced, if such transfer is to

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pay a premium or to carry out a nonforfeiture insurance option, and is required to be made automatically, under a life insurance contract with such company that was entered into before the date of the filing of the petition and that is property of the estate.

(e) Subject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs, to turn over or disclose such recorded information to the trustee.

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Federal Rule of Bankruptcy Procedure 7001

An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings:

(1) a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee, or a proceeding under §554(b) or §725 of the Code, Rule 2017, or Rule 6002;

(2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, but not a proceeding under Rule 3012 or Rule 4003(d);

(3) a proceeding to obtain approval under §363(h) for the sale of both the interest of the estate and of a co-owner in property;

(4) a proceeding to object to or revoke a discharge, other than an objection to discharge under §§727(a)(8), 1 (a)(9), or 1328(f);

(5) a proceeding to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan;

(6) a proceeding to determine the dischargeability of a debt;

(7) a proceeding to obtain an injunction or other equitable relief, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for the relief;

(8) a proceeding to subordinate any allowed claim or interest, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for subordination;

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(9) a proceeding to obtain a declaratory judgment relating to any of the foregoing; or

(10) a proceeding to determine a claim or cause of action removed under 28 U.S.C. §1452.

No. 19-357

IN THE
Supreme Court of the United States

CITY OF CHICAGO,

Petitioner,

v.

ROBBIN L. FULTON,
GEORGE PEAKE, AND TIMOTHY SHANNON,

Respondents.

On Writ of Certiorari To The
United States Court Of Appeals
For The Seventh Circuit

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QUESTION PRESENTED

Whether creditors who seized property of a Chapter 13 debtor before the debtor's bankruptcy case was filed are prohibited from refusing to return the property to the debtor by Section 362(a)(3) of the Bankruptcy Code, 11 U.S.C. §362(a)(3), which stays “any act...to exercise control over property of the estate.”

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INTRODUCTION

Relying upon *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), the Seventh Circuit held that a creditor violates the automatic stay imposed by 11 U.S.C. §362(a)(3) when the creditor, without any substantive defense, refuses to comply with its obligation to deliver seized property of the bankruptcy estate to a Chapter 13 debtor. (Pet.App.10a-14a.) The City of Chicago, which seized the debtors' cars before they filed for bankruptcy and refused to return them, argues that this long-standing rule should be overturned. (Pet.Br.1-5.) The City's position is that the automatic stay only "stops" a creditor from "doing something" and thus, does not require the creditor to take any steps to ensure that the creditor is in compliance with §362(a)(3), such as by returning seized property to a debtor. (Pet.Br.17-21.)

But the text of §362(a)(3) refutes the City's position. *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) (courts should "begin...with the language of the statute itself"). Section 362(a)(3) stays, or to use the City's words, "stops" any act that "exercise[s] control over property of the estate." (Pet.Br.18.) The only way to "stop" the exercise of control over tangible estate property, like the debtors' cars, is to relinquish the property to the party the Bankruptcy Code designates to hold it, which here is the debtors. 11 U.S.C. §§1303, 1306(b).

Holding that §362(a)(3) requires a creditor to return property it has seized before a bankruptcy filing is not only faithful to its text, but also to the "fundamental

canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.” *Nat’l Ass’n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 666 (2007) (internal quotations, citations omitted); *accord Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997); *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 20 (1995). Bankruptcy Code §362(a)(3) works in tandem with §542(a) of the Code to serve the Code’s “overall statutory scheme” of securing the bankruptcy court’s “exercise of exclusive jurisdiction over *all* of the debtor’s property.” *Cent. Va. Cmty Coll. v. Katz*, 546 U.S. 356, 363-64 (2006) (emphasis added).

Bankruptcy Code §542(a) facilitates that exclusive jurisdiction by commanding that, except in circumstances all agree are inapplicable here, “an entity...in possession...of property” that “the trustee may use, sell, or lease under section 363” “*shall* deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.” 11 U.S.C. §542(a) (emphasis added). By using the term “shall,” Congress ensured that §542(a) made delivery of estate property at the start of a bankruptcy case “a mandate, not a liberty.” *Murphy v. Smith*, 138 S. Ct. 784, 787 (2018). As the leading treatise on bankruptcy explains, “[t]he failure of an entity in possession of estate property to turn over the property to the trustee would be a violation of section 362(a)(3) except as may otherwise be provided in section 542.” 3 Collier on Bankruptcy, ¶362.03[5] (16th ed.)

The City admits that its argument for reversal hinges on reading §362(a)(3) in a vacuum divorced from §542(a). The City argues that “[t]he question presented here is whether the automatic stay *by itself* requires creditors to turn over lawfully repossessed property...” (Pet.Br.2.) But, as the majority of courts have held, §362(a)(3) cannot and should not be read “by itself.” (Pet.App.11a (“[w]e observed that a majority of courts had found §542(a) worked in conjunction with §362(a))”.)¹ Section 362(a)(3) is part of a larger statutory scheme that imposes an obligation on creditors in possession of estate property to return that property to the debtor. 11 U.S.C. §542(a). Section 362(a)(3)’s text therefore must be read in the “broader context” of §542(a) and the Bankruptcy Code’s overall purpose of consolidating estate assets within the bankruptcy court’s exclusive jurisdiction to facilitate the debtor’s fresh start. *Robinson*, 519 U.S. at 341.

And it is within that “broader context” that the Seventh Circuit and the majority of other circuits have held that when a creditor fails to comply with its statutory obligation to deliver estate property to a debtor or trustee, the creditor acts to “exercise control”

¹ The Seventh Circuit had so ruled in *Thompson v. GMAC*, 566 F.3d 699, 702 (7th Cir. 2009). Other circuit court decisions with the same result include *In re Weber*, 719 F.3d 72, 79 (2d Cir. 2013); *In re Rozier*, 376 F.3d 1323, 1324 (11th Cir. 2004) (per curiam); *In re Del Mission Ltd.*, 98 F.3d 1147, 1151 (9th Cir. 1996); and *In re Knaus*, 889 F.2d 773, 775 (8th Cir. 1989). Two decisions of Bankruptcy Appellate Panels are in accord. See *In re Sharon*, 234 B.R. 676, 684-86 (B.A.P. 6th Cir. 1999); *In re Carrigg*, 216 B.R. 303, 305 (B.A.P. 1st Cir. 1998).

over estate property in violation of the automatic stay. (Pet.App.14a(citing cases).) The Seventh Circuit's judgment should be affirmed.

STATEMENT OF THE CASE

A. Statutory Background

When Congress enacted the Bankruptcy Reform Act of 1978, it made two major changes in the treatment of debtors' property in bankruptcy cases. Recognizing that the bankruptcy courts' exclusive jurisdiction over estate property is a "[c]ritical feature[] of every bankruptcy," *Katz*, 546 U.S. at 363, Congress expanded both the definition of estate property and the protections for such property.

Congress expanded the definition of estate property to include all "legal or equitable interests of the debtor in property" "wherever located and *by whomever held*." 11 U.S.C. §541(a)(1) (emphasis added); *see* Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, at 17, pt. II, at 30 (1973) ("Commission Report"). And consistent with this broadened definition, Congress added §542, entitled "Turnover of property to the estate" to the Bankruptcy Code, which had no analogue in the prior Bankruptcy Act. *See United States v. Whiting Pools, Inc.*, 674 F.2d 144, 152-53 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983). Section 542(a) generally commands:

[A]n entity...in possession, custody, or control, during the case, of property that

the trustee may use ... *shall deliver* to the trustee, and account for, such property....

11 U.S.C. §542(a) (emphasis added). In Chapter 11, 12, and 13 cases, Congress gave control over this assembled property to the debtor, rather than to the trustee. *See* 11 U.S.C. §§1107(a), 1203, 1207(b), 1303, 1306(b).

At the same time, the Bankruptcy Code also introduced the automatic stay, §362, to protect estate property. Section 362(a) is recognized as one of the “fundamental debtor protections provided by the bankruptcy laws” because, among other things, it “permits the debtor to attempt a repayment or reorganization plan.” H.R. Rep. No. 95-595, at 340 (1977). Relevant here, “[t]he stay bars ... [the] exercise of control over the debtor’s property” by unauthorized entities. *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, No. 18-938, 2020 WL 201023, at *4 (U.S. Jan. 14, 2020).

Finally, §363 allows a trustee in Chapter 7 cases or a debtor in Chapter 11, 12, and 13 cases to use estate property (except for cash and cash equivalents) in the ordinary course without the need for bankruptcy court approval. *See* 11 U.S.C. §§363(b), (c), 1303, 1304, 1306(b). If a creditor with a lien on estate property believes that a debtor’s use of estate property will reduce the value of its interest, the creditor may ask the bankruptcy court to condition the debtor’s use “as is necessary to provide adequate protection” of the creditor’s interest. *Id.* §363(e). If the automatic stay results in the debtor possessing property without providing adequate protection, the creditor must seek relief from the stay.

Id. §362(d). Procedurally, the burden is on the creditor to ask for adequate protection, *id.*; without a creditor request, neither §362 nor §363 impose any obligation on the debtor to offer adequate protection or to refrain from using the property. *Whiting Pools*, 462 U.S. at 204. Likewise, and contrary to the City’s argument (Pet.Br.8), nothing in §542(a) conditions the obligation to return estate property upon the debtor or trustee first providing adequate protection of the property at issue. *See* 11 U.S.C. §542(a); *Whiting Pools*, 462 U.S. at 203-04.

B. Respondents’ Chapter 13 Cases.

The Chicago Municipal Code permits the City to seize a car for unpaid parking tickets, failure to display a City tax sticker, and certain minor (“red-light”) moving violations. (Pet.App.3a,24a.) The City imposes a monetary penalty on the car and its owner, not the driver who received the ticket, and thus it is primarily a revenue-generating device. (Pet.App.25a.) In 2016, the City amended its Municipal Code to create a “possessory lien in favor of the City in the amount required to obtain release of the vehicle.” (Pet.App.4a (quoting Municipal Code of Chicago §9-92-080(f)).) Before 2016, the City released impounded cars to individuals after they filed Chapter 13 petitions, but after 2016 it stopped doing so. (Pet.App.4a,24a.)

The four cases at issue here involve debtors who filed Chapter 13 petitions after the City seized their vehicles. (Pet.App.2a-3a.) In each case, the City refused to return the debtor’s car notwithstanding the bankruptcy filing. (*Id.*)

1. *Robbin Fulton*. Robbin Fulton is the single mother of a pre-school-aged daughter; at the time of her bankruptcy filing, she worked at a Chicago area hospital. (Pet.App.4a; 18-02860 (Bankr. N.D. Ill.) (“FultonDkt.”) Dkt.1,Sch.I.) Ms. Fulton used her car, a 2015 Kia Soul, “to commute to work, transport her young daughter to day care, and care for her elderly parents on weekends.” (Pet.App.4a.) On Christmas Eve, 2017, the City seized her car for driving on a suspended license. (Pet.App.4a; JA143.) Ms. Fulton’s license was suspended for unpaid parking tickets and non-moving violations. (JA195-206.) Ms. Fulton swore under oath that she had no prior notice of the tickets as they were incurred by her ex-husband. (FultonDkt.62-1.) Ms. Fulton contacted the City to obtain the release of her car, but was told she would have to pay approximately \$4,000, which she could not afford to do. (JA143-44.)

On January 31, 2018, Ms. Fulton filed a Chapter 13 case. (Pet.App.4a.) The City filed an unsecured proof of claim for \$9,391.20. (Pet.App.4a;JA165-77.)

On March 21, the bankruptcy court confirmed Ms. Fulton’s Chapter 13 plan, which provided for payment over time to the City. (FultonDkt.20.) Specifically, Ms. Fulton committed to pay her creditors \$450 per month for 36 months and to pay, in addition, any tax refunds she received in excess of \$1,200. (JA180-81.) Ms. Fulton’s net monthly income was \$2,005.03, leaving her \$1,555.03 to pay living expenses for herself and her daughter, including \$900 in monthly rent. (Fulton Dkt.1,Schs.I,J.)

After the bankruptcy court confirmed her plan, Ms. Fulton again asked the City to return her car. (Pet.App.4a.) The City again refused. On April 27, it increased its claim to \$11,831.20 and, for the first time, asserted its claim was secured by her car. (Pet.App.4a;JA195-206.)

On May 2, unable to obtain the return of her car, Ms. Fulton filed a motion for turnover. (Pet.App.4a;JA143-47.) The City defended on the basis that Ms. Fulton should have filed an adversary complaint rather than a motion. (Pet.App.5a.)

On May 25, the bankruptcy court ordered the City to return Ms. Fulton's car by May 29 and imposed a daily sanction of \$100 if the City did not comply. (Pet.App.5a.) Instead of returning the car, the City filed a motion for a stay, which the bankruptcy court denied on June 6. (JA210-16.) The City then sought a district court stay, which the district court denied on September 10. (Pet.App.5a.) At that point, almost eight months after Ms. Fulton filed her bankruptcy case, the City finally returned her car. (*Id.*) At no time during that eight-month period or thereafter did the City initiate proceedings to obtain adequate protection under §363(e). (*Id.*) Nor has the City paid the sanctions.

2. *Timothy Shannon.* Timothy Shannon worked as a housekeeper earning \$2,128 per month after taxes. (18-04116 (Bankr. N.D. Ill.)("ShannonDkt.")Dkt.1,Sch.J.) He drove a 1997 Buick Park Avenue with 130,000 accumulated miles worth \$2,675. (Pet.App.102a.) On January 8, 2018, the City seized Mr. Shannon's car.

(Pet.App.5a.) Mr. Shannon filed a Chapter 13 bankruptcy case on February 15, 2018. (*Id.*)

As in Ms. Fulton's case, the City initially filed an unsecured claim for \$3,160 in fines dating back almost 20 years. (*Id.*;JA312-22.) On May 1, the bankruptcy court confirmed Mr. Shannon's Chapter 13 plan. (Pet.App.5a.) The plan committed to pay creditors, including the City, \$255 per month for 36 months plus any tax refunds in excess of \$1,200, leaving Mr. Shannon with \$1,873 per month to pay his living expenses. (JA325-26; ShannonDkt.1,Schs.I,J.)

Like Ms. Fulton, after he confirmed his plan, Mr. Shannon asked the City to return his car. (Pet.App.102a.) The City refused to do so unless Mr. Shannon amended his plan to treat the City as a secured creditor and pay it in full. (Pet.App.102a-03a.) The City also amended its claim, increasing it to \$5,600 and asserting for the first time that it was secured. (Pet.App.103a;JA334-35.)

On June 12, Mr. Shannon moved for sanctions, which the bankruptcy court granted on September 7. (Pet.App.5a,101a-47a.) The bankruptcy court rejected the City's argument that it could ignore the confirmed plan and demand full payment of its claim as a condition to returning the car. (Pet.App.107-08a.) The court held the City was "bound by the terms of Shannon's confirmed plan" and ordered the City "to return Shannon's car immediately," but noted that the City was "free to file a motion seeking adequate protection of its

lien interest.” (Pet.App.147a.) The City never did so. (Pet.App.6a.)

Following this order, the City returned Mr. Shannon’s car four months after he had requested its return. (Pet.App.6a.)

3. *George Peake.* George Peake used his car, a 2007 Lincoln MKZ, to travel approximately 45 miles from his home to his job each day. (Pet.App.6a.) On June 1, 2018, the City seized his car for unpaid parking fines. (*Id.*) Mr. Peake filed a Chapter 13 bankruptcy case on June 9. (*Id.*)

On June 20, Mr. Peake filed a motion for sanctions after the City refused to return his car. (Pet.App.6a.) On August 15, the bankruptcy court granted the motion, directing the City to release the car to Mr. Peake within two days. (Pet.App.6a;JA270.) The City moved for a stay pending appeal, which the bankruptcy court denied. (JA276.)

The City nevertheless refused to release Mr. Peake’s car, requiring him to move for civil contempt. (JA277-94.) Only after the City missed two additional deadlines for releasing Mr. Peake’s car did the bankruptcy court impose monetary penalties of \$100 per day between August 17 and 22, and \$500 per day thereafter. (JA295-96.) This order resulted in the City finally releasing Mr. Peake’s car. (Pet.App.6a.)

Similar to the Fulton and Shannon cases, the City never moved for adequate protection in Mr. Peake’s case, nor has it paid the fines.

4. *Jason Howard*. When Mr. Howard filed his bankruptcy petition, he was unemployed, receiving monthly Social Security and SNAP benefits totaling \$867. (Pet.App.7a; 17-25141 (Bankr. N.D. Ill.)(“Howard Dkt.”)Dkt.1,Sch.I.) Shortly before he filed his bankruptcy case, on August 9, 2017, the City impounded his 1975 Buick Regal, which had 150,000 miles on it and which Mr. Howard valued at \$1,000. (HowardDkt.1, Sch.B;Pet.App.7a.)

On August 23, the City filed a secured proof of claim for \$17,110.80. (Pet.App.7a.) On October 16, the bankruptcy court confirmed Mr. Howard’s plan, which treated the City as an unsecured creditor. (*Id.*) In his plan, Mr. Howard committed to pay \$100 per month for 60 months to his creditors, including the City. (HowardDkt.28.) The City did not object to the plan or appeal the confirmation order. (Pet.App.7a.) Instead, it “simply refused to release Mr. Howard’s vehicle unless he paid 100% of its claim.” (*Id.*)

Mr. Howard then attempted to amend his plan to satisfy the City’s demands, stating in a revised income schedule that he would be receiving an additional \$320 per month in family support and would pay his creditors \$420 per month. (HowardDkt.36,37.) Rather than allow the plan amendment, the bankruptcy court issued a rule to show cause why the City should not be held in contempt for refusing to release Mr. Howard’s car. (Pet.App.31a.) On April 19, 2018, the bankruptcy court fined the City \$50 per day since August 22, 2017 for its “willful violation of the automatic stay.” (Pet.App.40a-41a.)

The City never returned Mr. Howard's car. While the City's appeal was pending, Mr. Howard's Chapter 13 case was dismissed and the City disposed of the car. (Pet.App.7a.) Although Mr. Howard has not participated in the appeal, the Seventh Circuit concluded that the issues raised by his case were not moot because of the outstanding fines the bankruptcy court had ordered. (Pet.App.7a-8a.)

As in the other cases, the City never moved for adequate protection in Mr. Howard's case and never paid the fines.

C. The Seventh Circuit's Decision.

In a direct consolidated appeal from the four bankruptcy court orders, the Seventh Circuit affirmed, holding that when the City refused to return the debtors' cars, the City acted to exercise control over the cars in violation of §362(a)(3). (Pet.App.8a-17a.)

In reaching this conclusion, the Seventh Circuit rejected the primary legal argument that the City makes here—that refusing to return the cars was not an “act” to “exercise control” over the cars. The Seventh Circuit explained that the 1984 amendment to §362(a)(3), which added the prohibition on exercising control over estate property, necessarily involved more than seizures of a debtor's property while a bankruptcy case was pending since §362(a)(3) already stayed acts “to obtain possession” of estate property. (Pet.App.10a.) Broadening the reach of §362(a)(3) to address property seized before the bankruptcy filing was consistent with

“‘[t]he primary goal of reorganization bankruptcy’ of ‘group[ing] *all* of the debtor’s property together in his estate such that he may rehabilitate his credit and pay off his debts.’” (Pet.App.9a.) The Seventh Circuit then turned to the meaning of the word “control” and concluded that “[h]olding onto an asset, refusing to return it, and otherwise prohibiting a debtor’s beneficial use of an asset all fit within th[e] definition, as well as within the commonsense meaning of the word.” (*Id.*)

The Seventh Circuit also considered the effect of §542(a) in concluding that “turnover of a seized asset is compulsory.” (Pet.App.11a.) It concluded that the “status quo in bankruptcy is the return of the debtor’s property to the estate” and that by refusing to return the cars, the City was “actively resisting §542(a) to exercise control over debtors’ vehicles,” in violation of the automatic stay. (Pet.App.14a.) The Seventh Circuit recognized that the City wanted to retain the cars “not because it wants the vehicles but to put pressure on the debtors to pay their tickets,” which is “precisely what the stay is intended to prevent.” (*Id.*) The Seventh Circuit also noted that collection of vehicle fines constituted 9% of the City’s operating budget, and concluded that the City’s vehicle seizures were not based on protection of public safety. (Pet.App.24.)

The Seventh Circuit then rejected the City’s policy argument that if §362(a)(3) required the City to return a debtor’s car at the start of the bankruptcy case, the City would lack the opportunity to seek adequate protection of its interests. (Pet.App.14a-15a.) Noting that the City did not seek adequate protection in any of these four

cases, the Seventh Circuit cited procedures available to the City to seek emergency adequate protection if necessary. (Pet.App.15a-16a.)

Finally, the Seventh Circuit found no merit in the City's policy argument that §542(a) and §362(a)(3) imposed too great a burden on the City. Instead, "any burden is a consequence of the Bankruptcy Code's focus on protecting debtors and on preserving property of the estate for the benefit of *all* creditors." (Pet.App.16a.) The Seventh Circuit explained that the City, like any other creditor, "needs to satisfy the debts owed to it through the bankruptcy process[.]" (Pet.App.26a-27a.)

SUMMARY OF THE ARGUMENT

The issue before the Court is whether a creditor "acts" "to exercise control" over property of a Chapter 13 bankruptcy estate—and so violates the automatic stay under §362(a)(3)—if the creditor refuses the debtor's request for return of estate property that the creditor had seized before the bankruptcy case was filed. The question arises in the Chapter 13 cases of four debtors whose cars the City was holding when the debtors filed their bankruptcy cases. There is no dispute that the cars were property of the debtors' bankruptcy estates. *See* 11 U.S.C. §541(a). The City does not deny that it was exercising control over the cars when the cases were filed and the City admittedly refused to return the cars to the debtors while their cases were pending. (Pet.Br.10-13.) The more specific question then, is whether the City's refusal to return the debtors' cars when the debtors asked for them back was an "act" to

exercise control over estate property, prohibited by §362(a)(3).

The City did indeed act. Section 362(a)(3) prohibits two distinct kinds of conduct in connection with estate property. First, it stays any act “to obtain” the property—a specific, discrete event. But the second prohibition, staying any act “to exercise control” over the property, deals with a continuing course of conduct. When presented with the debtors’ requests for return of their cars, the City had to act, either by releasing the cars and ending its control over them, or by denying the debtors access to the cars and so continuing to exercise its control over the property. The Seventh Circuit’s decision below rested on what the City agrees (Pet.Br.17-18) is the “commonsense meaning” of “control”—“[h]olding onto an asset, refusing to return it, and otherwise prohibiting a debtor’s beneficial use of an asset.” (Pet.App.9a (quoting *Thompson v. GMAC*, 566 F.3d 699, 702 (7th Cir. 2009)).)

Section 362(a) operates in conjunction with another provision of the Bankruptcy Code, §542(a). That provision protects the rights of a trustee to use estate property during the case. It commands that an entity in possession or control of such property “shall deliver” the property to the trustee. 11 U.S.C. §542(a). The City has acknowledged that §542(a) extends this protection, with the requirement of delivery, to Chapter 13 debtors, who exercise the trustee’s property rights under §1303 and §1306(b). (Pet.Br.6.) The City’s refusal to return the debtors’ cars was an “act” violating §542(a), as the Seventh Circuit again held: “In refusing to return the

vehicles to their respective estates, the City was not passively abiding by the bankruptcy rules but actively resisting §542(a) to exercise control over debtors' vehicles." (Pet.App.14a.)

The City seeks to avoid the clear language of both §362(a)(3) and §542(a) by reading into those provisions limitations the provisions do not contain. In the City's view, the automatic stay does no more than freeze the relationship between debtors and creditors as of the moment before the bankruptcy filing, and so the stay purportedly requires no post-filing action on the part of creditors. (Pet.Br.18-21.) This argument would neuter §362(a)(3)'s prohibition on "exercis[ing] control" over estate property. The only way to "stay" or "stop" the exercise of control is to relinquish control. But, under the City's view that all §362(a)(3) does is preserve the pre-bankruptcy status quo, a creditor would not be required to relinquish its hold on estate property.

Section 362(a)(3) contains no language limiting creditor responsibility in this manner. Further, several other provisions of §362(a) require creditors to take action changing the pre-bankruptcy status quo in order to implement the balance between debtor and creditor interests that the Code establishes. For example, under §362(a)(1), which stays the continuation of collection proceedings, a creditor may not sit back and allow pre-bankruptcy collection proceedings to continue, but must instead take affirmative action to stop them. And to avoid collecting a prepetition claim, stayed by §362(a)(6), a creditor may have to take action such as releasing academic transcripts.

The City (and one of its *amici*) also suggests that §362(a)(3) only stays acts to exercise control over intangible property, and that, for physical objects, §362(a)(3) only prohibits acts to obtain possession. (Pet.Br.30-31;BrubakerBr.17-23.) Section 362(a)(3)’s text, however, flatly contradicts this limitation on §362(a)(3), staying “acts” both “to obtain possession” and “to exercise control” to *all* estate property equally. 11 U.S.C. §362(a)(3).

The City further argues that a prerequisite to the obligation to deliver estate property under §542(a) is the entry of a court order. The City ignores both the absence of any requirement for a court order in §542(a) and the presence of a court order requirement in §542(e) for disclosing documents relating to a debtor’s property or financial affairs.

Finally, the City argues that, before delivery of property is required under §362(a)(3) and §542(a), the debtor must show that the creditor’s interest in the property would be adequately protected. (Pet.Br.43-44.) But there is nothing in either provision making the debtor’s right to the return of property dependent on adequate protection. To the contrary, the provisions of the Bankruptcy Code that address adequate protection—§362(d) and §363(e)—place the procedural burden on the creditor to ask for adequate protection, something the City never did here. Instead, what the City did is exactly what *Whiting Pools* prohibited: it withheld seized property from a debtor’s efforts to reorganize rather than following the Bankruptcy Code’s

procedures and moving for adequate protection itself. 462 U.S. at 211-12.

The City's conduct here violated a central purpose of the Bankruptcy Code—advancing effective reorganization, both of households in Chapter 13 and businesses in Chapter 11. *Id.* at 208. Applying §362(a)(3) and §542(a) consistently with their language is necessary to honor this purpose.

ARGUMENT

I. A Creditor Violates The Automatic Stay When It Refuses To Return Estate Property To The Debtor.

A. The Majority Rule Is Consistent With Section 362(a)'s Text And Its Context And Purpose Within The Code.

The majority of courts have held that a creditor violates §362(a)(3) when it refuses to return estate property to the debtor. (Pet.App.14a (citing cases).) The majority interpretation of §362(a)(3) is grounded in the “fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.” *Nat’l Ass’n of Home Builders*, 551 U.S. at 666; *accord Robinson*, 519 U.S. at 341. The analysis begins with §362(a)(3)’s text: §362(a)(3) “stay[s]...any act to obtain possession of property of the estate or...to exercise control over property of the estate.” 11 U.S.C. §362(a)(3). The ordinary meaning of “exercise control” is

“to exercise restraining or directing influence over” or “to have power over.” *Thompson*, 566 F.3d at 702 (citing Merriam-Webster’s Collegiate Dictionary (11th ed. 2003)). The ordinary meaning of “stay” is to “stop.” *Stay*, Merriam-Webster’s Collegiate Dictionary. Thus, the words of §362(a)(3) stop creditors from exercising restraint over property of the estate.

Two other Bankruptcy Code sections provide important context for §362(a)(3). The first is §541(a), which defines “property of the estate.” Section 541(a)(1) makes “all legal or equitable interests of the debtor in property” “wherever located and *by whomever held*” “property of the estate.” 11 U.S.C. §541(a) (emphasis added). Based upon this text, this Court has long held that property of the estate includes property that a creditor seized from a debtor before the debtor filed for bankruptcy. *Whiting Pools*, 462 U.S. at 206-07.

The second section is §542(a), which directs what is to happen to property held by others after a bankruptcy filing. Section 542(a) unambiguously states that any entity holding property of the estate “shall deliver” that property to the trustee (in a Chapter 7 case) or the debtor (in a Chapter 11, 12, or 13 case). 11 U.S.C. §§542(a), 1107(a), 1203, 1207(b), 1303, 1306(b); *see also Whiting Pools*, 462 U.S. at 206-09.

Read together, §362(a)(3) stays, or stops, creditors from exercising control, or restraint, over property of the estate, which §541(a)(1) defines to include property held by a creditor. Logically, the only way for a creditor to stop controlling property it is holding is to relinquish

its control to someone else. The antonyms of exercising control are to “let go” and “lose.”² Section 542(a) establishes the party to whom the creditor should relinquish control.

Holding that §362(a)(3) protects both property of the estate and the right of the proper party under the Code to hold that property accords with §362(a)(3)’s role in the Code. The automatic stay is “one of the fundamental debtor protections provided by the bankruptcy laws.” *MidAtlantic Nat’l Bank v. New Jersey Dep’t of Env’tl. Prot.*, 474 U.S. 494, 503 (1986) (quoting H.R. Rep. No. 95-595, 340 (1977)). It protects a debtor’s property once the bankruptcy petition is filed and the estate is created. *Id.* Reading §362(a)(3) to protect rights in property that §541(a) creates and §542(a) marshals to the debtor or trustee is consistent with §362(a)’s purpose.

Thus, the Seventh Circuit correctly concluded that a creditor violates §362(a)(3) when it refuses a debtor’s request to return estate property is in accord with “the words of [§362(a)(3)],” “their context,” and “their place in the overall statutory scheme.” *Nat’l Ass’n of Home Builders*, 551 U.S. at 666.³

² See Thesaurus.com, “Exercise Control,” available at [thesaurus.com/browse/exercise%20control](https://www.thesaurus.com/browse/exercise%20control) (last visited March 4, 2020).

³ The debtors do not contend that either §362(a)(3) or §542(a) require turnover of property without a request by the trustee or debtor. A trustee may determine to abandon property of the estate, and debtors may choose to surrender collateral rather than retain

B. The City's Contrary Interpretation Of §362(a)(3) Fails.

The City begins its analysis by conceding the ordinary meaning of §362(a)(3)'s operative text. (Pet.Br.17-18; *see also* U.S.Br.12.) It then grudgingly acknowledges that the Seventh Circuit's finding of a stay violation "might make sense" if §362(a)(3) stated that "creditors may not exercise control over property of the estate." (Pet.Br.17-18.) But it attempts to minimize these concessions by claiming that two other words in §362(a)—"stay" and "act"—alter the ordinary understanding of what it means to "exercise control." (Pet.Br.18.)

The City argues that a "stay" must stop something new from taking place and that an "act" requires affirmative action; thus, the City reasons that §362(a) only stops a future act that alters the status of estate property as it existed immediately before the petition date and that "improve[s] the position the creditor held on the petition date." (Pet.Br.19-20.) The City reasons that because it already had control of the cars on the petition date, it did not "act" to improve its position when it refused to return the debtors' cars, and so did not violate §362(a)(3). (Pet.Br.20-21.) This argument fails for multiple reasons.

First, the premise underlying the City's argument—that the exercise of control over estate property is a

the property and pay the claim that it secures. 11 U.S.C. §§521(a)(2), 554, 1325(a)(5)(C).

static, one-time event—effectively removes the word “exercise” from the statutory text. Section 362(a)(3) distinguishes between “any act *to obtain possession* of property of the estate” or “any act...*to exercise control* over property of the estate.” 11 U.S.C. §362(a)(3) (emphasis added). These two parts of §362(a)(3) using different words, prohibit different conduct. *See Obduskey v. McCarthy & Holthus LLP*, 139 S. Ct. 1029, 1037 (2019) (interpreting the Fair Debt Collection Practices Act so as to avoid making one of its provisions superfluous).

There is a substantial difference in meaning between obtaining possession of estate property and exercising control over it. Obtaining possession is a discrete event, but exercising control involves ongoing conduct. An entity might continuously “exercise” control over property for many years; it cannot “obtain” possession of property continuously over time.

Indeed, the distinction between obtaining possession and exercising control is the basis for Congress’s amendment of §362(a)(3) in 1984, which added the stay of exercising control over estate property. In response, the City argues that the purpose of the 1984 amendment, which added §362(a)(3), was to extend the stay to intangible property, and so the stay of acts to “exercise control” should apply only to property that cannot be physically possessed. (Pet.Br.29-32;BrubakerBr.17-23.) This is groundless because Congress did not state in §362(a)(3) that the stay of exercising control applied only to intangible property.

In *Union Bank v. Wolas*, this Court rejected a similar attempt to add qualifying language to the text of another provision of the Bankruptcy Code. 502 U.S. 151, 162 (1991). There, the argument was that §547(c)(2)—the ordinary course of business defense to a preference claim—should be qualified so that it applied only to a preference action seeking to avoid a payment made on account of short-term rather than long-term debt. *Id.* at 152. Although there was some legislative history to support this limitation on the defense, the text of §547(c)(2), like §362(a)(3) here, contained no such qualifying language. *Id.* at 157. As this Court explained, “even if Congress adopted the 1984 amendment to redress particular problems of specific short-term creditors,” the Court was still required to give effect to the statute’s plain meaning which drew no such distinction. *Id.* at 157-58.

The same result is even more appropriate here, as there is no legislative history that supports the City’s proposed limitation on the reach of §362(a)(3). Further, the City’s argument is dubious since, without the amendment, an entity controlling intangible estate property could reasonably be said to have taken possession of the property. *See, e.g., In re Computer Commc’ns, Inc.*, 824 F.2d 725, 728 (9th Cir. 1987) (holding creditor’s termination of a contract in 1980 violated §362(a)(3)’s prohibition on obtaining estate property). But even if the amendment did confirm §362(a)(3)’s application to intangible property, its more significant effect was adding a stay of the *exercise* of control over *all* estate property.

The difference between “obtaining possession” and “exercise[ing] control” is essential to fully protect estate property. Staying a creditor from obtaining possession of property has no effect on a creditor who obtained the property before the stay was entered. But exercising control is ongoing; §362(a)(3) requires that the exercise of control be stopped. Continuing to exercise control over estate property is an act violating the stay under §362(a)(3), and this stay applies to all property of the estate, with no distinction between tangible and intangible property.

Put another way, if Congress had intended the “exercise” of “control” to occur only one time, at the moment the creditor first achieved possession of estate property, Congress would have written §362(a)(3) to state that it stayed any act “to obtain” control of estate property. Instead, by using the verb “exercise” as opposed to the verb “obtain,” §362(a)(3)’s text explicitly applies to acts “exercise[ing] control” that are ongoing and continuing. Because the City continued to “exercise control” over the cars during the bankruptcy cases by refusing to return the cars, there was a post-petition “act” violating the stay.

Second, the City argues that the “acts” the stay prohibits are limited to new affirmative conduct and do not include acts of omission, or what it terms “passive” conduct. From this premise the City concludes that its refusal to return the cars was “passive possession” and “doing nothing,” rather than an act violating the automatic stay. (Pet.Br.20.) The principal flaw in this argument is, again, that continuing to exercise control is

affirmative conduct. But even if viewed as a “passive” act, the text of §362(a)(3) draws no distinction between acts of omission and other acts; it stays *all* “act[s].”

By seeking to add words to §362(a)(3) to limit its reach to affirmative action, as opposed to acts of omission, the City again seeks to add an improper limit to the text of §362(a)(3) by imposing an ambiguous qualifier that will be the subject of endless litigation. *Union Bank*, 502 U.S. at 157-58; accord *EEOC v. Abercrombie & Fitch Stores, Inc.*, 135 S. Ct. 2028, 2033 (2015). For example, is paying a security guard to watch the car, active or passive conduct? Is that an “act” or merely preserving what the City views as the status quo? Would it matter if the guard was added because of thefts in the area? Drawing the line between what is active and passive conduct will be unadministrable. In fact, under the City’s proposed rule, the City can be said to have engaged in new acts here by keeping the cars under lock and key, refusing to return the cars when asked, and demanding payments outside of the debtors’ chapter 13 plans. (Pet.App.4a-5a,45a,102a-103a.)

Further, the attempted expansion is even more improper than it was in *Union Bank* because, with respect to §542(a), unlike §547(c)(2), there is *no* legislative history that even remotely supports the City’s attempts to rewrite the statute. Accordingly, this Court should reject the amorphous distinction between “active” and “passive” acts that the City attempts to write into §362(a)(3).

Certainly the failure to act can violate a legal duty. *See, e.g., Padilla v. Kentucky*, 559 U.S. 356, 370 (2010) (“we agree that there is no relevant difference ‘between an act of commission and an act of omission’ in this context”); *accord In re Fretz*, 244 F.3d 1323, 1330 (11th Cir. 2001) (“acts of omission designed to evade payment or collection of taxes are sufficient to satisfy §523(a)(1)(C)” of the Bankruptcy Code) (citations omitted).

Courts agree that creditors may violate other provisions of the automatic stay by failing to act. For example, numerous courts have held that when a school refuses to provide a debtor with a transcript of her grades, the school is engaged in an “act” “to collect a debt” which violates §362(a)(6). *See, e.g., In re Kuehn*, 563 F.3d 289, 294 (7th Cir. 2009); *In re Merchant*, 958 F.2d 738, 741 (6th Cir. 1992). Similarly, §362(a)(1), which stays the continuation of proceedings to collect claims against the debtor, has repeatedly been interpreted to require the creditor who initiated the proceedings “to inform other courts” of the bankruptcy and take the actions necessary to ensure the stay is effectuated. *See, e.g., In re Soares*, 107 F.3d 969, 978 (1st Cir. 1997); *In re Koch*, 197 B.R. 654, 660 (Bankr. W.D. Wis. 1996) (“relying primarily on §362(a)(1) and (2), courts have consistently placed an affirmative duty on garnishing creditors to stop garnishment proceedings once notified of the bankruptcy filing and to return any funds garnished in violation of the stay to the estate”), *abrogation on other grounds recognized by In re Rieck*, 439 B.R. 698 (Bankr. W.D. Wis. 2010).

Likewise, in *Aldy v. Valmet Paper Machinery*, the Fifth Circuit rejected an argument of the sort the City makes here and held that “an omission is an act.” 74 F.3d 72, 76 (5th Cir. 1996). It concluded that a failure to warn was an “act” under the Foreign Sovereign Immunities Act, which denied immunity to a foreign sovereign when its alleged liability was based on a commercial “act” outside of the United States. *Id.*; see *Miller v. Strahl*, 239 U.S. 426, 433 (1915) (assessing liability for “acts of omission”); *Helmers v. Anderson*, 156 F.2d 47, 52 (6th Cir. 1946) (“[a] failure to perform a legal duty at the time required is equivalent...to an affirmative act”).

Here, the City continued to possess something it was not legally entitled to keep. And the City did something to retain the debtors’ cars: it refused to deliver the cars and it kept the cars locked and guarded in its auto pounds where the debtors could not access them. The City took these actions knowing that the cars were critically important to the success of the debtors’ Chapter 13 plans. As the Seventh Circuit concluded, the City affirmatively decided to use the leverage that withholding the debtors’ cars created to demand greater payment of its claims, “precisely what the stay is intended to prevent.” (Pet.App.14.) The Seventh Circuit’s conclusion that the City “acted” here in violation of §362(a)(3) was legally and factually correct.

Third, the City’s crabbed reading of the word “stay” in §362(a) also is inconsistent with §362(a)’s text. Relying upon *Nken v. Holder*, 556 U.S. 418 (2009), the City argues that the automatic stay is comparable to a stay pending appeal or a prohibitory injunction, which does

not alter the parties' positions as they existed before the stay went into effect, but simply prevents future action to implement the order subject to appeal. (Pet.Br.18-19.) On this basis, the City asserts that its control over the debtors' cars, being in place before the filing of the debtors' bankruptcy cases, was part of the status quo that the automatic stay protected. *Nken*, however, contradicts the City's argument.

Nken addressed whether a stay of a removal order pending an appeal was an injunction subject to the strict limits for injunctions imposed under the Illegal Immigration Reform and Immigrant Responsibility Act of 1996. 556 U.S. at 423-24. In concluding that a stay pending appeal was not the same as an injunction, the Court stated: "Whether such a stay might technically be called an injunction is beside the point; that is not the label by which it is generally known. The sun may be a star, but 'starry sky' does not refer to a bright summer day." *Id.* at 430. By the same logic, the Bankruptcy Code's automatic stay is not the same as a stay pending appeal. *Nken's* description of how a stay pending appeal works, which description forms the basis of the City's constricted reading of the word "stay" as used in §362(a)(3), is therefore "beside the point." *Id.*

Instead, the meaning of "stay" as used in §362(a)(3) should be informed by the "specific context" in which the Bankruptcy Code uses this word. What §362(a)(3) stays, or stops, is an "act" to "exercise control." When the exercise of control is the possession of tangible property, the only way to "stop" exercising control is to relinquish

that control by returning the property to the person entitled to control it.

The City has no answer to how one “stays” or “stops” the exercise of control over a debtor’s property if not by relinquishing it. One of its *amici*, the United States, agrees that the only way to stop “exercis[ing] control” over estate property is to relinquish control. (U.S.Br.12-13.) But it nonetheless argues that Congress could not have intended to impose this obligation on creditors because this result could be accomplished by the creditor “leaving [the cars] unlocked and unguarded in the lot, or by giving them to the first passerby that expressed interest.” (*Id.*) But the Government’s argument itself recognizes that §542(a) establishes a debtor’s right to receive the relinquished property. (*Id.*)

The City’s argument that a stay maintains the status quo flounders by using the wrong definition of the status quo. The City assumes that the status quo is what was happening immediately before the bankruptcy filings. But immediately before a bankruptcy filing, creditors are able to collect their claims, prosecute their lawsuits, set off their debts against any property of the debtor they are holding, and take a whole host of actions that they cannot take once a bankruptcy case is filed. Thus, the automatic stay does alter the status quo as it existed before bankruptcy to the detriment of those creditors who were winning the race to recover from a debtor’s assets. This makes the situation different from a stay pending appeal discussed in *Nken*. When a stay pending appeal is entered, the status quo is generally the entry of a judgment, but collection has not yet occurred. The

appeal stay keeps that same status in place while the litigation proceeds on appeal.

The automatic stay, however, does something quite different. Instead of maintaining a pre-bankruptcy filing status quo, the automatic stay sets a new baseline as of the moment the petition is filed. Among other things, that new baseline, or post-bankruptcy status quo, is the marshalling of all of the debtor's property into the appropriate hands, consistent with *Katz*, 546 U.S. at 363-64 and *Whiting Pools*, 462 U.S. at 206-07. By refusing to return the cars to the debtors, the City was acting contrary to the status quo as established by the debtors' bankruptcy filings and violating the automatic stay.

Finally, the City's argument that §362(a) only stays acts "that would improve the position the creditor held on the petition date" (Pet.Br. 20-21) misses the point of §362(a)(3). Like the stay preventing continued collection actions, the stay of control over estate property operates to reduce the advantage that some creditors have over others. By staying creditor lawsuits, §362(a)(1) assures that all creditors may be paid on a pro rata basis, a change from the pre-bankruptcy situation that is definitely not in the interest of the creditor winning the race to the courthouse and likely to be paid more. Similarly, §362(a)(3) puts all of the estate property in the hands of the Chapter 13 debtor. This result increases the likelihood that all creditors will be paid through a completed plan, and removes the obstacles to completing a plan that would exist if a debtor is deprived of necessary property—like a car to drive to work.

But, even if §362(a)(3) only stayed acts that are intended to improve the creditor's position, when a creditor, like the City, actively resists its obligation to comply with §542(a), it necessarily acts to improve its position relative to other creditors who are complying with the law. The City's conduct here is a textbook example. The cars at issue were extremely important to the debtors, three of whom needed the cars to get to work. However, to the City, the value it might receive from selling the cars was substantially less than the debt it was owed. By withholding the cars, and refusing to return them until the debtors paid the City outside of their confirmed Chapter 13 plans more than the cars were worth, the City was exercising control over estate property to leverage a greater payment for itself. (Pet.App.4a-6a,45a-46a,103a.) As the Seventh Circuit correctly concluded, what the City did here is "precisely what the stay is intended to prevent." (Pet.App.14a.)

C. The Seventh Circuit Correctly Rejected The City's Legislative History Arguments.

In an effort to countermand §362(a)(3)'s text, the City makes four unavailing legislative history arguments.

First, the City contends that prior to 1984, creditors could refuse to deliver property until a debtor sued to get it back and that Congress did not intend to change this pre-Code practice when it amended §362(a)(3). (Pet.Br.25-27.) As an initial matter, this Court does not need to reach this argument because §362(a)'s text is plain. *Union Bank*, 502 U.S. at 157-58. Whatever the

pre-Code practice was, “it cannot overcome [§362(a)(3)’s] language.” *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 10 (2000) (citations omitted). As this Court has explained, historical practice “is a tool of construction” that “informs [the Court’s] understanding of the Code.” That practice is “not an extratextual supplement.” *Id.*

The City’s historical argument also is inaccurate. Prior to 1984, at least one court did in fact hold that §542(a) was self-executing so that the failure to deliver estate property was “probably contumacious.” *In re Larimer*, 27 B.R. 514, 516 (Bankr. D. Idaho 1983).

Second, the City argues that Congress could not have intended that §362(a)(3) apply to a refusal to return estate property because this addition was included in a bill that was originally titled “An Act to Correct Technical Errors, Clarify and Make Minor Substantive Changes to Public Law 95-598 (the Bankruptcy Reform Act of 1978).” (Pet.Br.28-29.) Ultimately, however, the amendment to §362(a)(3) was made by the Bankruptcy Amendments and Federal Judgeship Act of 1984, which was much more than a technical amendments bill. Pub. L. No. 98-353, §441(a)(2), 98 Stat. 333, 371 (1984). Regardless, “the technical nature of the amendment... does not alter the wide-ranging effect of the statutory text[.]” *Freytag v. Comm’r*, 501 U.S. 868, 875 (1991).

Here, as the Seventh Circuit correctly concluded, the 1984 amendment to §362(a)(3) had to be more than a technical correction that did not change the law. (Pet.App.10a.) “[T]he mere fact that [in 1984] Congress

expanded the provision to prohibit conduct above and beyond obtaining possession of an asset suggests that it intended to include conduct by creditors who seized an asset pre-petition.” *Thompson*, 566 F.3d at 702.

Third, the City argues that it is implausible that Congress would have amended §362(a)(3) so that it could be used to enforce §542(a). (Pet.Br.27-29.) But §542(a) marshals estate property and §362(a) is the Code provision that protects estate property from wrongful creditor interference. *Ritzen*, 2020 WL 201023, at *4. Thus, an amendment to strengthen the protections for property subject to delivery under §542(a) was reasonably placed within §362(a).

Fourth, the City argues that if possessing property is an act to exercise control, §362(a)(3)’s “obtain possession” language would be surplusage because obtaining possession of a tangible asset is tantamount to controlling it. Therefore, the City argues that the 1984 amendment should be read to apply only to intangible property that cannot be physically possessed. (Pet.Br.29-32.) This argument, ironically, contradicts the City’s contention that the amendment was not intended to make substantive changes, but as explained above, it is also groundless. Finally, even if there is some redundancy here, “[r]edundancies across statutes are not unusual events in drafting, and so long as there is no ‘positive repugnancy’ between two laws, a court must give effect to both.” *Conn. Nat’l Bank v. Germain*, 503 U.S. 249, 253 (1992) (citations omitted). There is no repugnancy here.

II. Section 362(a)(3) Should Be Read In The Context Of §542(a) Which Commands Delivery Of Estate Property To A Debtor Or Trustee.

The City's arguments for ignoring the interplay between §362(a)(3) and §542(a) are unavailing. The unstated linchpin of the City's argument is that §542(a)'s turnover requirement is not self-executing. (Pet.Br.32-43.) According to the City, a creditor has no obligation under §542(a) to return estate property until a bankruptcy court orders it to do so. Based on this incorrect understanding of when the obligation to return property is triggered under §542(a), the City reasons that a creditor who refuses to return property is not exercising control over the property because it is entitled to retain the property until a court orders otherwise. (Pet.Br.32-43.) Like its construction of §362(a)(3), the City's construction of §542(a) is contrary to §542(a)'s text. *See* 3 Collier on Bankruptcy, ¶362.03[5] (16th ed.)

A. The Text Of §542(a) Compels The Conclusion That §542(a) Is Self-Executing.

The text of §542(a) unambiguously states that any entity holding estate property "shall deliver" that property to the trustee (in a Chapter 7 case) or the debtor (in a Chapter 11, 12, or 13 case). 11 U.S.C. §§542(a), 1107(a), 1203, 1207(b), 1303, 1306(b). The City's argument that the turnover obligation §542(a) imposes on a creditor is not triggered until a court orders

turnover ignores §542(a)'s unambiguous text in three fundamental ways.

The first problem with the City's reading of §542(a) is that the City ignores Congress's use of the verb "shall." As this Court has repeatedly explained, when Congress uses "shall" in connection with an action, it means that the action is mandatory. *See Kingdomware Techs., Inc. v. United States*, 136 S. Ct. 1969, 1977 (2016); *Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998). "[T]he word 'shall' is ordinarily the language of command." *Alabama v. Bozeman*, 533 U.S. 146, 153 (2001). "Unlike the word 'may,' which implies discretion, the word 'shall' usually connotes a requirement." *Kingdomware*, 136 S. Ct. at 1977.

Section 542(a)'s operative language commands that any "entity" in possession of estate property "*shall deliver*" that property "to the trustee" or to the debtor in a Chapter 11, 12, or 13 case. 11 U.S.C. §542(a) (emphasis added). The commanding nature of Congress's use of "shall" in §542(a) is underscored by the fact that another part of §542—§542(e)—states that the court "may" order certain parties holding documents related to the debtor to deliver those documents to the trustee. As this Court noted in *INS v. Cardoza-Fonseca*, "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." 480 U.S. 421, 432 (1987) (citation omitted).

Here, this principle is even more relevant, since the exclusion of relevant language concerns two subparts of a single section, not two different sections of the same statute. When a statute distinguishes between “shall” and “may” in its subparts, as §542(a) and §542(e) do here, “it is generally clear that ‘shall’ imposes a mandatory duty.” *Kingdomware Techs.*, 136 S. Ct. at 1977. Thus, by arguing that a creditor is not commanded to comply with §542(a)’s turnover requirements, despite Congress’s clear decision to place an unconditional command in §542(a), the City flouts a fundamental principle of statutory construction.

The second problem with the City’s reading of §542(a) is that it reads requirements into the statute that Congress did not include. It is axiomatic that “[n]othing is to be added to what the text states or reasonably implies (*casus omissus pro omisso habendus est*).” *Shea v. Kerry*, 961 F. Supp. 2d 17, 29 n.3 (D.D.C. 2013) (quoting Antonin Scalia & Brian A. Garner, *Reading Law: The Interpretation of Legal Texts* 93-100 (2012)), *aff’d*, 796 F.3d 42 (D.C. Cir. 2015). Although the City pays lip service to Congress’s use of the mandatory “shall” in §542(a), conceding that it “[i]mposes [a] [m]andatory [d]uty [t]o [t]urn [o]ver” (Pet.Br.36), the City argues that this mandatory obligation *only* comes into existence *after* the debtor obtains a court order directing turnover. (Pet.Br.36-41.)

But §542(a) does not expressly state, or even hint, that a court order is a prerequisite to turnover. If Congress wanted to impose that requirement, it could have easily done so by inserting the phrase “*after notice*

and hearing” or “*after entry of a court order*” before the command “*shall deliver.*” In fact, there are 75 instances in the Bankruptcy Code where Congress provides that an action is required or permitted only after “notice and hearing.” (See 1a-4a, *infra.*) Notably, one of those instances occurs within §542. Subpart (e) states:

[s]ubject to any applicable privilege, *after notice and a hearing, the court may order* an attorney, accountant, or other person that holds recorded information,...relating to the debtor’s property or financial affairs, *to turn over or disclose such recorded information to the trustee.*

11 U.S.C. §542(e)(emphasis added).

If, as the City argues, Congress had intended that a creditor could wait to comply with §542(a) until a court orders compliance, it would have drafted §542(a) as it drafted §542(e), providing explicitly that “notice and hearing” and a court order were prerequisites for delivery. But instead of doing what it did in subpart (e) and 74 other times in the Bankruptcy Code (*see* 1a-4a, *infra*), Congress used the command “shall deliver to the trustee” without qualification. 11 U.S.C. §542(a). By asking this Court to add the additional requirement of filing suit and obtaining an order into §542(a)’s text, the City violates the basic rule of statutory construction that courts may not add language to a statute that Congress itself did not include. *See, e.g., Abercrombie & Fitch*, 135 S. Ct. at 2033; *Shea*, 961 F. Supp. 2d at 29 n.3.

Finally, the City's construction of §542(a) ignores its prefatory clause, which states: "*Except as provided* in subsection (c) or (d) of this section...." (emphasis added). Had Congress wanted to add the exception that a creditor could retain estate property until a court ordered its return, Congress would "ha[ve] done so clearly and expressly" with the other exceptions it did include in §542(a). *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 453 (2007) (quoting *FCC v. Nextwave Pers. Commc'ns Inc.*, 537 U.S. 293, 302 (2003)).

B. The City's Attempts To Dismiss §542(a)'s Text Are Unavailing.

The City's responses to the clear text of §542(a) are not convincing.

First, the City dismisses §542(a)'s use of the unconditional command "shall" by arguing that even if §542(a) "impose[s] a duty of turnover that is mandatory when the statute's conditions for turnover are met, that duty is enforced like any other statutory obligation, through a judicial proceeding to obtain a court order directing compliance." (Pet.Br.37.) This argument side-steps the point.

When the conditions of the statute are met—and they were met here—the creditor has a "mandatory" duty *before* the entry of a court order to deliver the debtor's property. A creditor holding seized property is not entitled to retain the property until ordered to deliver it. While a court order may be necessary if the

creditor is recalcitrant, as the City was here, it is not a prerequisite or a condition to the duty being imposed.

Second, the City compares §542(a) to the avoiding powers set forth in §§544-545 and §§547-549 of the Code and argues that these statutes do not command the recipient of an avoidable transfer to return that transfer to the estate without a court order, and thus §542(a) should be read the same way. (Pet.Br.39.) But the City's comparison is misplaced. Unlike §542(a), these Code sections do not state that an "entity" that has received an avoidable transfer "shall deliver the transferred property to the trustee" without exception. Instead, they provide that a trustee "may avoid" certain types of transfers. 11 U.S.C. §§544(b), 545, 547(b), 548(a), 549(a). Recovery of the property, however, is under §550, which does require a court proceeding. 11 U.S.C. §550. The avoidance provisions are at all parallel to §542(a).

In contrast to the avoidance provisions, there are sections of the Bankruptcy Code that are generally comparable to §542(a), such as §341(a), which states the "United States trustee *shall* convene and preside at a meeting of creditors;" §342(b), which states that the clerk "*shall* give" a written notice to certain debtors; and §521, which states the debtor "*shall*" file certain documents and undertake certain actions. 11 U.S.C. §§341(a), 342(b), 521. There is no credible argument that these statutory provisions, which impose mandatory self-executing duties on debtors and others in connection with the administration of bankruptcy cases, can be ignored until a court orders compliance. In total, there are 47 similar provisions in the Code which employ this

same structure of commanding that a party “shall” do something in aid of the administration of the bankruptcy case. (*See* 5a-7a *infra*.) Holding that these parties have no obligation to undertake these acts until ordered by a court would burden the courts with unnecessary litigation and interfere with a “chief purpose of the bankruptcy laws”: ‘to secure a prompt and effectual’ resolution of bankruptcy cases ‘within a limited period.’” *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1803 (2019) (quoting *Katchen v. Landy*, 382 U.S. 323, 328 (1966)).

Section 542(a), which uses the same language and structure as provisions like §341(a), §342(b), and §521 should be read the same way. Like the provisions that set out the duties of various parties in a bankruptcy case, §542(a) serves the very important purpose of marshalling estate assets and allowing debtors to use those assets to facilitate the debtor’s fresh start. *Whiting Pools*, 462 U.S. at 203-09. Forcing debtors to wait months to get their property back would imperil their ability to earn the wages necessary to fund their Chapter 13 plans.

These cases illustrate the point. The City aggressively fought to keep the debtors’ cars, retaining one for almost eight months, and another for four months. (Pet.App.5a-6a.) The City held these cars even though the requirements of §542(a) were met, while taking no action to obtain adequate protection of its lien interests. (Pet.App.5a-7a.) Instead, the City used the delay to leverage the debtors into paying more than the City was otherwise entitled to receive, “precisely what the stay is intended to prevent.” (Pet.App.14a.)

Third, the City cites a footnote in *Whiting Pools* which listed the three conditions to delivery of property set forth in §542(a). As this footnote states:

Section 542 provides that the property be usable under §363, and that turnover is not required in three situations: when the property is of inconsequential value or benefit to the estate, §542(a), when the holder of the property has transferred it in good faith without knowledge of the petition, §542(c), or when the transfer of the property is automatic to pay a life insurance premium, §542(d).

462 U.S. at 206 n.12.

The City argues that these conditions “make it evident that the turnover provision cannot be ‘self-effectuating,’” and instead require a court to find that the conditions are met before any duty to comply is triggered. (Pet.Br.37) The Court’s point in listing these conditions, however, actually contradicts the City’s reading of § 542(a). The Court was explaining that none of §542(a)’s conditions applied to allow the creditor to withhold possession of the debtor’s property in *Whiting Pools*, just as in the debtors’ cases. 462 U.S. at 206. Later in the opinion, the Court emphasized: “§542(a) simply requires the [creditor] to seek protection of its interest according to the congressionally established bankruptcy procedures, *rather than by withholding the seized*

property from the debtor's efforts to reorganize.” 462 U.S. at 212 (emphasis added).

Fourth, the City argues that Congress did not intend §542(a) to be self-executing because the House Report for the 1978 Bankruptcy Code stated that the procedure for turnover “will be dealt with by the Rules of Bankruptcy Procedure.” (Pet.Br.40 (citing H.R. Rep. No. 95-595, at 293, 297 (1977).) Based on this legislative statement, the City erroneously concludes that Congress intended a rule like current Bankruptcy Rule 7001 to be read into §542(a) and so there is no duty to turnover estate property until a debtor or trustee obtains a court order. (Pet.Br.39-40.) Each step of this argument fails.

As an initial matter, this Court has held that 28 U.S.C. §2075 precludes the Bankruptcy Rules from “abridg[ing], enlarg[ing], or modify[ing] any substantive right” found in the Code. *See Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 453-54 (2004) (holding Rule 7001(6)'s summons requirement cannot override substance of 11 U.S.C. §523(a)(8)); *see also Roell v. Withrow*, 538 U.S. 580, 587 & n.5 (2003) (holding implied consent to proceed before a federal magistrate was effective even though Fed. R. Civ. P. 73(b) required a statement of consent, because the governing statute, 28 U.S.C. §636(c), did not require express consent). Because §542(a) does not require an order for turnover to be effective, the Bankruptcy Rules cannot impose that requirement.

Even if legislative history could override §2075, the history the City cites would not do so. The statement the City quotes is found in an appendix to a general discussion of how the Supreme Court's rulemaking authority would operate under the Bankruptcy Code. (Pet.Br.40 quoting H.R. Rep. No. 95-595, at 293, 297.) Under the prior Bankruptcy Act, the Supreme Court had the authority to issue rules that superseded Act provisions. H.R. Rep. No. 95-595, at 292. The 1978 Code repealed this power. 28 U.S.C. §2075. The legislative history the City relies upon discusses this change, stating "the Supreme Court may continue to promulgate rules of practice and procedure for bankruptcy cases, but [the 1978 law] repeals the provision that permits rules to supersede Acts of Congress." H.R. Rep. No. 95-595, at 292. Given this statement, Congress did not intend the Bankruptcy Rules to amend §542(a) substantively.

Moreover, the cited appendix listed 322 different types of events that would occur under the Code, including the turnover of estate property, but it did not link any particular rule to any designated event. *See* H.R. Rep. No. 95-595 at 293-308. At the end of the appendix, the House Report qualifies this list by stating that "the rules may not affect substantive rights." *Id.* at 308. Thus, nothing about this appendix supports the City's statement that Congress intended a rule like Rule 7001 (or any other rule for that matter) to be read into §542(a) so as to alter its substance. Furthermore, if the City's point is that this history suggests that §362(a)(3) does not protect property subject to §542(a) because matters related to §362 are typically brought by motion and not by complaint, the appendix also contains the

following qualifier: “in many instances, a motion or application will suffice.” H.R. Rep. No. 95-595 at 308. The legislative history therefore defeats this argument as well.

Likewise, the City’s citation to 28 U.S.C. §157, which describes “orders to turn over property” as “core”, does not help its argument. (Pet.Br.39.) Section 157 does not indicate anything with respect to whether Congress intended §542(a) to be self-executing. All §157 addresses is whether a bankruptcy court can enter judgment if a dispute arises over whether property should be returned. For example, if the trustee in a Chapter 7 case contended that property claimed by a third party was actually owned by the debtor, §157 sets out Congress’s position that a bankruptcy court has jurisdiction to issue a final judgment in the matter. But, the fact that the Bankruptcy Rules and Judicial Code contain rules governing the conduct of litigation when litigation becomes necessary to recover estate property does not mean that a court order is prerequisite to the turnover obligation in the first instance. That is akin to arguing that parties to a contract are free to ignore contract terms until a suit is brought to compel compliance. The presence of procedures to force persons to do what the law requires them to do on their own does not excuse performance in accordance with the law until those procedures are commenced.

Finally, the City argues that a lawsuit is prerequisite to the obligation to comply with §542(a) because that allegedly was the practice before the Code was enacted. (Pet.Br.40-41.) But, again, pre-Code

practice cannot alter §542(a)'s text. "[W]hile pre-Code practice, 'informs [the Court's] understanding of the language of the Code,' it cannot overcome that language. It is a tool of construction, not an extratextual supplement." *Hartford Underwriters*, 530 U.S. at 10 (citations omitted). That is precisely what the City is attempting to do here: impose an "extratextual supplement" that §542(a)'s text does not support.⁴

* * *

The City's attempts to minimize and rewrite §542(a) fail. By its unambiguous terms, §542(a) compels any person holding estate property to deliver that property to the trustee (in Chapter 7 cases) or the debtor (in Chapter 11, 12, and 13 cases).

III. Bankruptcy Code §362(a)(3) And §542(a) Work Together To Protect The Bankruptcy Court's Exclusive Jurisdiction Over Estate Property.

The City, joined by the Government, contends that §362(a)(3) plays no role in protecting rights established by §542(a). (Pet.Br.32-41;U.S.Br.19-20.) They first argue

⁴ Although the Court does not need to delve into pre-Code history to reject the City's argument, the City's contention that Congress intended §542(a) to require a court order as a prerequisite to turnover cannot be squared with the fact that Congress both expanded §541's definition of estate property and added §542, which did not exist under the prior Act, based on the recommendation of the Commission on Bankruptcy Laws that doing so would reduce litigation over estate property. *See* Commission Report at 30, §2-201.

that the meaning given by the majority decisions would make §542(a) redundant of §362(a)(3) since both would require turnover of estate property. Their second argument is that §363(a)(3) is incompatible with §542(a), because it would require turnover of all estate property held by the creditor, while §542(a) excludes certain property from its delivery command. Neither of these arguments is well-grounded.

First, §362(a)(3) is far from redundant. Before Congress added its stay of acts to exercise control over estate property, there was no express mechanism in the Bankruptcy Code to enforce the delivery requirement of §542(a). The Government's brief suggests that parties seeking the delivery of estate property might ask courts to fashion a remedy under §105(a) of the Code, which allows a court to enter "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." (U.S.Br.23.) However, the process of seeking relief under §105(a) is both less certain and likely more costly, in both time and expense, than a motion to enforce the automatic stay, which, in addition to being supported by a well-developed body of case law, provides individual debtors with a right to damages for a willful stay violation. 11 U.S.C. §362(k).

Second, although there are differences in scope between §362(a)(3) and §542(a), these differences are both minor and easily reconciled. The three limits on property subject to the delivery requirement in §542(a) are very unlikely ever to apply to property of the estate that a debtor seeks to obtain under §362(a)(3). Sections 542(c) and (d) address circumstances in which the

property to be delivered is no longer in the hands of the person who would otherwise be required to deliver it. 11 U.S.C. §542(c), (d). Section 542(c) provides that if a party holding property without knowledge or notice of the bankruptcy case has transferred estate property to someone other than the trustee in good faith, the transfer is treated as if it had been made to the debtor and is not subject to turnover under §542(a). Similarly, Section 542(d) allows a life insurance company to make automatic payments from a policy toward premiums without being subject to turnover under §542(a). Neither of these exceptions authorize a person holding estate property to retain it after a debtor or trustee asks to have it returned. The only potentially applicable limit, set out in §542(a) itself, is for property of “inconsequential value or benefit to the estate.” Theoretically, a party entitled to possession of estate property could demand to receive it from a third-party even if the property was arguably of inconsequential value. But the likelihood of such a dispute is very small, given that property of inconsequential value cannot, by its nature, fund a debtor’s rehabilitation.

To the extent there is redundancy, this Court has held that “[r]edundancies across statutes are not unusual events in drafting, and so long as there is no ‘positive repugnancy’ between two laws, ... a court must give effect to both.” *Germain*, 503 U.S. at 253 (internal citations omitted). If there is conflict, the proper resolution is not to discard one of the provisions, but to treat both as effective to the extent possible, and give precedence to the more specific provision. *See id.*; *Busic v. United States*, 446 U.S. 398, 406 (1980) (“[A] more

specific statute will be given precedence over a more general one, regardless of their temporal sequence.”). Thus, in the unlikely event there are disputes over whether property is of inconsequential value or benefit to the estate, courts would recognize the §542(a) exception as a defense to a motion to enforce the stay under §362(a)(3).

Third, the City and Government ignore the fundamental interplay between §362, which protects estate property, and §541 and §542 which establish what *is* estate property that §362 protects. Rather than acting independently of each other, §362(a)(3) and §542(a) work in tandem to protect the bankruptcy court’s exclusive jurisdiction over estate property. *See* 3 Collier on Bankruptcy, ¶362.03[5] (16th ed.)

Section 542(a) establishes that the bankruptcy estate “includes property of the debtor that has been seized by a creditor prior to the filing of a petition for reorganization.” *Whiting Pools*, 462 U.S. at 209. The automatic stay, which is “one of the fundamental debtor protections provided by the bankruptcy laws,” protects that property once the bankruptcy petition is filed and the estate is created. *MidAtlantic Nat’l Bank*, 474 U.S. at 503 (quoting H.R. Rep. No. 95-595, 340 (1977)). Section 362(a) does so by “permit[ing] the debtor to attempt a repayment or reorganization plan” using that property while also ensuring that creditors do not interfere with estate property during the bankruptcy case. H.R. Rep. No. 95-595, at 340; *accord Whiting Pools*, 462 U.S. at 208-09. Thus, adopting the argument that §362(a)(3) has nothing to do with protecting the property that §542(a)

brings into the bankruptcy estate would eviscerate “one of the fundamental debtor protections.” *MidAtlantic Nat’l Bank*, 474 U.S. at 503.

Finally, holding that §362(a)(3) protects the estate’s rights in property held by creditors also does not, as the City argues, improperly expand the debtor’s interests in that property. (Pet.Br.23-24.) In *Raleigh v. Illinois Department of Revenue*, this Court held that while “[c]reditors’ entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor’s obligation,” that general rule is “subject to any qualifying or contrary provisions of the Bankruptcy Code.” 530 U.S. 15, 20 (2000). With respect to property held by creditors, Congress made a policy decision when it enacted §541(a) to define estate property to include property “by whomever held”; Congress simultaneously added a new provision to the bankruptcy laws, §542(a), that gave a debtor the right to possess property that had been seized pre-bankruptcy. *Whiting Pools*, 674 F.2d at 152-53. Sections 541(a) and 542(a) are “qualifying” or “contrary” provisions that alter the right to possession as it exists under state law.

Furthermore, because §362(a) protects *all* estate property, not just the property in the debtor’s possession on the petition date, it acts to protect the right to possession Congress granted to debtors in §542(a). *Mission Product Holdings, Inc. v. Tempnology, LLC*, which the City cites (Pet.Br.23), is not to the contrary. 139 S. Ct. 1652 (2019). It recognizes that the Bankruptcy Code does expand property interests in certain circumstances. *Id.* at 1663.

Thus, rather than containing redundant or disabling provisions, §362(a)(3) and §542(a) work in tandem to protect the bankruptcy court's exclusive jurisdiction over estate property.

IV. The Seventh Circuit's Decision Is Wholly Consistent With *Strumpf*.

The City also contends that the Seventh Circuit's decision is inconsistent with this Court's ruling in *Strumpf*. (Pet.Br.42-43.) The City would read *Strumpf* as holding that a creditor does not violate the automatic stay when it refuses to return property to a debtor. (*Id.*) But *Strumpf* addressed a different subsection of §542: §542(b), which is not involved here. Significantly, in reaching its conclusion that the stay was not violated in *Strumpf*, the Court expressly distinguished its holding from the factual circumstances present here. 516 U.S. at 21.

In *Strumpf*, the debtor owed money to the bank where he also kept a checking account. *Id.* at 17. After the debtor filed for bankruptcy, the bank froze the account and filed a motion for stay relief so that it could offset its loan balance against the checking account. *Id.* at 17-18. The debtor argued that when the bank froze his account, the bank violated the automatic stay because §362(a)(7) barred "the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor[.]" *Id.* at 17.

The Court rejected the debtor's argument that the bank violated the automatic stay when it temporarily froze the debtor's checking account. *Id.* at 19. The Court held that a temporary freeze was "not a setoff within the meaning of §362(a)(7)," because a setoff required permanent action. *Id.* The Court also rejected the debtor's argument that even a temporary refusal to pay was wrongful under §542(b) or §362(a)(3). 516 U.S. at 19-21.

Central to the Court's ruling was the fact that a bank account "consists of nothing more or less than a promise to pay"; put differently, a bank account is not a pot of money that belongs to the depositor. *Id.* at 21. Because a bank account is a contractual promise to pay, §542(b), not §542(a), was the applicable turnover provision. Section 542(b) requires entities that owe a debt to the debtor, like a bank owes to its depositors, to pay such debt "except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor." 11 U.S.C. §542(b). The Court reasoned that "[i]t would be an odd construction of § 362(a)(7) that required a creditor with a right of setoff to do immediately that which §542(b) specifically excuses it from doing as a general matter: pay a claim to which a defense of setoff applies." *Strumpf*, 516 U.S. at 20.

Because the text of §542(b) expressly excused the bank from paying what was due, the Court also rejected the debtor's argument that the bank had exercised control over property of the estate in violation of §362(a)(3). *Id.* at 21. The Court explained that the debtor's reliance on §362(a)(3) "rests on the false

premise that petitioner's administrative hold took something from respondent, or exercised dominion over property that belonged to respondent." *Id.* The Court stated: "That view of things might be arguable if a bank account consisted of money belonging to the depositor and held by the bank," but because a bank account is only a "promise to pay," the bank was not exercising control over estate property. *Id.* Instead, the bank was "merely" refusing to "perform its promise." *Id.*

The City's argument ignores both the textual differences between §542(a) and §542(b) and the critical differences between a car and a bank account. Unlike §542(b), which expressly allowed the bank to protect its setoff rights under §553, §542(a) contains no exception to the obligation to return estate property that would allow a creditor to retain the property notwithstanding §542(a)'s mandate.

An additional distinction between §542(a) and §542(b) is that, unlike the promise to pay that a bank account represents, a car is tangible personal property. Thus, as *Strumpf* expressly stated, its holding in no way protects a creditor who withholds property from the trustee or debtor in violation of §542(a), as opposed to temporarily refusing to honor a promise to pay money. *Id.*

Strumpf's harmonization of §362(a)(7) with §542(b) has relevance here: the automatic stay affecting property of the estate must be interpreted consistently with the turnover provisions of §542, just as the Seventh Circuit did below.

CONCLUSION

For all of the foregoing reasons, the judgment of the court of appeals should be affirmed.

March 4, 2020

Respectfully submitted,

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In re *Fulton*, 926 F.3d 916 (2019)

67 Bankr.Ct.Dec. 100, Bankr. L. Rep. P 83,412



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Certiorari Granted by *Chicago, Il v. Fulton*, U.S., December 18, 2019

926 F.3d 916

United States Court of Appeals, Seventh Circuit.

IN RE: Robbin L. FULTON, Debtor-Appellee.

Appeal of: City of Chicago

In re: Jason S. Howard, Debtor-Appellee.

Appeal of: City of Chicago

In re: George Peake, Debtor-Appellee.

Appeal of: City of Chicago

In re: *Timothy Shannon*, Debtor-Appellee.

Appeal of: City of Chicago

No. 18-2527, No. 18-2793, No. 18-2835, No. 18-3023

|
Argued May 14, 2019|
Decided June 19, 2019**Synopsis**

Background: Bankruptcy court issued rule to show cause why city should not be sanctioned for refusing to release Chapter 13 debtor's vehicle, which had been impounded because of unpaid parking tickets. The United States Bankruptcy Court for the Northern District of Illinois, *Jacqueline P. Cox, J.*, 584 B.R. 252, entered judgment in favor of debtor, and city appealed. In separate Chapter 13 case, debtor moved to enforce automatic stay by requiring city to release vehicle, and the United States Bankruptcy Court for the Northern District of Illinois, *Deborah Lee Thorne, J.*, 588 B.R. 811, granted motion. City appealed. In yet another case, debtor again filed motion to enforce stay against city, which motion was granted by the United States Bankruptcy Court for the Northern District of Illinois, *Carol A. Doyle, J.*, 590 B.R. 467, and city appealed. Finally, city appealed from a grant of like relief by the United States Bankruptcy Court for the Northern District of Illinois, *Jack B. Schmetterer, J.*, 2018 WL 2570109, and city appealed.

Holdings: Consolidating cases for purposes of appeal, the Court of Appeals, *Flaum*, Circuit Judge, held that:

[1] city violated stay by its continued postpetition retention of motor vehicles impounded prepetition;

[2] stay exception for “any act to perfect, or to maintain or continue the perfection of, an interest in property” did not permit city to continue to retain possession of motor vehicles; and

[3] “police or regulatory power” exception to automatic stay did not apply.

Affirmed.

Procedural Posture(s): On Appeal; Motion to Enforce Automatic Stay.

West Headnotes (21)

[1] Bankruptcy

🔑 Moot questions

Issues relating to creditor's alleged violation of automatic stay are not mooted by dismissal of underlying bankruptcy case. 📄 11 U.S.C.A. § 362(a).

[2] Bankruptcy

🔑 Sanctions, in general

Court must have the power to compensate victims for violations of automatic stay and to punish the violators, even after conclusion of underlying bankruptcy case. 📄 11 U.S.C.A. § 362(a).

[3] Bankruptcy

🔑 Conclusions of law; de novo review

Bankruptcy

🔑 Clear error

On appeal in bankruptcy case, the Court of Appeals reviews bankruptcy court's factual findings for clear error and its conclusions of law de novo. *Fed. R. Bankr. P. 8013*.

[4] Bankruptcy

🔑 Repossession

In re Fulton, 926 F.3d 916 (2019)

67 Bankr.Ct.Dec. 100, Bankr. L. Rep. P 83,412

Creditor “exercises control” over property of the estate in violation of automatic stay when, subsequent to filing of bankruptcy petition, creditor refuses to return property of debtor that it has repossessed prepetition.  11 U.S.C.A. § 362(a)(3).

5 Cases that cite this headnote

[5] **Bankruptcy**

 Notice to creditors; commencement

Stay provision that bars creditor from exercising control over property of the estate becomes effective immediately upon filing bankruptcy petition and is not dependent upon the debtor first

bringing a turnover action.  11 U.S.C.A. §§ 362(a)(3), 542.

1 Cases that cite this headnote

[6] **Bankruptcy**

 Repossession

Creditor that has repossessed debtor's motor vehicle prepetition is required to turn over such property of the estate following commencement of debtor's bankruptcy case, prior to a court determination establishing debtor's obligation to provide adequate protection for creditor's interest in vehicle.  11 U.S.C.A. §§ 362(a)(3), 542.

1 Cases that cite this headnote

[7] **Bankruptcy**

 Collection and Recovery for Estate; Turnover

Turnover of estate property by creditor in possession thereof is compulsory. 11 U.S.C.A. § 542(a).

2 Cases that cite this headnote

[8] **Bankruptcy**

 Acts excepted from stay

City which, prior to commencement of debtors' Chapter 13 cases, had impounded motor vehicles

belonging to debtors based on their unpaid parking and moving tickets improperly exercised control over property of the estate, in violation of automatic stay, by refusing to return vehicles postpetition in order to avoid losing its possessory lien interests in vehicles; while city argued that its passive retention of motor vehicles that it had lawfully impounded was not an “act” to exercise control over property of the stay, of kind barred by automatic stay, city's argument ignored fundamental purpose of bankruptcy, to allow debtors to regain their financial foothold and repay their creditors, something for which motor vehicle was necessary.  11 U.S.C.A. § 362(a)(3).

[9] **Bankruptcy**

 Collection and Recovery for Estate; Turnover

Turnover statute compels the return of estate property, including property in which debtor did not have a possessory interest at the time the bankruptcy proceedings commenced. 11 U.S.C.A. § 542(a).

[10] **Bankruptcy**

 Adequate Protection

It is obligation of creditor with possessory lien interest in debtor's property to come to court and ask for adequate protection of its interest, not the debtor's obligation to file adversary proceeding against every creditor holding her property at the time that she files for bankruptcy.

[11] **Bankruptcy**

 Construction and Operation

Courts construe the Bankruptcy Code liberally in favor of debtors and strictly against creditors.  11 U.S.C.A. § 101 et seq.

[12] **Bankruptcy**

 Automatic Stay

Automatic stay is one of the fundamental debtor protections provided by bankruptcy laws, and courts therefore narrowly construe exceptions to the stay in order to give the stay its intended broad application.  11 U.S.C.A. § 362(a).

[13] Bankruptcy

 Acts excepted from stay

Stay exception for “any act to perfect, or to maintain or continue the perfection of, an interest in property” did not permit city to continue to retain possession of motor vehicles that it had impounded prepetition for Chapter 13 debtors’ unpaid parking and moving tickets; involuntary turnover of vehicles by city solely to comply with its obligations under the Bankruptcy Code would not result in loss of its possessory lien interest in vehicles.  11 U.S.C.A. § 362(b)(3).

[14] Bankruptcy

 Acts excepted from stay

By enacting stay exception for “any act to perfect, or to maintain or continue the perfection of, an interest in property,” and by limiting trustee’s power to avoid an unperfected lien by making that power subject to any nonbankruptcy law that permits perfection to relate back, Congress sought to prevent a trustee from avoiding the lien of creditor when only the intervening bankruptcy stopped creditor from perfecting or continuing perfection of its lien; purpose of these provisions is to prevent creditors from losing their lien rights due to debtor’s bankruptcy filing, not to permit creditors to retain possession of debtors’ property.  11 U.S.C.A. §§ 362(b)(3),  546(b).

[15] Bankruptcy

 Administrative Proceedings and Governmental Action

“Police or regulatory power” exception to automatic stay is narrowly construed to apply to the enforcement of state laws affecting health,

welfare, morals and safety, but not to regulatory laws that directly conflict with control of the res or property by bankruptcy court.  11 U.S.C.A. § 362(b)(4).

[16] Bankruptcy

 Administrative Proceedings and Governmental Action

City’s retention of possession of motor vehicles which it had impounded prepetition for unpaid parking tickets and other monetary penalties assessed against Chapter 13 debtors, the vehicles’ owners, and not against offending drivers, until such time as tickets and penalties were paid in full, was focused on debtors’ financial obligations, not on public safety matters, and did not come within “police or regulatory power” exception to automatic stay.  11 U.S.C.A. § 362(b)(4).

[17] Bankruptcy

 Administrative Proceedings and Governmental Action

Courts apply two tests to determine whether a state’s actions fall within the “police or regulatory power” exception to automatic stay, the “pecuniary purpose” test and the “public policy” test, and the satisfaction of either test is sufficient for the stay exception to apply.  11 U.S.C.A. § 362(b)(4).

[18] Bankruptcy

 Administrative Proceedings and Governmental Action

“Pecuniary purpose” test for whether an action comes within the “police or regulatory power” exception to automatic stay requires court to look to what specific acts the government wishes to carry out and determine if such execution will result in an economic advantage over third parties in relation to debtor’s estate.  11 U.S.C.A. § 362(b)(4).

[19] Bankruptcy**Administrative Proceedings and Governmental Action**

If focus of the State's alleged exercise of its police power is directed at debtor's financial obligations, rather than at the State's health and safety concerns, then automatic stay is applicable.  11 U.S.C.A. § 362(b)(4).

[20] Bankruptcy**Administrative Proceedings and Governmental Action**

"Public policy" test for whether an action comes within the "police or regulatory power" exception to automatic stay considers whether the State's action is principally to effectuate public policy or to adjudicate private rights.

 11 U.S.C.A. § 362(b)(4).

[21] Bankruptcy**Administrative Proceedings and Governmental Action**

Even if court assumed that city's adjudication of parking and minor moving violations against Chapter 13 debtors was result of city's exercise of its police and regulatory powers, city could not enforce these final determinations of liability, which were in nature of money judgments, by retaining possession of debtors' vehicles until it was paid in full, without violating automatic stay; city had to seek satisfaction of any prepetition debts owed to it by debtors through bankruptcy process, just like any other creditor.  11 U.S.C.A. § 362(b)(4).

1 Cases that cite this headnote

*919 Appeal from the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division. No. 18-02860—**Jack B. Schmetterer**, *Bankruptcy Judge*.

Appeal from the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division. No. 17-25141—**Jacqueline P. Cox**, *Bankruptcy Judge*.

Appeal from the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division. No. 18-16544—**Deborah Lee Thorne**, *Bankruptcy Judge*.

Appeal from the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division. No. 18-04116—**Carol A. Doyle**, *Chief Bankruptcy Judge*.

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Before [Flaum](#), [Kanne](#), and [Scudder](#), Circuit Judges.

Opinion

[Flaum](#), Circuit Judge.

***920** In this consolidated appeal of four Chapter 13 bankruptcies, we consider whether the City of Chicago may ignore the Bankruptcy Code’s automatic stay and continue to hold a debtor’s vehicle until the debtor pays her outstanding parking tickets. Prior to the debtors’ filing for bankruptcy, the City impounded each of their vehicles for failure to pay multiple traffic fines. After the debtors filed their Chapter 13 petitions, the City refused to return their vehicles, claiming it needed to maintain possession to continue perfection of its possessory liens on the vehicles and that it would only return the vehicles when the debtors paid in full their outstanding fines. The bankruptcy courts each held that the City violated the automatic stay by “exercising control” over property of the bankruptcy estate and that none of the exceptions to the stay applied. The courts ordered the City to return debtors’ vehicles and imposed sanctions on the City for violating the stay.

This is not our first time addressing this issue: in [Thompson v. General Motors Acceptance Corp.](#), 566 F.3d 699 (7th Cir. 2009), we held that a creditor must comply with the automatic stay and return a debtor’s vehicle upon her filing of a bankruptcy petition. We decline the City’s request to overrule [Thompson](#). We therefore affirm the bankruptcy courts’ judgments relying on [Thompson](#), and we also agree with the bankruptcy courts that none of the exceptions to the stay apply.

I. Background

The Chicago Municipal Code permits creditor-appellant the City of Chicago to immobilize and then impound a vehicle if its owner has three or more “final determinations of liability,” or two final determinations that are over a year old, “for parking, standing, compliance, automated traffic

law enforcement system, or automated speed enforcement system violation[s].” Municipal Code of Chicago (“M.C.C.”) § 9-100-120(b); *see also id.* § 9-80-240(a) (providing for impoundment of vehicles “operated by a person with a suspended or revoked driver’s license”). The fines for violations of the City’s Traffic Code range from \$ 25 (e.g., parallel parking violation) to \$ 500 (e.g., parking on a public street without displaying a wheel tax license emblem). *Id.* § 9-100-020(b)–(c). Failure to pay the fine within twenty-five days automatically doubles the penalty. *Id.* § 9-100-050(e). After a vehicle is impounded, the owner is further subjected to towing and storage fees, *see id.* § 9-64-250(c), and to the City’s costs and attorney’s fees for collection activity. *Id.* §§ 1-19-020, 2-14-132(c)(1)(A). To retrieve her vehicle, an owner may either pay the fines, towing and storage fees, and collection costs and fees in full, *id.* § 2-14-132(c)(1)(A), or pay the full amount via an installment plan over a period of up to thirty-six months, provided she makes an initial payment of half the fines and penalties plus all of the impoundment, towing, and storage charges. *Id.* § 9-100-101(a)(2)–(3).

In 2016, the City amended the Code to include: “Any vehicle impounded by the City or its designee shall be subject to a possessory lien in favor of the City in the amount required to obtain release of the vehicle.” *Id.* § 9-92-080(f). Based on this provision, the City began refusing to release impounded vehicles to debtors who had filed Chapter 13 petitions. That is just what occurred in these four cases.

A. In re Fulton

Debtor-appellee Robbin Fulton uses a vehicle to commute to work, transport her ***921** young daughter to day care, and care for her elderly parents on weekends. On December 24, 2017, three weeks after she purchased a 2015 Kia Soul, the City towed and impounded the vehicle for a prior citation of driving on a suspended license. Fulton filed a Chapter 13 bankruptcy petition on January 31, 2018 and filed a plan on February 5, treating the City as a general unsecured creditor. The City filed a general unsecured proof of claim on February 23 for \$ 9,391.20. After the court confirmed Fulton’s plan on March 21, she requested the City turn over her vehicle. The City then amended its proof of claim to add impound fees, for a total of \$ 11,831.20, and to assert its status as a secured creditor; it did not return Fulton’s vehicle.

On May 2, Fulton filed a motion for sanctions arguing the City was required to turn over her vehicle pursuant to [Thompson](#) and that its failure to do so was sanctionable

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conduct. The City countered that Fulton must seek turnover through an adversary proceeding. It asserted it was retaining possession to perfect its possessory lien and was thus excepted from the automatic stay pursuant to 11 U.S.C. § 362(b)(3).

On May 25, the bankruptcy court held that the City was required to return Fulton's vehicle under *Thompson* and that the City was not excepted from the stay under § 362(b)(3). The court ordered the City to turn over Fulton's vehicle no later than May 29, imposed a sanction of \$ 100 for every day the City failed to comply, and sustained Fulton's objection to the City's claim as a secured creditor. The City moved to stay the order in the district court pending appeal; the district court denied the stay request on September 10. Eventually, the City returned Fulton's vehicle. At no point did the City initiate proceedings to protect its rights under § 363(e).

B. In re Shannon

The City impounded debtor-appellee Timothy Shannon's 1997 Buick Park Avenue on January 8, 2018 for unpaid parking tickets. Shannon filed a Chapter 13 petition on February 15. On February 27, the City filed an unsecured proof of claim for \$ 3,160 in fines dating back to 1999. Shannon, in turn, filed a proposed plan that did not include the City as a secured creditor, to which the City did not object, and the court confirmed the plan on May 1. When Shannon sought the return of his vehicle, the City amended its proof of claim, adding fines, storage, and towing fees for a total of \$ 5,600, and stated the claim was secured by its possession of Shannon's vehicle.

Shannon filed a motion for sanctions on June 12, asserting the stay required the City to turn over his vehicle. The court granted his motion on September 7; it held the City's claim was unsecured because it did not object to the plan that characterized the debt as such. It also determined the City violated the stay by failing to return Shannon's vehicle, that the §§ 362(b)(3) and (b)(4) exceptions to the stay did not apply, and that the City further violated § 362(a)(4) and (a)(6) by retaining the vehicle. The court noted the City was free to file a motion seeking adequate protection of its lien. The City returned Shannon's car and did not file any such motion.

C. In re Peake

Debtor-appellee George Peake relies on his car to travel approximately forty-five miles from his home to work. The City impounded his 2007 Lincoln MKZ for unpaid fines on June 1, 2018. Peake filed a Chapter 13 petition on June 9. In response, the City filed a secured proof of claim for \$ 5,393.27 and asserted a possessory lien on his vehicle. After the City refused Peake's request to return his vehicle, he filed a motion for sanctions and for turnover. On August 15, the bankruptcy court granted the motion; it held that neither § 362(b)(3) nor (b)(4) applied, so the City's retention of Peake's vehicle violated the stay, and it ordered the City to release his vehicle immediately. The City filed a motion to stay the order pending appeal, which the court denied on August 22. The same day, Peake filed a motion for civil contempt based on the City's refusal to release his vehicle. The court granted the motion and entered an order requiring the City to pay monetary sanctions—\$ 100 per day from August 17 through August 22 and \$ 500 per day thereafter until the City returned his vehicle. The City filed an emergency motion for a stay pending appeal in our Court, which we denied. Finally, the City released Peake's vehicle. At no point did the City file a motion to protect its interest in the vehicle.

D. In re Howard

The City immobilized debtor-appellee Jason Howard's vehicle on August 9, 2017 and impounded it soon after. Howard filed a Chapter 13 petition on August 22. The City filed a secured proof of claim on August 23 for \$ 17,110.80. The court confirmed Howard's plan on October 16, which included a nonpriority unsecured debt of \$ 13,000 owed to the City for parking tickets. Though the Code did not impose an automatic stay when Howard filed his petition due to his prior dismissed bankruptcy petitions, see 11 U.S.C. § 362(c)(4)(A), the court granted Howard's motion to impose a stay when it confirmed his plan on October 16. The City did not object to its treatment as unsecured under the plan and did not appeal the confirmation order; rather, it simply refused to release Howard's vehicle unless he paid 100% of its claim.

On January 22, 2018, the court issued a rule to show cause to the City why it should not be sanctioned for refusing to release Howard's vehicle in accordance with *Thompson*. The court rejected the City's argument that it was excepted from the stay under § 362(b)(3) and, on April 16, 2018,

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ordered sanctions of \$ 50 per day beginning August 22, 2017 for the City's violation of the stay.

[1] [2] After the City filed its opening appellate brief, Howard filed notice of his intention not to participate in the appeal. His counsel explained Howard's bankruptcy case had been dismissed and the City disposed of his vehicle. He has since filed a new bankruptcy case to address his parking tickets but has abandoned interest in the vehicle that was the subject of the relevant Chapter 13 petition in the bankruptcy court below. However, "issues related to an alleged violation of the automatic stay" are not mooted by dismissal of a bankruptcy petition, *Denby-Peterson v. Nu2u Auto World*, 595 B.R. 184, 188 (D.N.J. 2018); a court "must have the power to compensate victims of violations of the automatic stay and punish the violators, even after the conclusion of the underlying bankruptcy case." *In re Johnson*, 575 F.3d 1079, 1083 (10th Cir. 2009) (citing *In re Davis*, 177 B.R. 907, 911–12 (B.A.P. 9th Cir. 1995)).

* * *

In each of these four cases, the City appealed the bankruptcy courts' orders finding the City violated the stay. These cases have been consolidated for appeal.

II. Discussion

[3] The main question before us is whether the City is obligated to return a debtor's vehicle upon her filing of a Chapter 13 bankruptcy petition, or whether the City is entitled to hold the debtor's vehicle until she pays the fines and costs or until she obtains a court order requiring the City to turn over the vehicle. We review a *923 bankruptcy court's factual findings for clear error and conclusions of law de novo. *In re Jepson*, 816 F.3d 942, 945 (7th Cir. 2016).

A. The Automatic Stay

Section 362(a)(3) of the Bankruptcy Code provides that a Chapter 13 bankruptcy petition "operates as a stay, applicable to all entities, of ... 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." 11 U.S.C. § 362(a)(3) (emphasis added). We applied this provision to a very similar factual situation in *Thompson v. General Motors*

Acceptance Corp. There, a creditor seized a debtor's car after he defaulted on payments. 566 F.3d at 700. The debtor filed a Chapter 13 petition and attempted to retrieve his car, but the creditor refused. *Id.* We considered two issues relating to § 362(a)(3): whether the creditor "exercised control" of property of the bankruptcy estate by failing to return the vehicle after the debtor filed for bankruptcy, and whether the creditor was required to return the vehicle prior to a court determination establishing the debtor could provide adequate protection for the creditor's interest in the vehicle. *Id.* at 701.

1. "Exercise Control"

[4] First, we observed in *Thompson* there was no debate the debtor has an equitable interest in his vehicle, and "as such, it is property of his bankruptcy estate." 566 F.3d at 701 (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983)); see 5 Collier on Bankruptcy ¶ 541.01 (16th ed. 2019) ("Congress's intent to define property of the estate in the broadest possible sense is evident from the language of the statute which, in section 541(a)(1), initially defines the scope of estate property to be all legal or equitable interests of the debtor in property as of the commencement of the case, wherever located and by whomever held."). We then rejected the creditor's argument that passively holding the asset did not satisfy the Code's definition of exercising control: "Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within th[e] definition, as well as within the commonsense meaning of the word." *Thompson*, 566 F.3d at 702. As we explained, limiting the reach of "exercising control" to "selling or otherwise destroying the asset," as the creditor proposed, did not fit with bankruptcy's purpose: "The primary goal of reorganization bankruptcy is to group *all* of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized pre-petition." *Id.* (citing *Whiting Pools*, 462 U.S. at 203–04, 103 S.Ct. 2309).

Additionally, Congress amended § 362(a)(3) in 1984 to prohibit conduct that "exercise[d] control" over estate assets.

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We determined this addition suggested congressional intent to make the stay more inclusive by including conduct of “creditors who seized an asset pre-petition.” *Id.*; see *In re Javens*, 107 F.3d 359, 368 (6th Cir. 1997) (“The fact that ‘to obtain possession’ was amended to ‘to obtain possession ... or to exercise control’ hints [] that this kind of ‘control’ might be a broadening of the concept of possession ... It could also have been intended to make clear that [] § 362(a)(3) applied to property of the estate that was not in the possession of the debtor.” (first alteration in original)); *In re Del Mission Ltd.*, 98 F.3d 1147, 1151 (9th Cir. 1996) (The 1984 amendment “broaden[ed] the scope of § 362(a)(3) to proscribe the mere knowing retention of estate property.”). We therefore held that in retaining possession of the car, the creditor violated the automatic stay in § 362(a)(3). *Thompson*, 566 F.3d at 703.

*924 2. Compulsory Turnover

[5] Next, we concluded § 362(a)(3) becomes effective immediately upon filing the petition and is not dependent on the debtor first bringing a turnover action. *Id.* at 707–08. In so concluding, we relied on a plain reading of §§ 363(e) and 542(a) and the Supreme Court’s decision in *Whiting Pools*.

[6] Section 363(e) provides:

[O]n request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased ... by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

11 U.S.C. § 363(e). The creditor acknowledged, and we agreed, that it has the burden of requesting protection of its interest in the asset under § 363(e). “However, if a creditor is allowed to retain possession, then this burden is rendered meaningless—a creditor has no incentive to seek protection

of an asset of which it already has possession.” *Thompson*, 566 F.3d at 704. For § 363(e) to have meaning then, the asset must be returned to the estate prior to the creditor seeking protection of its interest. *Id.*; cf. *In re Sharon*, 234 B.R. 676, 684 (B.A.P. 6th Cir. 1999) (“[T]he Bankruptcy Code does not elevate [the creditor’s] adequate protection right above the Chapter 13 debtor’s right to possession and use of a car.”).

[7] Moreover, § 542(a) “indicates that turnover of a seized asset is compulsory.” *Thompson*, 566 F.3d at 704. Section 542(a) requires that a creditor in possession of property of the estate “shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.” 11 U.S.C. § 542(a) (emphasis added). We observed that a majority of courts had found § 542(a) worked in conjunction with § 362(a) “to draw back into the estate a right of possession that is claimed by a lien creditor pursuant to a pre-petition seizure; the Code then substitutes ‘adequate protection’ for possession as one of the lien creditor’s rights in the bankruptcy case.”

Thompson, 566 F.3d at 704 (quoting *Sharon*, 234 B.R. at 683). Because “[t]he right of possession is incident to the automatic stay,” *id.*, the creditor must first return the asset to the bankruptcy estate. Only then is “the bankruptcy court [] empowered to condition the right of the estate to keep possession of the asset on the provision of certain specified adequate protections to the creditor.” *Id.*; see also 11 U.S.C. § 362(d)(1) (“On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under [] § 362(a) ... for cause, including the lack of adequate protection of an interest in property”).

The Supreme Court indicated as much in *Whiting Pools* when it explained that a “creditor with a secured interest in property included in the estate must look to [] § 363(e) for protection, rather than to the nonbankruptcy remedy of possession.” 462 U.S. at 204, 103 S.Ct. 2309 (emphasis added).

3. Thompson Controls

[8] Applying *Thompson* to the facts before us, we conclude, as each bankruptcy court did, that the City violated

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the automatic stay pursuant to § 362(a)(3) by retaining possession of the debtors' vehicles after they declared bankruptcy. See *In re Shannon*, 590 B.R. 467, 477 (Bankr. N.D. Ill. 2018), ECF No. 64 (“*Thompson* [] requires any secured creditor in possession of a debtor's vehicle to return it immediately and seek adequate protection”); *In re Peake*, 588 B.R. 811, 816 (Bankr. N.D. Ill. 2018), ECF No. 40 (“[T]he City's conduct in retaining possession of the vehicle violates [§] 362(a)(3) as that section *925 has been interpreted ... in *Thompson*”); *In re Fulton*, 18-bk-02860, Mem. Op. at 2, 2018 WL 2392854 (Bankr. N.D. Ill. May 25, 2018), ECF No. 39 (“[T]he City is circumventing entirely the procedural burden imposed on it by *Thompson* and the protections provided to debtors by the automatic stay.”); *In re Howard*, 17-bk-25141, Mem. Op. at 10, 2018 WL 1830910 (Bankr. N.D. Ill. Apr. 16, 2018), ECF No. 63 (“[Section 362(a)] does not authorize continued possession of impounded vehicles in contravention of the *Thompson* ruling.”). The City was required to return debtors' vehicles and seek protection within the framework of the Bankruptcy Code rather than through “the nonbankruptcy remedy of possession.” *Whiting Pools*, 462 U.S. at 204, 103 S.Ct. 2309.

The City acknowledges *Thompson* controls but asks us to overrule *Thompson* for three reasons: (1) property impounded prior to bankruptcy is not property of the bankruptcy estate because the debtors did not have a possessory interest in their vehicles at the time of filing; (2) the stay requires creditors to maintain the status quo and not take any action, such as returning property to the debtor, so the onus is on the debtor to move for a turnover action to retrieve her vehicle; and (3) the plain language of § 362(a)(3) requires an “act” to exercise control, and passive retention of the vehicle is not an “act.”

[9] We decline the City's request; *Thompson* considered and rejected these arguments. More fundamentally, the City's arguments ignore the purpose of bankruptcy—“to allow the debtor to regain his financial foothold and repay his creditors.” *Thompson*, 566 F.3d at 706; see also 5 Collier on Bankruptcy ¶ 541.01 (“[The] central aggregation and protection of property [] promote[s] the fundamental purposes of the Bankruptcy Code: the breathing room given

to a debtor that attempts to make a fresh start, and the equality of distribution of assets among similarly situated creditors according to the priorities set forth within the Code.”). To effectively do so, a debtor must be able to use his assets “while the court works with both debtor and creditors to establish a rehabilitation and repayment plan.” *Thompson*, 566 F.3d at 707; see also *Whiting Pools*, 462 U.S. at 203, 103 S.Ct. 2309 (“[T]o facilitate the rehabilitation of the debtor's business, all the debtor's property must be included in the reorganization estate.”). This is why § 542 compels the return of property to the estate, including “property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced.” *Whiting Pools*, 462 U.S. at 205, 103 S.Ct. 2309; see *In re Weber*, 719 F.3d 72, 79 (2d Cir. 2013) (“*Whiting Pools* teaches that the filing of a petition will generally transform a debtor's equitable interest into a bankruptcy estate's possessory right in the vehicle.”). Thus, contrary to the City's argument, the status quo in bankruptcy is the return of the debtor's property to the estate. In refusing to return the vehicles to their respective estates, the City was not passively abiding by the bankruptcy rules but actively resisting § 542(a) to exercise control over debtors' vehicles.

What's more, the position we took in *Thompson* brought our Circuit in line with the majority rule, held by the Second, Eighth, and Ninth Circuits. See *Weber*, 719 F.3d 72; *Del Mission* 98 F.3d 1147; *In re Knaus*, 889 F.2d 773 (8th Cir. 1989). Although the Tenth Circuit recently adopted the City's view, see *In re Cowen*, 849 F.3d 943 (10th Cir. 2017), that position is still the minority rule. Our reasoning in *Thompson* continues to reflect the majority position and we believe it is the appropriate reading of the bankruptcy statutes. At bottom, the City wants to maintain possession of the vehicles not because it wants the vehicles but to put pressure on *926 the debtors to pay their tickets. That is precisely what the stay is intended to prevent.¹

The City, though, pleads necessity; it claims that, without retaining possession, it is helpless to prevent the loss or destruction of the vehicles. It did not attempt in any of these cases, however, to seek adequate protection of its interests through the methods available under the Bankruptcy Code, and at oral argument, the City asserted it did not have “the opportunity” to request such protection before the bankruptcy

courts ordered it to return the vehicles. The record belies this statement. In each case, the parties engaged in motion practice, often over the course of months, before the courts held the City to be in violation of the stay. At any point the City could have sought adequate protection of its interests, but it chose not to avail itself of the Code's available procedures.

See, e.g.,  11 U.S.C. § 362(d)(1) (court may relieve creditor from the stay if debtor cannot adequately protect creditor's interest in the property);  *id.* § 362(f) (court may relieve creditor from stay "as is necessary to prevent irreparable damage to the interest of an entity in property"); *id.* § 363(e) (creditor may request court to place limits or conditions on trustee's power to use, sell, or lease property to protect creditor's interest).

[10] We recognize that once the City complies with the automatic stay and immediately turns over vehicles, it will need to seek protection on an expedited basis. Though we leave it to the City and the bankruptcy courts to fashion the precise procedure for doing so, we note the following: The City will have notice of the bankruptcy petition when the debtor requests her vehicle, if not sooner. At that time, the City may immediately file an emergency motion for adequate protection of its interest in a debtor's vehicle, which may be heard within a day or so, and the City can even file such motions ex parte if necessary. See *id.* § 363(e); *Fed. R. Bankr. P.* 4001(a)(2); see also  11 U.S.C. § 362(d)(1),  (f); *Bankr. N.D. Ill. R.* 9013-9(B)(9)(d) (motion for relief from stay under  § 362 where movant alleges security interest in vehicle "ordinarily [] granted without hearing"). It will be the rare occasion where a single day's delay will have lost the City the value of its security. Regardless, the Code is clear that it is the creditor's obligation to come to court and ask for protection, not, as the City advocates, the debtor's obligation to file an adversary proceeding against every creditor holding her property at the time she files for bankruptcy. Cf. *In re Lisse*, 921 F.3d 629, 639 (7th Cir. 2019) ("The basic premise [of Chapter 13] is to facilitate the debtor's ability to pay his creditors").

The City's argument that it will be overburdened with responding to Chapter 13 petitions is ultimately unavailing; any burden is a consequence of the Bankruptcy Code's focus on protecting debtors and on preserving property of the estate for the benefit of *all* creditors. It perhaps also reflects the importance of vehicles to residents' everyday lives, particularly where residents need their vehicles to commute to work and earn an income in order to eventually

pay off their fines and other debts.² It is not a reason to permit the *927 City to ignore the automatic stay and hold captive property of the estate, in contravention of the Bankruptcy Code.

Furthermore, if a debtor files a bankruptcy petition in bad faith and immediately dismisses her case, as the City claims many debtors do solely to retrieve their impounded vehicles, the City has recourse: it may file a bad faith motion against the debtor. If the court finds bad faith, it may immediately dismiss the case and may even sanction the debtor. 11 U.S.C. § 1307(c); see, e.g., *Lisse*, 921 F.3d at 639–41 (affirming sanctions and dismissal of Chapter 13 petition filed in bad faith to collaterally attack state court judgment); *In re Bell*, 125 F. App'x 54, 57 (7th Cir. 2005) (affirming dismissal of Chapter 13 petition with prejudice where debtors filed multiple petitions "solely to impede the foreclosure sale" of their home).

B. Exceptions to the Stay

[11] [12] The City next argues that even if the stay applies, it is excepted under  § 362(b)(3) and  (b)(4). "We construe the Bankruptcy Code 'liberally in favor of the debtor and strictly against the creditor.' "  *Village of San Jose v. McWilliams*, 284 F.3d 785, 790 (7th Cir. 2002) (quoting  *In re Brown*, 108 F.3d 1290, 1292 (10th Cir. 1997)). The automatic stay is "one of the fundamental debtor protections provided by the bankruptcy laws."  *Midlantic Nat'l Bank v. N.J. Dep't of Env'tl. Prot.*, 474 U.S. 494, 503, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986) (quoting S. Rep. No. 95–989, at 54 (1978), reprinted in 1978 U.S.C.A.N. 5787, 5840). We therefore narrowly construe exceptions "to give the automatic stay its intended broad application." *In re Grede Foundries, Inc.*, 651 F.3d 786, 790 (7th Cir. 2011); see  *In re Stringer*, 847 F.2d 549, 552 (9th Cir. 1988) ("Congress clearly intended the automatic stay to be quite broad. Exemptions to the stay, on the other hand, should be read narrowly to secure the broad grant of relief to the debtor." (footnotes omitted)).

1. Section 362(b)(3)

[13]  Section 362(b)(3) provides that a Chapter 13 bankruptcy petition does not operate as a  § 362(a) automatic stay:

of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of [the Bankruptcy Code] or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of [the Bankruptcy Code].

 **11 U.S.C. § 362(b)(3)**. Section 546(b) limits a trustee's power to avoid a nonperfected lien by making that power subject to any ***928** nonbankruptcy law that "permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection," or "provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation."  **11 U.S.C. § 546(b)(1)**. The classic example of this exception is for a creditor who has a grace period for perfecting its interest, such as under the Uniform Commercial Code. *See* 3 Collier on Bankruptcy ¶ 362.05 (explaining  **§ 362(b)(3)** permits a purchase-money secured creditor to retroactively perfect under the twenty-day grace period provided in Article 9 of the U.C.C. and permits the filing of continuations of financing statements under **U.C.C. § 9-515**).

[14] As the *In re Shannon* court explained, through  §§ **362(b)(3)** and  **546(b)**, "Congress sought only to prevent a trustee from avoiding the lien of a creditor when only the intervening bankruptcy stopped the creditor from perfecting or continuing perfection of its lien." Thus, the purpose of these sections is to prevent creditors from losing their lien rights because of the bankruptcy; they do not permit creditors to retain possession of debtors' property. Indeed, if the nonbankruptcy law requires a creditor to seize property after the filing of a bankruptcy petition to perfect or maintain the perfection of a lien,  **§ 546(b)(2)** replaces the seizure requirement with the giving of notice. *See* 3 Collier on Bankruptcy ¶ 362.05. "This assures that the trustee's right to maintain possession of the property will be unaffected by

the creditor's right to perfect its interest." *Id.* And the (b)(3) exception permits a creditor to give notice under  **§ 546(b)(2)** without violating the automatic stay.

Here, the City argues the Chicago Municipal Code (a nonbankruptcy law) gives it the right to retain possession of a debtor's vehicle until the debt is paid, thereby creating a possessory lien on the vehicle. *See, e.g.,* M.C.C. §§ 9-92-080(f), 9-100-120(b)–(c). It further asserts it must retain the vehicle to maintain perfection of its lien.

First, as to perfection, it is commonly understood that an interest in property is perfected when it is valid against other creditors who have an interest in the same property. *See Perfection*, Black's Law Dictionary (11th ed. 2019). The City's continued possession of a debtor's vehicle is one way to perfect its lien because it can demand the amount owed to it from any holder of an interest in the vehicle before it gives up possession, be that the debtor or another lienholder asserting its right to possession of the vehicle. *See* M.C.C. § 9-92-080(a), (c). However, possession is not the only way to perfect; the City can also perfect its lien by filing notice of its interest in the vehicle, such as with the Secretary of State or the Recorder of Deeds. And the Chapter 13 plan, itself, provides a public record of secured liens. *See* **11 U.S.C. § 1325(a)(5)** (regarding the rights of secured creditors related to confirmation of the plan). Thus, the City does not need to retain possession of the vehicle to maintain perfection of its lien.

Second, despite its arguments to the contrary, the City's possessory lien is not destroyed by its involuntary loss of possession due to forced compliance with the Bankruptcy Code's automatic stay. The City did not indicate any intent to abandon or release its lien, so its possessory lien survives its loss of possession to the bankruptcy estate. *See In re Estate of Miller*, 197 Ill.App.3d 67, 144 Ill.Dec. 890, 556 N.E.2d 568, 572 (1990) ("The law respecting common law retaining liens is that the involuntary relinquishment of retained property pursuant to a court order does not result in the loss of the lien."); *see also* ***929 In re Borden**, 361 B.R. 489, 495 (B.A.P. 8th Cir. 2007) ("[I]nvoluntary loss of possession does not defeat the [] lien."); *Restatement (First) of Security* § 80 cmt. c (1941) ("The lien is a legal interest dependent upon possession. Where the lienor voluntarily gives up the possession, his lien, at least so far as it is a legal interest, is gone. The lienor ... does not lose his legal interest if he is deprived without his consent of his possession.").³

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Because the City does not lose its perfected lien via the involuntary loss of possession of the debtors' vehicles to the bankruptcy estates, § 362(b)(3) does not apply to except it from the stay. To the extent the City has any doubt about the continuation of its lien, when it requests relief from the automatic stay and adequate protection, it could also ask the bankruptcy court to include in its order a notation of the City's continuing lien on the property.

2. Section 362(b)(4)

[15] [16] Alternatively, the City looks to § 362(b)(4) to except it from the stay. That section provides that a Chapter 13 bankruptcy petition does not operate as a § 362(a) automatic stay:

of the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's ... police or regulatory power.

 11 U.S.C. § 362(b)(4). "This exception has been narrowly construed to apply to the enforcement of state laws affecting health, welfare, morals and safety, but not to 'regulatory laws that directly conflict with the control of the res or property by the bankruptcy court.' "  *In re Cash Currency Exch., Inc.*, 762 F.2d 542, 555 (7th Cir. 1985) (quoting  *In re Missouri*, 647 F.2d 768, 776 (8th Cir. 1981)). The City asserts its impoundment of vehicles is an exercise of its police power to enforce traffic regulations as a matter of public safety. The debtors respond that the impoundment of vehicles enhances the City's revenue collection rather than protects public safety, and it is therefore an enforcement of a money judgment which § 362(b)(4) does not permit.

[17] Courts apply two tests to determine whether a state's actions fall within the scope of § 362(b)(4)—the pecuniary purpose test and the public policy test.  *Chao v. Hosp. Staffing Servs., Inc.*, 270 F.3d 374, 385–86 (6th Cir. 2001);  *In re First All. Mortg. Co.*, 263 B.R. 99, 107–08 (B.A.P. 9th Cir. 2001). Satisfying either test is sufficient for the exception to apply. See  *First All. Mortg.*, 263 B.R. at 108; see also 3 Collier on Bankruptcy ¶ 362.05.

[18] [19] The pecuniary purpose test requires the court to "look to what specific acts the government wishes to carry out and determine if such execution would result in an economic advantage over third parties in relation to the debtor's estate."  *Solis v. Caro*, No. 11-cv-6884, 2012 WL 1230824, at *5 (N.D. Ill. Apr. 12, 2012) (quoting  *930 *In re Emerald Casino, Inc.*, No. 03-cv-05457, 2003 WL 23147946, at *8 (N.D. Ill. Dec. 24, 2003)). "[I]f the focus of the police power is directed at the debtor's financial obligations rather than the [government's] health and safety concerns, the automatic stay is applicable." *In re Ellis*, 66 B.R. 821, 825 (N.D. Ill. 1986) (quoting  *In re Sampson*, 17 B.R. 528, 530 (Bankr. D. Conn. 1982)). Though the City says its impoundment laws are "designed to further the safety and welfare of Chicago residents" with just an "ancillary pecuniary benefit," we disagree. In retaining possession of the vehicles until it is paid in full, the City is "attempting to satisfy a debt outside the bankruptcy process," which would give it an advantage over other parties interested in the debtors' estates.  *Emerald Casino*, 2003 WL 23147946, at *9. The City's act is focused on the debtor's financial obligation, not its safety concerns, and thus fails the pecuniary purpose test.

[20] Alternatively, the public policy test considers whether the state action is principally to effectuate public policy or to adjudicate private rights.  *Hosp. Staffing Servs.*, 270 F.3d at 385–86; *Caro*, 2012 WL 1230824, at *4. The public policy the City highlights is enforcing its traffic ordinances against repeat offenders "for the safety and convenience of the public." It explains the traffic ordinance system gradually escalates, beginning with the issuance of fines then intensifying to immobilization and impoundment only after an individual ignores repeat citations. Without impoundment as a general deterrence, the City argues, it cannot enforce its traffic regulations. See  *Emerald Casino*, 2003 WL 23147946, at *6.

The debtors argue the balance between revenue collection and public safety weighs heavily toward the former. Additionally, prior to the 2016 Municipal Code amendment imposing a possessory lien on impounded vehicles, the City released impounded vehicles to Chapter 13 debtors. When the City recently amended the Code, it did not mention public safety concerns but rather stated the amendment was “in response to a growing practice of individuals attempting to escape financial liability for their immobilized or impounded vehicles.” Chi., Ill., Ordinance, Amendment of M.C.C. § 9-100-120 (July 6, 2017).

We are persuaded that, on balance, this is an exercise of revenue collection more so than police power. As debtors observe, a not insignificant portion of the City’s annual operating fund comes from its collection of parking and traffic tickets. *See* City of Chicago, 2019 Budget Overview 29, 192 (2018), <https://chicago.legistar.com/View.ashx?M=F&ID=6683992&GUID=CAEFBC7F-7C1A-4B2E-9F8B-0C931B3EE88> (fines, forfeitures, and penalties—primarily from parking tickets—constitute approximately nine percent of the 2019 fund). Moreover, the kind of violations the City enforces are not traditional police power regulations; these fines are for parking tickets, failure to display a City tax sticker, and minor moving violations. Even tickets for a suspended license, a seemingly more serious offense, are often the result of unpaid parking tickets and are thus not related to public safety. And the City impounds vehicles regardless of what violations the owner has accrued, without distinguishing between more serious violations that could affect public safety versus the mere failure to pay for parking. Most notably, the City imposes the monetary penalty on the owner of the vehicle, not the driver, which signals a seeming disconnect if the City actually has safety concerns about the offending driver. As the ordinance amending M.C.C. § 9-100-120 demonstrates, the City’s focus is on the financial liability of vehicle owners, not on public safety.

[21] But even if we assume that the adjudication of these violations is the result *931 of the City’s exercise of police and regulatory power, the City cannot enforce these final determinations of liability if they are “money judgment[s]” as the term is used in § 362(b)(4). *See* S. Rep. No. 95-989, at 52 (1978), *reprinted in* 1978 U.S.C.A.N. 5787, 5838 (“Since the assets of the debtor are in the possession and control of the bankruptcy court, and ... constitute a fund out of which all creditors are entitled to share, enforcement by a governmental unit of a money judgment would give it

preferential treatment to the detriment of all other creditors.”). A judgment is a “money judgment” that cannot be enforced without violating the automatic stay if it requires payment. 3 Collier on Bankruptcy ¶ 362.05 (“[T]he governmental unit still may commence or continue any police or regulatory action, including one seeking a money judgment, but *it may enforce only those judgments and orders that do not require payment.*” (emphasis added)); *First All. Mortg.*, 263 B.R. at 107 (same); *see also* 3 Collier on Bankruptcy ¶ 362.05 (“Although a governmental unit may obtain a liability determination, *it may not collect* on any monetary judgment received.” (emphasis added)); *SEC v. Brennan*, 230 F.3d 65, 71 (2d. Cir. 2000) (“[§ Section] 362(b)(4) permits the entry of a money judgment against a debtor ... [but] *anything beyond the mere entry of a money judgment* against a debtor is prohibited by the automatic stay.”).

The City claims it did not have money judgments “because it did not pursue the additional steps required to turn the citations into money judgments in the circuit court.” We disagree. A “money judgment” is simply an order that identifies “the parties for and against whom judgment is being entered” and “a *definite* and *certain* designation of the amount ... owed.” *Penn Terra Ltd. v. Dep’t of Envtl. Res.*, 733 F.2d 267, 275 (3d Cir. 1984). Prior to impounding a vehicle, the City must administratively adjudicate the debtor’s violations, *see* M.C.C. § 9-100-010, and those adjudications result in a determination of final liability—*i.e.*, a judgment. Only after a debtor has two or three judgments against it does the Municipal Code authorize the City to impound the vehicle until the debtor pays the judgments and related costs and fees. *See id.* §§ 2-14-132(c)(1)(A), 9-92-080, 9-100-120(b). So, without any additional steps, the City had final determinations of liability requiring these particular debtors to pay it specific sums.

The City does not contest that it conditioned the release of the debtors’ vehicles on payment of the amount specified in the final determinations of liability. *Cf. id.* § 9-100-100(b) (“Any fine and penalty ... remaining unpaid after the notice of final determination of liability is sent shall constitute a debt due and owing the city”). The continued possession of the vehicles is the City’s attempt to short-circuit the state court collection process and to enforce final judgments requiring monetary payment from the debtors. As such, the City is not excepted from the stay under § 362(b)(4). That the City is not excepted under § 362(b)(4) does not “permit[] debtors

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to park for free wherever they like, or to drive without a risk of fines for moving violations”  *In re Steenes*, 918 F.3d 554, 558 (7th Cir. 2019). This just means the City needs to satisfy the debts owed to it through the bankruptcy process, as do all other creditors.

For the foregoing reasons, we AFFIRM the judgments of the bankruptcy courts.

All Citations

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III. Conclusion

Footnotes

- 1 The *In re Shannon* court further found that  § 362(a)(4) and  (a)(6) also prohibit the City’s continued retention of debtors’ vehicles. Because the City is bound by the stay under  § 362(a)(3), we do not reach the applicability of the additional stay provisions.
- 2 We additionally note that the “flood” of Chapter 13 filings is evidence of the disproportionate effect of the City’s traffic fines and fees on its low-income residents, an issue that is not unique to Chicago. *See, e.g.*, Maura Ewing, *Should States Charge Low-Income Residents Less for Traffic Tickets?*, The Atlantic (May 13, 2017), <https://www.theatlantic.com/politics/archive/2017/05/traffic-debt-california-brown/526491/> (California); Sam Sanders, *Study Finds The Poor Subject To Unfair Fines, Driver's License Suspensions*, NPR: The Two-Way (Apr. 9, 2015), <https://www.npr.org/sections/thetwo-way/2015/04/09/398576196/study-find-the-poor-subject-to-unfair-fines-drivers-license-suspensions> (Missouri and California); Melissa Sanchez & Sandhya Kambhampati, *How Chicago Ticket Debt Sends Black Motorists Into Bankruptcy*, ProPublica Illinois (Feb. 27, 2018), <https://features.propublica.org/driven-into-debt/chicago-ticket-debt-bankruptcy/> (“[African-American] neighborhoods account for 40 percent of all debt, though they account for only 22 percent of all the tickets issued in the city over the past decade—suggesting how the debt burdens the poor.”); *see also* Torie Atkinson, Note, *A Fine Scheme: How Municipal Fines Become Crushing Debt in the Shadow of the New Debtors' Prisons*, 51 Harv. C.R.-C.L. L. Rev. 189, 217–22 (2016) (“The consequences of fines and fees can be dramatic and unforgiving: unemployment, loss of transportation, homelessness, loss of government or community services, and poor credit. And without the ability to accumulate wealth or capture even the smallest windfall for themselves, the poor become poorer, unable to climb out of an economic chasm.”).
- 3 The City’s attempt to distinguish between loss of possession due to compliance with a court order versus compliance with the automatic stay is in vain.  Section 362 provides for the imposition of punitive damages for willful violations of the automatic stay. *See*  11 U.S.C. § 362(k)(1). This demonstrates that failure to comply with the stay may be punished even more severely than failure to comply with a court order and, correspondingly, there is no question the stay *compels* the City to return the vehicles.

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In re Denby-Peterson, 941 F.3d 115 (2019)

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United States Court of Appeals, Third Circuit.

IN RE: Joy DENBY-PETERSON, Appellant

No. 18-3562

Argued May 23, 2019

Filed: October 28, 2019

Synopsis

Background: Chapter 13 debtor whose vehicle had been repossessed prepetition filed motion to compel turnover, and also sought to recover for creditor's alleged violations of automatic stay. The United States Bankruptcy Court for the District of New Jersey, [Andrew B. Altenburg, J.](#), 576 B.R. 66, denied motion in part. Debtor appealed. The United States District Court for the District of New Jersey, Noel L. Hillman, J., 595 B.R. 184, affirmed. Debtor appealed.

Holdings: The Court of Appeals, [Fuentes](#), Senior Circuit Judge, held that:

[1] as matter of first impression, stay provision had to be interpreted as prohibiting only postpetition affirmative act to exercise control over property of the estate;

[2] creditors that lawfully repossessed the motor vehicle securing their claim prior to commencement of debtor's Chapter 13 case, and that, once bankruptcy petition was filed, passively retained possession of vehicle did not thereby violate automatic stay;

[3] turnover provision of the Bankruptcy Code is not self-executing, and creditor's obligation to turn over estate property in its possession is not automatic; and

[4] even assuming that turnover provision was self-executing, creditors' alleged violation of turnover statute, in failing to promptly turn over motor vehicle, was not also in nature of willful violation of automatic stay.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Damages, Contempt, or Sanctions for Violation of Automatic Stay.

West Headnotes (22)

[1] **Bankruptcy**

🔑 Conclusions of law; de novo review

Bankruptcy

🔑 Clear error

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals reviews district court's determinations de novo, reviewing the legal conclusions of the bankruptcy court de novo and its factual determinations for clear error. [Fed. R. Bankr. P. 8013](#).

[2] **Bankruptcy**

🔑 Automatic Stay

Automatic stay serves twofold purpose: (1) of protecting debtor by stopping all collection efforts, harassment and foreclosure actions, thereby giving debtor a respite from creditors; and (2) of protecting creditors as whole by preventing particular creditors from acting unilaterally in their self-interest to obtain payment from a debtor to the detriment of other creditors. 📄 [11 U.S.C.A. § 362\(a\)](#).

[3] **Bankruptcy**

🔑 Proceedings, Acts, or Persons Affected

Automatic stay, by barring any act to obtain possession of property of the estate or to exercise control over property of the estate, prevents dismemberment of estate, and enables an orderly distribution of debtor's assets. 📄 [11 U.S.C.A. § 362\(a\)\(3\)](#).

[4] **Bankruptcy**

🔑 Damages and attorney fees

Creditor's violation of automatic stay is a "willful violation," of kind supporting damages award against creditor, when the creditor violates the

stay with knowledge that bankruptcy petition has been filed.  11 U.S.C.A. § 362(k).

[5] **Bankruptcy**

 Damages and attorney fees

“Willful violation” of automatic stay, of kind supporting a damages award against the offending creditor, does not require the creditor to intend to violate the stay; rather, it requires that the acts which violate the stay must be intentional.  11 U.S.C.A. § 362(k).

[6] **Statutes**

 Language

Statutory interpretation must begin with the language of the statute itself.

[7] **Bankruptcy**

 Construction and Operation

In interpreting provision of the Bankruptcy Code, court is not guided by a single sentence or member of a sentence, but looks to the provisions of the whole law, and to its object and policy.

 11 U.S.C.A. § 101 et seq.

[8] **Statutes**

 What constitutes ambiguity; how determined

Statutes

 Context

To determine the plainness or ambiguity of statutory language, court, in addition to considering the statutory language itself, may also engage in a studied examination of the statutory context.

[9] **Bankruptcy**

 Construction and Operation

If court ultimately determines that the provision of the Bankruptcy Code in question is clear and unambiguous, court must simply apply it

as written; however, if court finds that the provision is ambiguous, then it must turn to pre-Code practice and legislative history to find its meaning.

[10] **Statutes**

 Undefined terms

When statutory terms are left undefined, court must look to their ordinary meaning.

[11] **Bankruptcy**

 Proceedings, Acts, or Persons Affected

Provision of automatic stay that prohibits any party from taking “any act to obtain possession of property of the estate ... or to exercise control over property of the estate” prohibits only “acts to exercise control,” and not the actual “exercise of control” itself, and must be interpreted as prohibiting only postpetition affirmative act to exercise control over property of the estate.  11 U.S.C.A. § 362(a)(3).

[12] **Bankruptcy**

 Proceedings, Acts, or Persons Affected

Language of bankruptcy statute imposing an automatic stay to prohibit anyone from taking “any act to obtain possession of property of the estate ... or to exercise control over property of the estate” is prospective in nature.  11 U.S.C.A. § 362(a)(3).

[13] **Bankruptcy**

 Repossession

Creditors that lawfully repossessed motor vehicle securing their claim prior to commencement of debtor's Chapter 13 case, and that, once bankruptcy petition was filed, passively retained possession of the vehicle pending an order by bankruptcy court, did not “act to exercise control” over property of the estate in violation of automatic stay and were not liable to debtor in damages for failing to immediately return vehicle once notified of

debtor's bankruptcy filing.  11 U.S.C.A. § 362(a)(3),  (k).

1 Cases that cite this headnote

[14] Bankruptcy

 Automatic Stay

One of the automatic stay's primary purposes is to maintain the status quo between the debtor and his creditors, thereby affording the parties and the bankruptcy court an opportunity to appropriately resolve competing economic interests in orderly and effective way.  11 U.S.C.A. § 362(a).

[15] Bankruptcy

 Proceedings, Acts, or Persons Affected

Given that bankruptcy statute imposing an automatic stay to prohibit anyone from taking “any act to obtain possession of property of the estate ... or to exercise control over property of the estate” was clear and unambiguous in prohibiting only affirmative, postpetition acts to obtain possession of, or to exercise control over, estate property, there was no need to resort to legislative history to uncover the statute's meaning.  11 U.S.C.A. § 362(a)(3).

[16] Bankruptcy

 Collection and Recovery for Estate; Turnover

Turnover provision of the Bankruptcy Code is not self-executing, and creditor's obligation to turn over estate property in its possession is not automatic. 11 U.S.C.A. § 542(a).

[17] Bankruptcy

 Form and nature; adversary proceeding or application or motion

In order to obtain turnover of property allegedly included in bankruptcy estate, debtor must bring an adversary proceeding in bankruptcy court in order to give the court an opportunity to

determine whether the property is subject to turnover. 11 U.S.C.A. § 542(a).

[18] Bankruptcy

 Proceedings

Debtor's right to turnover is subject to substantive and procedural requirements that must be evaluated by the bankruptcy court; it is only after bankruptcy court has determined whether those requirements are met that debtor's right to turnover is triggered. 11 U.S.C.A. § 542(a).

[19] Bankruptcy

 Nature and form; adversary proceedings

“Adversary proceeding,” as that term is used in the Bankruptcy Rules, is essentially a self-contained trial within the original bankruptcy case itself, in which a panoply of additional procedures apply. Fed. R. Bankr. P. 7001.

[20] Bankruptcy

 Proceedings

Turnover provision does not placing the onus on creditors to immediately surrender property in their possession which the debtor claims is an estate asset and is subject to turnover, without regard to any affirmative defenses that they might have to turnover, and then immediately file a motion in bankruptcy court asserting their rights. 11 U.S.C.A. § 542(a).

[21] Bankruptcy

 Form and nature; adversary proceeding or application or motion

While the word “shall,” as used in turnover provision stating that any entity in possession, custody or control of any property that trustee can use, sell, or lease “shall deliver” that property to trustee, might be mandatory in nature, it was mandatory only in context of adversary proceeding presided over by bankruptcy court. 11 U.S.C.A. § 542(a).

[22] Bankruptcy **Damages and attorney fees**

Even assuming that turnover provision of the Bankruptcy Code was self-executing, lack of any cross-references between turnover and automatic stay provisions prevented court from finding that creditors' alleged violation of turnover statute, in failing to promptly turn over motor vehicle that they had lawfully repossessed prepetition upon being notified of debtor's Chapter 13 filing, was also in nature of willful violation of automatic stay, for which debtor was entitled to award of damages.  11 U.S.C.A. §§ 362(k), 542(a).

*118 Appeal from the United States District Court for the District of New Jersey (D.C. No. 1-17-cv-09985), District Judge: Hon. [Noel L. Hillman](#)

Attorneys and Law Firms

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[Craig Goldblatt](#) [Argued], WilmerHale, 1875 Pennsylvania Avenue, N.W., Washington, DC 20006, Counsel for Amicus Curiae in Support of the District Court's Judgment

Before: [McKEE](#), [SHWARTZ](#), and [FUENTES](#), Circuit Judges.

OPINION OF THE COURT

[FUENTES](#), Circuit Judge.

At the center of this bankruptcy appeal is “America's first sports car”: the Chevrolet Corvette.¹ Joy Denby-Peterson purchased a Chevrolet Corvette in July 2016. Several months later, the Corvette was repossessed by creditors after Denby-Peterson defaulted on her car payments. Denby-Peterson subsequently filed an emergency voluntary Chapter 13 petition in the Bankruptcy Court for the District of New Jersey. She then notified the creditors of the bankruptcy filing and demanded that they return the Corvette to her.

After the creditors did not comply with her demand, Denby-Peterson filed a motion for turnover in the Bankruptcy Court. She sought an order (1) compelling the creditors to return the Corvette to her, and (2) imposing sanctions for the creditors' alleged violation of the Bankruptcy Code's automatic stay.² The Bankruptcy Court entered an order mandating turnover of the Corvette to Denby-Peterson but denying Denby-Peterson's request for sanctions. The Bankruptcy Court denied the sanctions request on the basis that the creditors did not violate the automatic stay by failing to return the repossessed Corvette to Denby-Peterson upon receiving notice of the bankruptcy filing. Denby-Peterson *119 appeals from an order of the District Court affirming the Bankruptcy Court.

We are now presented with an issue of first impression for our Court: whether, upon notice of the debtor's bankruptcy, a secured creditor's failure to return collateral that was repossessed pre-bankruptcy petition is a violation of the automatic stay. We answer in the negative, and thus join the minority of our sister courts—the Tenth and D.C. Circuits—in holding that a secured creditor does not have an affirmative obligation under the automatic stay to return a debtor's collateral to the bankruptcy estate immediately upon notice of the debtor's bankruptcy because failure to return the collateral received pre-petition does not constitute “an[] act ... to exercise control over property of the estate.”³ We will therefore affirm the order of the District Court affirming the Bankruptcy Court.

I.**A. Facts**

On July 21, 2016, Debtor Joy Denby-Peterson purchased a used yellow 2008 Chevrolet Corvette from a car dealership named Pine Valley Motors. To finance her purchase, Denby-Peterson entered into a retail installment contract with Pine Valley Motors, which, in turn, assigned its rights under the contract to its affiliate company, NU2U Auto World.⁴ Under the contract, Denby-Peterson agreed to pay (1) a \$3,000 cash down payment; (2) a deferred down payment of \$2,491 by August 11, 2016 to pay sales taxes and registration fees to obtain permanent license plate tags; and (3) weekly installment payments of \$200 for 212 weeks. Between July 2016 and February 2017, Denby-Peterson made payments totaling \$9,200 under the contract, including the \$3,000 down payment applied on the day of the sale. She never made the

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required down payment of \$2,491. As a result, the creditors repossessed the Corvette in February or March 2017.⁵ The Corvette was never titled or registered in Denby-Peterson's name.

B. Bankruptcy Court Proceedings

i. Denby-Peterson's Chapter 13 Bankruptcy Petition

After the Corvette was repossessed, Denby-Peterson filed a voluntary petition for relief under Chapter 13 of the Bankruptcy Code on March 21, 2017. Under  [Section 362](#) of the Code, the filing of the petition triggered an automatic stay of “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.”⁶

***120** Within two days, the creditors received notice of Denby-Peterson's bankruptcy filing. Counsel for Denby-Peterson had notified them of the filing and demanded that they return the Corvette to Denby-Peterson. Counsel also maintained that the creditors' failure to return the Corvette would result in a violation of the automatic stay. He faxed a letter to the creditors which stated, in relevant part:

BE ADVISED your failure to release the vehicle to Ms. Denby-Peterson is a violation of the Automatic Stay. If the vehicle has not been released before 5pm today, this firm will seek damages, costs, and attorneys' fees against your company for willful violations of the automatic stay.⁷

The creditors did not comply with Denby-Peterson's demand and thus remained in possession of the Corvette.

ii. Denby-Peterson's Motion for Turnover and Sanctions

Denby-Peterson then filed a motion⁸ for turnover in Bankruptcy Court, asking the Bankruptcy Court to (1) order the creditors to return the Corvette to her, and (2) impose sanctions for the creditors alleged violation of the

automatic stay. Denby-Peterson sought costs and attorneys' fees for filing the motion; compensation for “non-economic damages”; punitive damages; and “all other relief the Court deem[ed] just and equitable.”⁹

The creditors opposed the motion. They also filed a proof of claim, asserting a security interest in the Corvette in the amount of \$28,773.¹⁰

iii. The Bankruptcy Court's Decision

Following a two-day hearing, the Bankruptcy Court issued a written decision and order granting the motion in part and denying it in part. The Bankruptcy Court, *inter alia*, granted Denby-Peterson's request for turnover and thus ordered the creditors to return the Corvette to Denby-Peterson within seven days, but denied Denby-Peterson's sanctions request.

The Bankruptcy Court held, *inter alia*, that (1) the creditors must return the Corvette under the Bankruptcy Code's turnover provision in Section 542(a),¹¹ and (2) the creditors did not violate the automatic stay by retaining possession of the Corvette ***121** upon receiving notice of the bankruptcy filing. Thus, the Bankruptcy Court determined that the creditors were not liable for sanctions based on an alleged violation of the automatic stay.

In reaching its holdings, the Bankruptcy Court found that Denby-Peterson had an equitable interest in the Corvette at the time of the bankruptcy filing, and therefore, the Corvette was property of the estate subject to turnover.¹²

Next, the Bankruptcy Court considered whether the creditors violated the automatic stay by failing to return the Corvette after learning of the bankruptcy filing. It identified the split among our sister circuits on this issue, pointing out that the Second, Seventh, Eighth, and Ninth Circuits (“the majority”) have held that the Bankruptcy Code's turnover provision requires immediate turnover of estate property that was seized pre-petition and that failure to do so violates the automatic stay.¹³ However, the Tenth and D.C. Circuits (“the minority”) “have instead held that a creditor does not violate the stay in regard to property of the estate if it merely maintains the status quo.”¹⁴ The Bankruptcy Court noted that the minority was critical of the majority's rule that [Section](#)

542(a)'s turnover provision "is self-effectuating" because "it does not allow for the possibility of defenses to turnover."¹⁵

The Bankruptcy Court ultimately adopted the minority position, describing it as "particularly persuasive"¹⁶ and pointing out that "[f]rom the inception of this case there was an issue regarding exactly what ... [Denby-Peterson]'s interest in ... [the Corvette] was."¹⁷ Accordingly, the Bankruptcy Court concluded that the creditors did not violate the automatic stay by failing to turn over the Corvette to Denby-Peterson "prior to adjudication of ... [her] right to redeem the [Corvette]," and thus, sanctions were not warranted.¹⁸

C. Denby-Peterson's Appeal to the District Court

Denby-Peterson appealed the Bankruptcy Court's order denying her sanctions request. Similar to the Bankruptcy Court, the District Court found "the minority position more persuasive."¹⁹ The District Court thus affirmed the Bankruptcy Court's order denying Denby-Peterson's sanctions request.²⁰

*122 [1] Denby-Peterson now appeals to our Court.²¹ Because the creditors are not participating in this appeal, we appointed Craig Goldblatt as *amicus curiae* to defend the judgment of the District Court.²²

II.

On appeal, Denby-Peterson renews her argument that the creditors violated the automatic stay by not returning the repossessed Corvette upon learning of the bankruptcy filing. To provide context for the issue before us, we will discuss the Bankruptcy Code's automatic stay before addressing the merits of this appeal.

Under  Section 362 of the Bankruptcy Code, entitled "[a]utomatic stay," the filing of a bankruptcy petition automatically triggers a stay.²³ Of particular relevance to this appeal, subsection (a)(3) provides that a bankruptcy petition "operates as a stay, applicable to all entities, of ... any act to obtain possession of property of the estate ... or to exercise control over property of the estate."²⁴ Property of the bankruptcy estate, in turn, generally includes "all legal or equitable interests of the debtor in property as of the

commencement of the case,"²⁵ "wherever located and by whomever held."²⁶

[2] [3] The automatic stay imposed by the Bankruptcy Code has a "twofold" purpose:

(1) to protect the debtor, by stopping all collection efforts, harassment, and foreclosure actions, thereby giving the debtor a respite from creditors and a chance 'to attempt a repayment or reorganization plan or simply be relieved of the financial pressures that drove him [or her] into bankruptcy;' and (2) to protect 'creditors by preventing particular creditors from acting unilaterally in self-interest to obtain payment from a debtor to the detriment of other creditors.'²⁷

*123 In furtherance of the automatic stay's overarching purpose,  Section 362(a)(3) "prevent[s] dismemberment of the estate," and enables an "orderly" distribution of the debtor's assets.²⁸

[4] [5] The consequences for willful violations of the automatic stay are set forth in  Section 362(k) which provides that, subject to one exception, "an individual injured by any willful violation" of the automatic stay is entitled to "actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages."²⁹ We have explained that "[i]t is a willful violation of the automatic stay when a creditor violates the stay with knowledge that the bankruptcy petition has been filed. Willfulness does not require that the creditor intend to violate the automatic stay provision, rather it requires that the acts which violate the stay be intentional."³⁰

III.

With the foregoing statutory background in mind, we now turn our attention to the issue of first impression before our Court: whether, upon receiving notice of a bankruptcy petition, a secured creditor violates the automatic stay by maintaining possession of collateral that it lawfully repossessed pre-petition. Specifically, we must decide whether the creditors' failure to return the Corvette to Denby-Peterson upon learning of her bankruptcy filing was a violation of the automatic stay.³¹

As we previously acknowledged, there is a circuit split on this issue, which we have not yet joined. Under the majority position, held by the Second, Seventh, Eighth, Ninth, and Eleventh Circuits, a secured creditor, upon learning of the bankruptcy filing, must return the collateral to the debtor and failure to do so violates the automatic stay.³² However, both the Tenth and D.C. Circuits disagree with the majority's interpretation of the automatic stay provision.³³ Under their view, a secured creditor is not obligated to return the collateral to the debtor until the debtor obtains a court order from the Bankruptcy Court requiring the creditor to do so. Thus, according to the minority, a creditor does not violate the automatic stay by retaining possession of the collateral after being notified of the bankruptcy filing.

Here, Denby-Peterson urges us to adopt the view of the majority of our sister circuits, advancing two theories in support of her position that the creditors violated the automatic stay. First, she maintains that the creditors' failure to return the Corvette violated the plain language of  Section 362(a)(3)'s automatic stay provision by being “an[] act ... to exercise control over *124 property of the estate.”³⁴ Second, Denby-Peterson asserts that  Section 362(a)(3)'s automatic stay provision and Section 542(a)'s turnover provision operate together such that a violation of the turnover provision results in a violation of the automatic stay. Thus, according to Denby-Peterson, the creditors were required to immediately turn over the Corvette, and by not doing so, they violated the automatic stay. For the reasons that follow, we are not persuaded by those arguments and thus hold that the creditors in this case did not violate the automatic stay. In so holding, we join the minority of our sister circuits.

IV.

A.

[6] We begin our interpretation of  Section 362(a)(3) of the Bankruptcy Code “where all such inquiries must begin: with the language of the statute itself.”³⁵

[7] [8] [9] In examining the Bankruptcy Code, we are not “guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.”³⁶ Thus, to determine the plainness or ambiguity

of  Section 362(a)(3)'s statutory language, in addition to considering the statutory language itself, we may also engage in “a studied examination of the statutory context.”³⁷ If we ultimately determine that a provision “is clear and unambiguous, [we] must simply apply it.”³⁸ However, if we find that a provision is ambiguous,³⁹ “we then turn to pre-Code practice and legislative history to find meaning.”⁴⁰

With these principles of construction in mind, we will now examine the language of  Section 362(a)(3). To reiterate,  Section 362(a)(3) provides, in relevant part, that the filing of a bankruptcy petition “operates as a stay ... of ... any act to ... exercise control over property of the estate.”⁴¹ According to Denby-Peterson, under the plain language of the automatic stay, a creditor who does not turn over property of the estate after a debtor demands its return exercises control over that property, thereby violating the automatic stay. While we agree that  Section 362(a)(3) is unambiguous, we decline to hold that a plain reading of that Section compels the conclusion that the creditors in this case violated the automatic stay by failing to turn over the Corvette to Denby-Peterson.

*125 [10] The operative terms and phrases of  Section 362(a)(3) are “stay,” “act,” and “exercise control.” Because the Bankruptcy Code does not define them, we must look to their ordinary meanings.⁴²

We start with the meaning of the word “stay.” *Black's Law Dictionary* defines “stay” as “[t]he postponement or halting of a proceeding, judgment, or the like” or “[a]n order to suspend all or part of a judicial proceeding or a judgment resulting from that proceeding.”⁴³ Moreover, *Webster's Third New International Dictionary* defines “stay” as a noun (as it is used in  Section 362) as: (1) “a bringing to a stop,” (2) “the action of halting,” and (3) “the state of being stopped.”⁴⁴

Next, the noun “act” means, among other things, “[s]omething done; the action or process of achieving this.”⁴⁵ *Black's Law Dictionary* similarly defines “act,” in relevant part, as “[s]omething done or performed,” or “[t]he process of doing or performing.”⁴⁶

Finally, as to the phrase “exercise control,” we will separately consider the verb “exercise” and the noun “control.” The

relevant definition of “exercise” is “[t]o put in action or motion.”⁴⁷ *Webster’s Third New International Dictionary* also defines “exercise,” in relevant part, as “to ... make effective in action.”⁴⁸ Additionally, “control,” as a noun, means, among other things, “[t]he fact or power of directing and regulating the actions of people or things; direction, management; command.”⁴⁹

[11] [12] From these definitions, we gather that  [Section 362\(a\)\(3\)](#) prohibits creditors from taking any affirmative act to exercise control over property of the estate. As correctly pointed out by the District Court, the statutory language “is prospective in nature ... the *exercise* of control is not stayed, but the *act* to exercise control is stayed.”⁵⁰ Therefore, we agree with the minority position held by two of our sister courts—the text of  [Section 362\(a\)\(3\)](#) requires a post-petition affirmative *126 act to exercise control over property of the estate.⁵¹

B.

[13] Here, a post-petition affirmative act to exercise control over the Corvette is not present. The creditors repossessed the Corvette before Denby-Peterson had filed for bankruptcy. Accordingly, pre-bankruptcy petition, the creditors had possession and control of the Corvette, and post-bankruptcy petition, the creditors merely passively retained that same possession and control. Although the creditors exercised control over the Corvette by keeping it in their possession after learning of the bankruptcy filing, the requisite post-petition affirmative “act ... to exercise control over” the Corvette is not present in this case.⁵² An application of the plain language of the statute to the facts of this case thus shows that the creditors did not violate the automatic stay.⁵³

[14] Our conclusion is bolstered by the legislative purpose and underlying policy goals of the automatic stay. It is well-established that one of the automatic stay’s primary purposes is “‘to maintain the status quo between the debtor and [his] creditors, thereby affording the parties and the [Bankruptcy] Court an opportunity to appropriately resolve competing economic interests in an orderly and effective way.’”⁵⁴ Here, the creditors had possession of the Corvette both before and after the bankruptcy filing. Thus, by keeping possession of the Corvette after learning of the bankruptcy filing, the creditors

preserved the pre-petition status quo. To hold that such a retention of possession violates the automatic stay would directly contravene the status-quo aims of the automatic stay.

In sum, the plain language of the automatic stay provision in  [Section 362\(a\)\(3\)](#) and the automatic stay’s legislative purpose indicate that Congress did not intend passive retention to qualify as “an act to ... exercise control over property of the estate.”⁵⁵ In light of our interpretation of  [Section 362\(a\)\(3\)](#), we thus hold that the creditors did not engage in a post-petition “act to ... exercise control” over the Corvette and thus did not violate the automatic stay.⁵⁶

C.

Denby-Peterson, on the other hand, disregards the automatic stay’s legislative purpose and instead relies on  [Section 362\(a\)\(3\)](#)’s scarce legislative history to support her position. She maintains that her *127 “plain language reading of  [Section 362](#) is bolstered by the 1984 Amendments to the Bankruptcy Code.”⁵⁷ We disagree.

[15] Given  [Section 362\(a\)\(3\)](#)’s unambiguous text, we need not resort to legislative history to uncover its meaning.⁵⁸ In any event, we point out that the relevant legislative history fails to shed light on Congress’s intent behind the 1984 addition of the “exercise control over property of the estate” clause. The legislative history reveals that, as originally enacted in 1978,  [Section 362\(a\)\(3\)](#) only stayed “any act to obtain possession of property of the estate or of property from the estate.”⁵⁹ Thereafter, in 1984, Congress amended  [Section 362\(a\)\(3\)](#) by inserting the “or to exercise control over property of the estate” clause.⁶⁰ Congress, however, “gave no explanation of its intent.”⁶¹

Denby-Peterson nevertheless urges us to follow the Seventh Circuit’s view that “the mere fact that Congress expanded the provision to prohibit conduct above and beyond obtaining possession of an asset suggests that it intended to include conduct by creditors who seized an asset pre-petition.”⁶² We will not do so because the legislative history would be pertinent only to the extent that Congress clearly expressed an intent to interpret  [Section 362\(a\)\(3\)](#) contrary to its

plain language. Here, Congress did not express any intent, much less an intent to include creditors' passive retention of property that was seized pre-petition.⁶³ Moreover, even assuming that  [Section 362\(a\)\(3\)](#) is ambiguous, thereby warranting consideration of legislative history, the legislative history's silence provides no guidance regarding Congress's rationale for adding the "or to exercise control over property of the estate" clause. Accordingly, the interpretation that Denby-Peterson urges us to adopt is unsupported by  [Section 362\(a\)\(3\)](#)'s legislative history as well as its statutory language.

V.

We now consider Denby-Peterson's final attempt to overcome the plain language of  [Section 362\(a\)\(3\)](#). Denby-Peterson asserts that  [Section 362](#)'s automatic stay should be read in conjunction with [Section 542\(a\)](#)'s allegedly self-effectuating turnover provision. We are not persuaded.

Under [Section 542\(a\)](#), creditors who are in possession of property of the estate *128 must turn over such property to the debtor "during the [Bankruptcy] case."⁶⁴ The turnover provision states, in relevant part, that "an entity, other than a custodian," such as a creditor,⁶⁵

in possession, custody, or control, during the case, of property that the [debtor] may use, sell, or lease under section 363 ..., or that the debtor may exempt under section 522 ... shall deliver to the [debtor], and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.⁶⁶

Denby-Peterson contends that we should join the majority of our sister circuits and conclude that: (1) [Section 542\(a\)](#)'s turnover provision is self-executing; (2) therefore, the creditors had a mandatory duty to return the Corvette to Denby-Peterson upon receiving notice of the bankruptcy

filing; and (3) when the creditors rejected Denby-Peterson's demand for turnover, they violated the automatic stay.⁶⁷ We respectfully disagree with the majority. For the following reasons, we conclude that Denby-Peterson's threefold argument is unpersuasive.

A.

[16] [17] First, in our view, [Section 542\(a\)](#)'s turnover provision is not self-executing; in other words, a creditor's obligation to turn over estate property to the debtor is not automatic.⁶⁸ Rather, the turnover provision requires the debtor to bring an adversary proceeding in Bankruptcy Court in order to give the Court the opportunity to determine whether the property is subject to turnover under [Section 542\(a\)](#).

[18] Both the Federal Rules of Bankruptcy Procedure and the text of the turnover provision support our conclusion by demonstrating that the debtor's right to turnover is subject to substantive and procedural requirements that must be evaluated by the Bankruptcy Court.⁶⁹ It is only after the Bankruptcy Court determines whether those requirements are met that the debtor's right to turnover is triggered.

i.

[19] We start with the procedure behind turnover. Denby-Peterson argues that a creditor's duty to turn over collateral is automatically triggered when a creditor receives notice of the bankruptcy petition. *129 In other words, procedurally, says Denby-Peterson, all the debtor must do to initiate turnover is file a bankruptcy petition and notify the creditor of the filing. However, [Federal Rule of Bankruptcy Procedure 7001\(1\)](#) explicitly indicates otherwise. Under that Rule, the debtor must bring a request for turnover in an adversary proceeding before a Bankruptcy Court.⁷⁰ Accordingly, contrary to Denby-Peterson's claim, the debtor must not only file a bankruptcy petition, he or she must also initiate a turnover proceeding by (1) filing a complaint in Bankruptcy Court and (2) serving a creditor with a copy of the complaint.⁷¹ This procedural requirement negates any possibility that a creditor's duty to turn over property is automatic.⁷²

ii.

Moreover, the plain language of the Bankruptcy Code's turnover provision also shows that the provision is not self-effectuating. [Section 542\(a\)](#) provides that only property of the estate, as defined in [Section 541](#), that is either (1) "property that the [debtor] may use, sell, or lease under section 363" or (2) property "that the debtor may exempt under section 522," is subject to turnover.⁷³ The turnover provision also explicitly limits the right to turnover to estate property that (1) is in the possession, custody or control of a creditor, and (2) is not "of inconsequential value or benefit to the estate."⁷⁴ Thus, on its face, the turnover provision includes numerous explicit conditions that must be satisfied before a property is subject to turnover.

[20] In the case before us today, Denby-Peterson asks us to essentially ignore [Section 542\(a\)](#)'s statutory prerequisites and find that a creditor must immediately turn over any collateral that a debtor deems to be subject to turnover. We will not do so. We further note that mandating creditors to automatically turn over any property that the debtor deems worthy of turnover would allow debtors to temporarily strip creditors of their rights to assert affirmative defenses such as laches,⁷⁵ or to [§130](#) claim that the property is not property of the estate. While it is true that creditors would presumably be able to assert these defenses in Bankruptcy Court after turning over the collateral to the debtor, we do not read the turnover provision as placing the onus on creditors to surrender the collateral and then immediately file a motion in Bankruptcy Court asserting their rights.

In sum, in light of the plain language of [Section 542\(a\)](#)'s turnover provision, and the procedural and substantive requirements underlying turnover, it would be illogical for us to interpret the turnover provision as imposing an automatic duty on creditors to turn over collateral to the debtor upon learning of a bankruptcy petition. We therefore reject Denby-Peterson's claim that the turnover provision is self-effectuating.⁷⁶ Instead, we conclude that the turnover provision is effectuated by virtue of judicial action. The Chapter 13 debtor must first seek court intervention, such as through an adversary proceeding, and then the Bankruptcy Court, not the debtor, must ultimately decide whether certain property must be turned over to the debtor.⁷⁷

B.

[21] Additionally, we point out that our interpretation of the turnover provision is not changed by the turnover provision's use of the phrase "shall deliver to the [debtor]."⁷⁸ As argued by Denby-Peterson, it may well be so that the word "shall" [§131](#) strongly suggests that turnover is mandatory.⁷⁹ However, turnover is mandatory only in the context of an adversary proceeding presided over by the Bankruptcy Court. Under [Rule 7001\(1\)](#), the debtor must bring an adversary proceeding seeking turnover. True, the turnover provision states: "shall deliver," but the question before us is when must a creditor deliver? The answer is when the Bankruptcy Court says so in the context of an adversary proceeding brought under [Rule 7001\(1\)](#). We view the statutory and procedural framework as: (1) the Chapter 13 debtor must seek court relief, such as by initiating an adversary proceeding requesting turnover; (2) the Bankruptcy Court then determines whether the property is subject to turnover; and (3) if it is, in accordance with that determination, the Bankruptcy Court issues a court order compelling a creditor to turn over property to the debtor.

Our conclusion is further supported by the United States Supreme Court's reasoning in [Citizens Bank of Maryland v. Strumpf](#).⁸⁰ In that case, the Court considered the interplay between the automatic stay⁸¹ and the turnover provision in [Section 542\(b\)](#). Notably, notwithstanding the word "shall" in that turnover provision, the [Strumpf](#) Court did not interpret the provision as self-executing.

[Section 542\(b\)](#)'s turnover provision states: "an entity that owes a debt that is property of the estate ... *shall* pay such debt to ... the trustee."⁸² However, an entity is excused from that obligation "to the extent that such debt may be offset under section 553 ... against a claim against the debtor."⁸³ Thus, similar to the turnover provision at issue in this case, the turnover provision in subsection (b) includes the word "shall" as well as a defense to turnover.

In [Strumpf](#), the Supreme Court held that a bank's temporary withholding of funds in a debtor's bank account, pending resolution of the bank's setoff right,⁸⁴ did not violate the automatic stay. In reaching that holding, the Court reasoned, among other things, that interpreting

Section 542(b)'s turnover provision as self-executing would “eviscerate” the provision's exceptions to the duty to pay.⁸⁵ Here, we likewise decline to interpret Section 542(a)'s “shall deliver” clause in a way that would disregard the provision's explicit defenses.⁸⁶

***132 C.**

[22] Even assuming the turnover provision is self-executing, as pointed out by the Tenth Circuit, “there is still no textual link between [Section] 542 and [Section] 362.”⁸⁷ The language of the automatic stay provision and the turnover provision do not refer to each other. The absence of an express textual link between the two provisions indicates that they should not be read together, so violation of the turnover provision would not warrant sanctions for violation of the automatic stay provision.

VI.

Guided by the plain language of the Bankruptcy Code's automatic stay and turnover provisions, the legislative purpose and policy goals of the automatic stay, and the reasoning of the Supreme Court and our two sister circuits, we hold that a creditor in possession of collateral that was repossessed before a bankruptcy filing does not violate the automatic stay by retaining the collateral post-bankruptcy petition.

We will thus affirm the order of the District Court affirming the Bankruptcy Court's order denying Denby-Peterson's request for sanctions.

All Citations

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Footnotes

¹ H.R. Res. 970, 110th Cong. (2008).

² See  11 U.S.C. §§ 362(a)(3),  (k).

³ *Id.* § 362(a)(3).

⁴ For the sake of brevity, we will collectively refer to Pine Valley Motors and NU2U Auto World as “the creditors.”

⁵ The retail installment contract's “repossession” clause states, in relevant part: “[i]f you are in default, we may take the vehicle from you after we give you any notice required by law.” Bankr. Petition No. 17-15532-ABA, Doc. No. 17-5 at 3. “Default,” in turn, is defined as including, among other things: (1) “failure to pay any installment when due”; (2) “failure to perform or breach of any section of th[e] contract”; and (3) “failure to obtain and maintain the insurance required by th[e] contract.” *Id.*

Before the Bankruptcy Court, the parties disputed the date of repossession. Denby-Peterson claimed that the Corvette was repossessed on March 13, 2017, while the creditors claimed that it was repossessed one month earlier, in February 2017. All parties nevertheless agree that the repossession occurred before Denby-Peterson filed for bankruptcy.

⁶  11 U.S.C. § 362(a)(3).

⁷ Bankr. Petition No. 17-15532-ABA, Doc. No. 5-3 at 3. See  11 U.S.C. § 362(k)(1).

⁸ The motion was entitled “motion for return of repossessed auto and seeking sanctions against creditor for violat[ing] the automatic stay.” Bankr. Petition No. 17-15532-ABA, Doc. No. 5 (original in uppercase and bold).

⁹ Bankr. Petition No. 17-15532-ABA, Doc. No. 5-7 at 3. See  11 U.S.C. § 362(k)(1) (stating, in relevant part, that “an individual injured by any willful violation of a stay ... shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages”); see also *In re Lansaw*, 853 F.3d 657, 667 (3d Cir. 2017), cert. denied sub nom. *Zokaïtes v. Lansaw*, — U.S. —, 138 S. Ct. 1001, 200 L.Ed.2d 253 (2018) (“expressly concluding that ‘actual damages’ under  § 362(k)(1) include damages for emotional distress resulting from a willful violation of the automatic stay.”).

¹⁰ The retail installment contract's “security interest” clause provides that (1) Denby-Peterson gave the creditors a security interest in, *inter alia*, the Corvette, and (2) the security interest “cover[ed] all amounts [she] owe[d].” Bankr. Petition No. 17-15532-ABA, Doc. No. 17-5 at 3.

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- 11 See 11 U.S.C. § 542(a) (stating, in relevant part, that “an entity, other than a custodian, in possession, custody, or control, during the case, of property that the [debtor] may use, sell, or lease under section 363 of this title ... shall deliver to the [debtor], and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate”).
- 12 See *id.* § 541(a) (defining “property of the estate,” in relevant part, as “all legal or equitable interests of the debtor in property as of the commencement of the case”).
- 13 See *In re Fulton*, 926 F.3d 916 (7th Cir. 2019); *In re Weber*, 719 F.3d 72 (2d Cir. 2013); *In re Del Mission Ltd.*, 98 F.3d 1147 (9th Cir. 1996); *In re Knaus*, 889 F.2d 773 (8th Cir. 1989); see also *In re Rozier*, 376 F.3d 1323, 1324 (11th Cir. 2004) (per curiam) (holding that the “district court did not err by affirming the bankruptcy court’s order holding [the creditor] in willful contempt of the automatic stay ... by refusing to return the vehicle”).
- 14 *In re Denby-Peterson*, 576 B.R. 66, 80 (Bankr. D.N.J. 2017) (citing *In re Cowen*, 849 F.3d 943 (10th Cir. 2017); *United States v. Inslaw, Inc.*, 932 F.2d 1467 (D.C. Cir. 1991)).
- 15 *Denby-Peterson*, 576 B.R. at 82.
- 16 *Id.*
- 17 *Id.*
- 18 *Id.* at 83.
- 19 *Denby-Peterson v. Nu2u Auto World*, 595 B.R. 184, 190 (D.N.J. 2018).
- 20 While Denby-Peterson’s appeal to the District Court was pending, the Bankruptcy Court dismissed the underlying bankruptcy case based on Denby-Peterson’s failure to make all required pre-confirmation payments to the Trustee. Before addressing the merits of the appeal, the District Court concluded that Denby-Peterson’s appeal was not mooted by the dismissal because the automatic-stay-related issue “is an ancillary issue not closely intertwined with the underlying bankruptcy.” *Denby-Peterson*, 595 B.R. at 188.
- 21 The District Court had jurisdiction under 28 U.S.C. § 158 (a). We have jurisdiction under 28 U.S.C. § 158(d)(1). Because the District Court acted as an appellate court, we review its determinations *de novo*. *In re Bocchino*, 794 F.3d 376, 379 (3d Cir. 2015). We review the legal conclusions of the Bankruptcy Court *de novo* and its factual determinations for clear error. *Id.* at 380.
- Generally, “[t]he imposition or denial of sanctions is subject to abuse-of-discretion review.” *In re Miller*, 730 F.3d 198, 203 (3d Cir. 2013). We have not, however, addressed our standard of review for the imposition or denial of sanctions for violations of the automatic stay. We nevertheless need not do so now given that (1) the Bankruptcy Court denied sanctions based on its conclusion that the creditors did not violate the automatic stay, and (2) we now hold that both the Bankruptcy Court and the District Court correctly concluded that there was no such violation.
- 22 We thank Mr. Goldblatt for his excellent briefing and oral advocacy in this matter.
- 23 11 U.S.C. § 362.
- 24 *Id.* § 362(a)(3). See H.R. Rep. No. 95-595, at 340 (1977) (stating that “[s]ubsection (a) defines the scope of the automatic stay, by listing the acts that are stayed by the commencement of the case”).
- 25 11 U.S.C. § 541(a)(1).
- 26 *Id.* § 541(a). In a Chapter 13 case, such as this case, the concept of property of the estate is broader. See *id.* § 1306 (a)(1) (providing that the Chapter 13 estate includes, in addition to the property specified in Section 541, property “that the debtor acquires after the commencement of the bankruptcy case” but before the case is either closed, dismissed, or converted).
- 27 *Constitution Bank v. Tubbs*, 68 F.3d 685, 691 (3d Cir. 1995) (quoting *Maritime Elec. Co. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1991)). See *Taggart v. Lorenzen*, — U.S. —, 139 S. Ct. 1795, 1804, 204 L.Ed.2d 129 (2019) (explaining that the automatic stay “aims to prevent damaging disruptions to the administration of a bankruptcy case in the short run”); *Inslaw*, 932 F.2d at 1473 (“The object of the automatic stay provision is essentially to solve a collective action problem—to make sure that creditors do not destroy the bankrupt estate in their scramble for relief.”).
- 28 H.R. Rep. No. 95-595, at 341.
- 29 11 U.S.C. § 362(k)(1). See *Id.* § 362(k)(2) (providing a “good faith” exception to Section 362(k)(1)).

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- 30  [In re Lansdale Family Rests., Inc.](#), 977 F.2d 826, 829 (3d Cir. 1992) (internal citations omitted).
- 31 It is undisputed here that the creditors repossessed the Corvette before Denby-Peterson had filed for bankruptcy and that the Corvette was property of Denby-Peterson's bankruptcy estate.
- 32 See  [Fulton](#), 926 F.3d 916;  [Weber](#), 719 F.3d 72;  [Del Mission](#), 98 F.3d 1147;  [Knaus](#), 889 F.2d 773;  [Rozier](#), 376 F.3d 1323.
- 33 See  [Cowen](#), 849 F.3d 943;  [Inslaw](#), 932 F.2d 1467.
- 34  11 U.S.C. § 362(a)(3).
- 35  [Ransom v. FIA Card Servs., N.A.](#), 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011) (internal quotation marks omitted).
- 36  [Kelly v. Robinson](#), 479 U.S. 36, 43, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) (internal quotation marks omitted). See  [In re Price](#), 370 F.3d 362, 369 (3d Cir. 2004) (emphasizing that “in interpreting the Bankruptcy Code, the Supreme Court has been reluctant to declare its provisions ambiguous, preferring instead to take a broader, contextual view”);  [Official Comm. of Unsecured Creditors of Cybergenics Corp., ex rel. Cybergenics Corp. v. Chinery](#), 330 F.3d 548, 559 (3d Cir. 2003) (“Statutory construction is a holistic endeavor, and this is especially true of the Bankruptcy Code.” (quotation marks, alterations and citations omitted)).
- 37  [Price](#), 370 F.3d at 369.
- 38 [In re KB Toys Inc.](#), 736 F.3d 247, 251 (3d Cir. 2013) (citing  [Roth v. Norfalco L.L.C.](#), 651 F.3d 367, 379 (3d Cir. 2011)).
- 39 See  [Price](#), 370 F.3d at 369 (explaining that “a provision is ambiguous when, despite a studied examination of the statutory context, the natural reading of a provision remains elusive”).
- 40  [In re Friedman's Inc.](#), 738 F.3d 547, 554 (3d Cir. 2013).
- 41  11 U.S.C. § 362(a)(3).
- 42 See  [Lamar, Archer & Cofrin, LLP v. Appling](#), — U.S. —, 138 S. Ct. 1752, 1759, 201 L.Ed.2d 102 (2018).
- 43 Stay, *Black's Law Dictionary* (11th ed. 2019). Black's Law Dictionary further defines “automatic stay” as “[a] bar to all judicial and extrajudicial collection efforts against the debtor or the debtor's property, subject to specific statutory exceptions.” *Id.*
- 44 *Webster's Third New International Dictionary* 2231 (1993); see Stay, Oxford English Dictionary Online, <https://www.oed.com/view/Entry/189408?rskey=uCJBz6& result=3& isAdvanced=false> (including, among its definitions of “stay,” “[t]he action of stopping or bringing to a stand or pause”) (last visited Aug. 15, 2019).
- 45 Act, Oxford English Dictionary Online, <https://www.oed.com/view/Entry/1888?rskey=eprROF& result=4> (last visited Aug. 15, 2019).
- 46 Act, *Black's Law Dictionary* (11th ed. 2019).
- 47 Exercise, Oxford English Dictionary Online, <https://www.oed.com/view/Entry/66089?rskey=QNVdyF& result=2& isAdvanced=false> (last visited Aug. 15, 2019); see Exercise, *Black's Law Dictionary* (11th ed. 2019) (describing “exercise” as meaning, in relevant part, “[t]o make use of; to put into action”).
- 48 *Webster's Third New International Dictionary* 795.
- 49 Control, Oxford English Dictionary Online, <https://www.oed.com/view/Entry/40562?rskey=qZlHZJ& result=1> (last visited Aug. 15, 2019); see Control, *Black's Law Dictionary* (11th ed. 2019) (identifying “the power or authority to manage, direct, or oversee” as one of the definitions of “control”).
- 50 [Denby-Peterson](#), 595 B.R. at 190.
- 51 See  [Cowen](#), 849 F.3d at 949 (concluding that  [Section 362\(a\)\(3\)](#) “stays entities from *doing* something to ... exercise control over the estate's property”);  [Inslaw](#), 932 F.2d at 1474 (“The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate.”).
- 52  11 U.S.C. § 362(a)(3).
- 53 Denby-Peterson's characterization of the creditors' post-petition behavior as a refusal to return the Corvette upon request does not alter our conclusion. A creditor's refusal to comply with a debtor's turnover request is not an affirmative act;

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- rather, it is inaction. Denby-Peterson's attempt to reframe creditors' failure to act as an affirmative act is unavailing as it does not alter the passive nature of the creditors' post-petition role in relation to the Corvette. See [Nat'l Fed'n of Indep. Bus. v. Sebelius](#), 567 U.S. 519, 555, 132 S.Ct. 2566, 183 L.Ed.2d 450 (2012) (recognizing "the distinction between doing something and doing nothing").
- 54 [Taylor v. Slick](#), 178 F.3d 698, 702 (3d Cir. 1999) (quoting [Zeoli v. RIHT Mortg. Corp.](#), 148 B.R. 698, 700 (D.N.H. 1993)) (emphasis and alteration in original).
- 55 [11 U.S.C. § 362\(a\)\(3\)](#).
- 56 *Id.*
- 57 Appellant's Br. at 13.
- 58 See [Doe v. Hesketh](#), 828 F.3d 159, 167 (3d Cir. 2016).
- 59 Bankruptcy Reform Act of 1978, [Pub. L. 95-598](#), [§ 362 \(a\)\(3\)](#), 92 Stat. 2549, 2570 (1978).
- 60 Bankruptcy Amendments and Federal Judgeship Act of 1984, [Pub. L. No. 98-353](#), [§ 362\(a\)\(3\)](#), 98 Stat. 333, 371 (1984).
- 61 [In re Young](#), 193 B.R. 620, 623 (Bankr. D.D.C. 1996).
- 62 [Thompson v. Gen. Motors Acceptance Corp., LLC](#), 566 F.3d 699, 702 (7th Cir. 2009). See [Fulton](#), 926 F.3d at 923 (declining to overrule [Thompson](#) and reiterating that the amendment "suggested congressional intent to make the stay more inclusive by including conduct of 'creditors who seized an asset pre-petition'" (quoting [Thompson](#), 566 F.3d at 702)); see also [Weber](#), 719 F.3d at 80 (describing the amendment as a "significant textual enlargement" that supports the view that "Congress intended to prevent creditors from retaining property of the debtor in derogation of the bankruptcy procedure ... without regard to what party was in possession of the property in question when the petition was filed").
- 63 See [Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.](#), 447 U.S. 102, 108, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980) ("Absent a clearly expressed legislative intention to the contrary, th[e] [statutory] language must ordinarily be regarded as conclusive.").
- 64 [11 U.S.C. § 542\(a\)](#). In a Chapter 13 case, such as this case, the debtor retains control over property of the estate. See *id.* § 1306(b). Accordingly, a Chapter 13 trustee does not take possession or liquidate property of the estate, except with respect to money collected for the purpose of making distributions to creditors under a plan. See *id.* §§ 1302, 1303.
- 65 See *id.* § 101(10)(A).
- 66 *Id.* § 542(a). See *id.* § 1303 (providing the Chapter 13 debtor "the rights and powers of a trustee under sections 363(b), 363(d), 363(e), 363(f), and 363(l)"); *id.* § 1306(b) (stating, in relevant part, that "the [Chapter 13] debtor shall remain in possession of all property of the estate").
- 67 See [Fulton](#), 926 F.3d 916; [Weber](#), 719 F.3d 72; [Del Mission](#), 98 F.3d 1147; [Knaus](#), 889 F.2d 773.
- 68 But see [Fulton](#), 926 F.3d at 924 (reaffirming that [Section 362\(a\)\(3\)](#) "becomes effective immediately upon filing the petition and is not dependent on the debtor first bringing a turnover action"); [Weber](#), 719 F.3d at 79 ("Section 542 requires that any entity in possession of property of the estate deliver it to the trustees, without condition or any further action: the provision is self-executing." (internal quotation marks omitted)).
- 69 See 4 Norton Bankr. L. & Prac. 3d § 62:3 (2019) (stating that "several [Bankruptcy] Code provisions play a role in determining whether a turnover will be ordered pursuant to Code § 542(a)").
- 70 See [Fed. R. Bankr. P. 7001\(1\)](#) (identifying, in relevant part, "a proceeding to recover money or property" as an adversary proceeding).
- 71 "An adversary proceeding is essentially a self-contained trial—still within the original bankruptcy case—in which a panoply of additional procedures apply," [In re Mansaray-Ruffin](#), 530 F.3d 230, 234 (3d Cir. 2008) (citing [Fed. R. Bankr. P. 7001-7087](#)), including the requirement that a complaint must be filed to commence such a proceeding, see [Fed. R. Bankr. P. 7003](#) (stating that [Federal Rule of Civil Procedure 3](#) "applies in adversary proceedings").
- 72 Here, as noted by the Bankruptcy Court, Denby-Peterson did not initiate an adversary proceeding. Instead, she filed a motion for turnover entitled, in relevant part, "Motion for Return of Repossessed Auto." [Denby-Peterson](#), 576 B.R. at 69.

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Faced with this procedural posture, the Bankruptcy Court concluded that the parties waived their right to an adversary proceeding. See [In re Village Mobile Homes, Inc.](#), 947 F.2d 1282, 1283 (5th Cir. 1991) (“Compliance with the requisites of an adversary proceeding may be excused by waiver of the parties.”). Treating the matter as a contested motion, the Court then addressed the merits of the turnover request. This difference in the procedural mechanism used to achieve turnover does not change our conclusion because, regardless of the form, a debtor must initiate a procedural event before the Bankruptcy Court in order for turnover to occur, if applicable, under the Bankruptcy Court’s supervision.

73 11 U.S.C. § 542(a).

74 *Id.*

75 See [In re Mushroom Transp. Co., Inc.](#), 382 F.3d 325, 337 (3d Cir. 2004); see also [In re Stancil](#), 473 B.R. 478, 484 (Bankr. D.D.C. 2012) (“The plain language of [section 542\(a\)](#) demonstrates that establishing inconsequential value or benefit to the estate is an affirmative defense to a turnover action.”).

76 Denby-Peterson’s reliance on the Supreme Court’s decision in [United States v. Whiting Pools, Inc.](#) is misplaced.

[462 U.S. 198, 201, 103 S.Ct. 2309, 76 L.Ed.2d 515 \(1983\)](#). Contrary to Denby-Peterson’s claim that [Whiting Pools](#)

implicitly supports the proposition that the turnover provision is self-effectuating, [Whiting Pools](#) suggests the opposite: that the turnover provision is not self-effectuating because adequate protection can serve as a condition precedent before turnover. See 11 U.S.C. § 542(a) (providing that “property that the [debtor] may use, sell, or lease under section 363” may be subject to turnover); *id.* § 363(e) (stating, in relevant part, that “the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest”); *id.* § 361 (providing examples of “adequate protection”).

In [Whiting Pools](#), the Bankruptcy Court, not the Chapter 11 debtor, ordered the creditor to turn over property to the debtor. [462 U.S. at 201, 103 S.Ct. 2309](#). Moreover, it did so only “on the condition that [the Chapter 11 corporate-debtor] provide the [creditor] with specified [adequate] protection for its interests.” *Id.* See [id. at n.7](#) (“Pursuant to [[Section 363\(e\) of the Bankruptcy Code](#)], the Bankruptcy Court set the following conditions to protect the tax lien: [the debtor] was to pay the [creditor] \$20,000 before the turnover occurred; [the debtor] also was to pay \$1,000 a month until the taxes were satisfied; the [creditor] was to retain its lien during this period; and if [the debtor] failed to make the payments, the stay was to be lifted.”). [Whiting Pools](#) thus suggests that turnover is required upon (1) the debtor’s filing of a motion for turnover, and (2) the issuance of a court order.

77 We also note that under pre-Code practice, turnover was not viewed as self-effectuating. Before the Bankruptcy Code was enacted, a secured creditor, who had repossessed collateral pre-bankruptcy, retained possession pending the Bankruptcy Court’s entry of a turnover order, see Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part I): Origins and Evolution of the Turnover Power*, 33 Bankr. L. Letter No. 8, at 4-7 (Aug. 2013), and “[n]othing in the legislative history evinces a congressional intent to depart from that [pre-Code] practice.” [Whiting Pools](#), 462 U.S. at 208, 103

S.Ct. 2309. See [In re VistaCare Grp., LLC](#), 678 F.3d 218, 227-28 (3d Cir. 2012) (recognizing that “courts should be ‘reluctant to accept arguments that would interpret the Code ... to effect a major change in pre-Code practice,’ absent at least some suggestion in the legislative history that such a change was intended” (quoting [Dewsnup v. Timm](#), 502 U.S. 410, 419, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992))).

78 11 U.S.C. § 542(a).

79 See [Alabama v. Bozeman](#), 533 U.S. 146, 153, 121 S.Ct. 2079, 150 L.Ed.2d 188 (2001) (“The word ‘shall’ is ordinarily the language of command.” (internal quotation marks omitted)); [Dessouki v. Att’y Gen. of United States](#), 915 F.3d 964, 966 (3d Cir. 2019) (recognizing that “the word ‘shall’ imposes a mandatory requirement”); see also Shall, *Black’s Law Dictionary* (11th ed. 2019) (defining “shall,” in relevant part, as “[h]as a duty to; more broadly, is required to,” and characterizing that usage as “the mandatory sense that drafters typically intend and that courts typically uphold”).

80 [516 U.S. 16, 116 S.Ct. 286, 133 L.Ed.2d 258 \(1995\)](#).

81 As relevant to [Strumpf](#), the filing of a bankruptcy petition stays “the setoff of any debt owing to the debtor that arose before the commencement of the [bankruptcy] case ... against any claim against the debtor.” 11 U.S.C. § 362(a)(7).

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82 *Id.* § 542(b) (emphasis added).

83 *Id.*

84 See  *Strumpf*, 516 U.S. at 19, 116 S.Ct. 286 (“Petitioner refused to pay its debt, not permanently and absolutely, but only while it sought relief under  § 362(d) from the automatic stay.”).

85  *Id.* at 20, 116 S.Ct. 286.

86 See  *Smith v. City of Jackson*, 544 U.S. 228, 233, 125 S.Ct. 1536, 161 L.Ed.2d 410 (2005) (“[W]hen Congress uses the same language in two statutes having similar purposes ... it is appropriate to presume that Congress intended that text to have the same meaning in both statutes.”).

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

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In re Charter Communications, Inc., 691 F.3d 476 (2012)

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Distinguished by In re: Fletcher International, Ltd., S.D.N.Y., January 4, 2016

691 F.3d 476

United States Court of Appeals,
Second Circuit.

In re CHARTER COMMUNICATIONS, INC.

R² Investments, LDC, Appellant,

v.

Charter Communications, Inc., CCH I, LLC,
CCH I Capital Corporation, CCH II, LLC, CCH

II Capital Corporation, Debtors—Appellees,

Paul G. Allen, Official Committee
of Unsecured Creditors, Appellees.Law Debenture Trust Company
of New York, Appellant,

v.

Charter Communications, Inc., CCH I, LLC,
CCH I Capital Corporation, CCH II, LLC, CCH

II Capital Corporation, Debtors—Appellees,

Paul G. Allen, Official Committee of

Unsecured Creditors, Appellees. *

Docket Nos. 11–1710–bk, 11–1726–bk.

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Argued: March 26, 2012.

|

Decided: Aug. 31, 2012.

Synopsis

Background: Confirmation hearing was held on pre-packaged Chapter 11 plan of related debtor entities, pursuant to which debtors sought to restructure their debt while reinstating senior loans that they had obtained on favorable terms. The Bankruptcy Court, [James M. Peck, J.](#), [419 B.R. 221](#), overruled objections and entered order confirming plan. Certain creditors appealed. The United States District Court for the Southern District of New York, [George B. Daniels, J.](#), [449 B.R. 14](#), dismissed appeal as equitably moot. Creditors appealed.

Holdings: The Court of Appeals, [John M. Walker, Jr.](#), Circuit Judge, held that:

[1] abuse of discretion standard of review applied and

[2] district court did not abuse its discretion in determining that appeal was equitably moot.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (18)

[1] **Bankruptcy**

Moot questions

Equitable mootness is a prudential doctrine under which a district court may dismiss a bankruptcy appeal when, even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable.

[60 Cases that cite this headnote](#)

[2] **Bankruptcy**

Moot questions

Equitable mootness in the bankruptcy setting requires the district court to carefully balance the importance of finality in bankruptcy proceedings against the appellant's right to review and relief.

[53 Cases that cite this headnote](#)

[3] **Bankruptcy**

Moot questions

Equitable mootness applies to specific claims, not entire appeals and must be applied with a scalpel rather than an axe.

[4] **Bankruptcy**

Presumptions and burdens of proof

An appeal is presumed equitably moot where the debtor's plan of reorganization has been substantially consummated. [11 U.S.C.A. § 1101\(2\)](#).

[19 Cases that cite this headnote](#)

[5] **Bankruptcy**

👉 Presumptions and burdens of proof

The presumption of equitable mootness can be overcome if (1) the court can still order some effective relief; (2) such relief will not affect the re-emergence of the debtor as a revitalized corporate entity; (3) such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the bankruptcy court; (4) the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (5) the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from.

[17 Cases that cite this headnote](#)

[6] **Bankruptcy**

👉 Moot questions

Substantial consummation does not necessarily make it impossible or inequitable for an appellate court to grant effective relief; nor is a claim automatically equitably moot if the relief requested would require that a confirmed plan be altered. 11 U.S.C.A. § 1101(2).

[2 Cases that cite this headnote](#)

[7] **Bankruptcy**

👉 Moot questions

When examining a debtor's contention that a claim is equitably moot, a court cannot rely solely on the debtor's conclusory predictions or opinions that the requested relief would doom the reorganized company; instead, an analytical inquiry into the likely effects of the relief an appellant seeks is required and must be based on facts.

[2 Cases that cite this headnote](#)

[8] **Bankruptcy**

👉 Discretion

Abuse of discretion standard of review applied to appeal of equitable mootness determination, since that determination involved discretionary balancing of equitable and prudential factors.

[3 Cases that cite this headnote](#)

[9] **Bankruptcy**

👉 Moot questions

District court did not abuse its discretion in determining that appeal from order confirming the Chapter 11 debtor's now substantially consummated plan was equitably moot, to extent that it sought order directing former principal shareholder to return some or all of his settlement consideration or directing reorganized debtor to pay similar consideration to noteholders; such consideration was essential part of settlement that formed cornerstone of plan, former shareholder already had performed and thereby secured billions of dollars of benefits for debtor and its creditors, benefits that far exceeded consideration that he received, and requested relief would necessitate reversal or unraveling of plan.

[10] **Bankruptcy**

👉 Effect of want of stay; conclusiveness of sale

Bankruptcy

👉 Moot questions

Analysis of equitably mootness factor regarding diligence in seeking stay was not affected by fact that stay was not granted to appellants.

[11] **Bankruptcy**

👉 Moot questions

Equitable mootness factor regarding affect of appeal of third-party releases on other parties did not favor application of that doctrine, since parties affected were parties to appeal or parties that participated actively in bankruptcy proceedings, requiring disgorgement of ill-

gotten gains would not have been inequitable if releases were unlawful, and striking releases from plan would have affected only those third-parties that benefited from releases; although less direct effects may have been felt by reorganized debtor's shareholders, debtor had fully disclosed existence of appeal and possibility of adverse ruling as risk factor in publicly filed reports.

[2 Cases that cite this headnote](#)

[12] Bankruptcy

 [Moot questions](#)

District court did not abuse its discretion in determining that appeal from order confirming Chapter 11 debtor's now substantially consummated plan, to extent that it sought to strike third party release provisions from plan, was equitably moot; release provisions were essential part of pre-negotiated plan that was product of extensive arm's length bargaining between debtor and its various constituencies, and granting requested relief would nullify and unravel plan.

[1 Cases that cite this headnote](#)

[13] Bankruptcy

 [Moot questions](#)

Normally, a nonseverability clause standing on its own cannot support a finding of equitable mootness; allowing a boilerplate nonseverability clause, without more, to determine the equitable mootness question would give the debtor and other negotiating parties too much power to constrain Article III review. [U.S.C.A. Const. Art. 3, § 1 et seq.](#)

[14] Bankruptcy

 [Moot questions](#)

Equitable mootness is a practical doctrine that requires courts to consider the actual effects of the relief requested on a debtor's emergence from bankruptcy.

[4 Cases that cite this headnote](#)

[15] Bankruptcy

 [Moot questions](#)

While a nonseverability clause may be one indication that a particular term was important to the bargaining parties, a district court cannot rely on such a clause to the exclusion of other evidence to support a finding of equitable mootness.

[6 Cases that cite this headnote](#)

[16] Bankruptcy

 [Moot questions](#)

District court did not abuse its discretion in determining that appeal from order confirming Chapter 11 debtor's now substantially consummated plan, to extent that it sought a stand-alone valuation of debtor with equity distributed to shareholders, was equitably moot; plan expressly provided for classification and treatment of claims and interests in great detail, and inasmuch as value of reorganized debtors, and how much equity would go to creditors and how much would go to shareholders, was key issue of reorganization, court could not see how such relief would have only minimal interference with other interests or how it would not inequitably disturb numerous consummated transactions and further transactions taken in reliance thereon.

[1 Cases that cite this headnote](#)

[17] Bankruptcy

 [Decisions Reviewable](#)

When the confirmation order is on appeal, the legal effects of that order, such as extinguishing equity, cannot themselves preclude review.

[18] Bankruptcy

 [Moot questions](#)

District court did not abuse its discretion in determining that appeal from order confirming Chapter 11 debtor's now substantially consummated plan, to extent that it was grounded on improper classification, artificial impairment,

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and absolute priority claims, was equitably moot; granting relief on any of the claims at issue, such as by modifying particular classification, was not possible given nonseverability and mutually dependent provisions in plan confirmation order, and any grant of relief requested would threaten to nullify existing plan and require negotiation of entirely new plan.  11 U.S.C.A. § 1129.

2 Cases that cite this headnote

Attorneys and Law Firms

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Before: **JOHN M. WALKER, JR.**, **LYNCH** and **LOHIER**, Circuit Judges.

Opinion

JOHN M. WALKER, JR., Circuit Judge:

On March 27, 2009, Charter Communications, Inc. (“CCI” and, together with its affiliated debtors, “Charter”) filed what the Bankruptcy Court for the Southern District of New York (James M. Peck, *Bankruptcy Judge*) described as “perhaps the largest and most complex prearranged

bankruptcies ever attempted, and in all likelihood ... among the most ambitious and contentious as well.”

 *JPMorgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC* (In re Charter Commc'ns), 419 B.R. 221, 230 (Bankr.S.D.N.Y.2009). Following the bankruptcy court's confirmation of Charter's proposed plan of reorganization (the “Plan”), the Law Debenture Trust Company of New York (“LDT”), as indenture trustee for certain notes issued by CCI, and R² Investments, LDC (“R²”), a CCI shareholder, appealed the confirmation order to the District Court for the Southern District of New York. The district court (George B. Daniels, *Judge*) dismissed those appeals under the doctrine of equitable mootness.  *R² Invs., LDC v. Charter Commc'ns, Inc.* (In re Charter Commc'ns), 449 B.R. 14 (S.D.N.Y.2011).

LDT and R² now appeal that dismissal. We agree with the district court that the appeals are equitably moot and affirm.

BACKGROUND

We recite only those facts necessary to this appeal. A full recitation of the facts may be found in the district court and bankruptcy court opinions. See  *In re Charter Commc'ns*, 449 B.R. 14;  *In re Charter Commc'ns*, 419 B.R. 221.

In 2008, Charter, the nation's fourth-largest cable television company and a leading provider of cable and a broadband service, was operationally sound but carried almost \$22 billion in debt at various levels of its corporate structure.¹

 *In re Charter Commc'ns*, 419 B.R. at 230–31. After the September 2008 collapse of Lehman Brothers and the financial crisis that ensued, Charter could no longer service its debt due to the tightening credit markets, Charter's excessive leverage, and lower valuations of companies

in the cable sector. *480  *Id.* at 232–33. Charter began negotiating with Paul G. Allen, a major investor whose ownership stake gave him control of the company, and a group of junior bondholders (referred to as the “Crossover Committee”).  *Id.* The negotiations culminated in a settlement (the “Allen Settlement”) that contemplated

Charter's prenegotiated reorganization in bankruptcy.  *Id.* Charter then filed for Chapter 11 bankruptcy, using the Allen Settlement as the cornerstone of its prenegotiated Plan.  *Id.*;  449 B.R. at 17. Left out of the negotiations, however,

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were LDT, the trustee for \$479 million in aggregate principal of convertible notes issued by CCI; R², a CCI shareholder; and J.P. Morgan Chase N.A. (“JPMorgan”), the holder of Charter’s senior debt. These entities had no input into the Allen Settlement or the prepackaged Plan. *Id.* at 17; 419 B.R. at 233.

To fully appreciate the key role Paul Allen played in Charter’s reorganization requires delving a bit into the weeds of the negotiations underlying the Allen Settlement. Charter’s reorganization strategy was driven by the goal of reinstating its senior credit facility with JPMorgan—that is, curing any breaches in its contracts with JPMorgan so that JPMorgan would be classified as an unimpaired creditor. *See* 11 U.S.C. § 1124(2). Charter wanted to avoid renegotiating its senior debt during the financial turmoil of late 2008 and early 2009 because it believed such renegotiation would at best lead to a higher interest rate and at worst result in Charter being closed off to new financing altogether. *In re Charter Commc’ns*, 419 B.R. at 233. Charter thus needed to structure its reorganization in a way that would avoid triggering a default under the credit agreement with JPMorgan. One condition Charter had consented to in the credit agreement was that Allen would retain thirty-five percent of the ordinary voting power of Charter Communications Operating, LLC (“CCO”), the obligor under the senior credit agreements. *Id.* at 230, 237–38. For the reorganization plan to succeed, Charter thus needed to induce Allen to retain these voting rights, even though most of his investment in Charter would be wiped out. *Id.* at 230–31. In addition, for Charter to preserve roughly \$2.85 billion of net operating losses, a valuable tax attribute, it needed Allen to forgo exercising contractual exchange rights and to maintain a one percent ownership interest in Charter Communications Holding Company, LLC (“Holdco”). *Id.* at 253. Because Charter’s main goals in restructuring, namely reinstating its senior debt and obtaining tax savings though preserving net operating losses, required Allen’s cooperation, Allen alone was in a position to provide “uniquely personal” benefits to Charter. *Id.* at 259.

Following “a spirited negotiation in which sophisticated adversaries and their expert advisors bargained with each other aggressively and in good faith,” *id.* at 241, Charter, the Crossover Committee, and Allen agreed to the Allen Settlement. As part of the Settlement, Allen agreed to retain a thirty-five percent voting interest in CCO and a one percent

ownership interest in Holdco, and to refrain from exercising his contractual exchange rights. *Id.* at 253–54. In return for these concessions, Allen would receive \$375 million, of which \$180 million was classified as pure settlement consideration. *Id.* at 241. The Allen Settlement further provided for a “\$1.6 billion rights offering, a stepped-up tax basis in a significant portion of [Charter’s] assets, and the purchase of [Allen’s]” preferred shares in CC VIII, LLC, a Charter subsidiary. *Id.* at 253. Allen also successfully negotiated for a liability release (other third parties, including the management of Charter, were released as well). *Id.* at 257–58 & n. 26. Under the reorganization Plan that resulted from the Allen Settlement, the CCI noteholders, represented by *481 LDT, would receive approximately 32.7 percent of their claims, *id.* at 242, and R² and other equity holders of CCI would receive nothing, *see* Debtor’s Disclosure Statement at 33.

On November 17, 2009, after a nineteen-day hearing, the bankruptcy court overruled all objections and confirmed the Plan as submitted by Charter. 419 B.R. at 271. The following week, the bankruptcy court denied R² and LDT’s motions for an emergency stay of the confirmation order. The district court (Sidney H. Stein, *Judge*, sitting in Part I) denied a stay pending appeal to that court, and the confirmation order and the Plan took effect on November 30, 2009. *See* *In re Charter Commc’ns*, 449 B.R. at 21. Charter immediately took actions under the Plan, including cancelling the equity issued by the prepetition Charter, issuing shares in the reorganized Charter, converting notes issued by the prepetition Charter entities into new notes, and issuing warrants to Charter’s prepetition noteholders. *Id.* at 24 nn. 19–20.

R² and LDT have objected to the Plan at every stage of these proceedings. Before the district court, they raised several overlapping challenges to the Plan’s confirmation. Their objections, viewed broadly, related to the Allen Settlement, the bankruptcy court’s valuation of Charter, and compliance with the Bankruptcy Code’s cramdown provisions for approving a plan over the objections of creditors. *See* *id.* at 21. Charter, Allen, and the Committee of Unsecured Creditors argued that, whatever the merit of R²’s and LDT’s legal claims, the relief they sought could not be granted without upsetting the already-consummated Plan and that the doctrine of equitable mootness barred the

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appeals. *Id.* at 17. The district court agreed and dismissed the appeals as equitably moot. R² and LDT filed separate appeals from that dismissal, which were argued in tandem.

DISCUSSION

I. Legal Standard for Equitable Mootness

[1] [2] [3] This appeal concerns equitable mootness, a prudential doctrine under which the district court may dismiss a bankruptcy appeal “when, even though effective relief could conceivably be fashioned, implementation of that

relief would be inequitable.” *Official Comm. of Unsecured Creditors of LTV Aerospace & Def. Co. v. Official Comm. of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.)*, 988 F.2d 322, 325 (2d Cir.1993) (“*Chateaugay I*”). Unlike constitutional mootness, which turns on the threshold question of whether a justiciable case or controversy exists, equitable mootness in the context presented here is concerned with whether a particular remedy can be granted without unjustly upsetting a debtor’s plan of reorganization. See

Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.), 416 F.3d 136, 143–44 (2d Cir.2005); see also *In re UNR Indus.*, 20 F.3d 766, 769 (7th Cir.1994) (“There is a big difference between *inability* to alter the outcome (real mootness) and *unwillingness* to alter the outcome (‘equitable mootness’).”). Equitable mootness in the bankruptcy setting thus requires the district court to carefully balance the importance of finality in bankruptcy proceedings against the appellant’s right to review and relief.

See *Chateaugay I*, 988 F.2d at 325–26; *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors’ Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 240 (5th Cir.2009) (noting that equitable mootness is “a judicial anomaly” because it creates an exception to courts’ “virtually unflagging obligation to exercise jurisdiction” (internal quotation marks omitted)). “[E]quitable *482 mootness applies to specific claims, not entire appeals” and must be applied “with a scalpel rather than an axe.” *In re Pac. Lumber*, 584 F.3d at 240–41.

[4] In this circuit, an appeal is presumed equitably moot where the debtor’s plan of reorganization has been substantially consummated. *Aetna Cas. & Sur. Co. v. LTV Steel Co. (In re Chateaugay Corp.)*, 94 F.3d 772, 776 (2d Cir.1996) (“*Chateaugay III*”); *Frito-Lay, Inc. v. LTV Steel*

Co. (In re Chateaugay Corp.), 10 F.3d 944, 952–53 (2d Cir.1993) (“*Chateaugay II*”). “Substantial consummation” is defined in the Bankruptcy Code to require that all or substantially all of the proposed transfers in a plan are consummated, that the successor company has assumed the business or management of the property dealt with by the plan, and that the distributions called for by the plan have commenced. See 11 U.S.C. § 1101(2).

[5] [6] [7] The presumption of equitable mootness can be overcome, however, if all five of the “*Chateaugay* factors” are met:

- (1) “the court can still order some effective relief”;
- (2) “such relief will not affect the re-emergence of the debtor as a revitalized corporate entity”;
- (3) “such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court”;
- (4) “the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings”; and
- (5) “the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from.”

Chateaugay II, 10 F.3d at 952–53 (internal citations, quotations, and alterations omitted). Substantial consummation thus “does not necessarily make it impossible or inequitable for an appellate court to grant effective relief.” *Id.* at 952. Nor is a claim automatically equitably moot if the relief requested would require that a confirmed plan be altered. In this regard, we disagree with the district court’s overly broad statement that invalidating a plan and remanding for renegotiation renders a request “*per se* equitably moot.”

In re Charter Commc’ns, 449 B.R. at 24 n. 21. The *Chateaugay* factors ensure that there is no *per se* equitable mootness by requiring a court to examine the actual effects of the requested relief. Finally, in examining a debtor’s contention that a claim is equitably moot, we cannot rely solely on the debtor’s conclusory predictions or opinions that the requested relief would doom the reorganized company.

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Instead, *Chateaugay II* requires an analytical inquiry into the likely effects of the relief an appellant seeks and must be based on facts. Only if all five *Chateaugay* factors are met, and if the appellant prevails on the merits of its legal claims, will relief be granted.

II. Standard of Review

[8] We turn first to the standard of review in appeals of equitable mootness determinations.² Generally in bankruptcy *483 appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law de novo. *Fed. R. Bankr.P. 8013*. On appeal to this court, we ordinarily review the district court's decision de novo. *In re Metromedia*, 416 F.3d at 139. Equitable mootness appeals arise in a somewhat different procedural posture: in an equitable mootness dismissal, the district court is not reviewing the bankruptcy court at all, but exercising its own discretion in the first instance. In so doing, the district court may rely on the bankruptcy court's factual findings, unless clearly erroneous, and if necessary receive additional evidence. Perhaps because of the unusual nature of equitable mootness dismissals, the courts of appeals are split over whether a de novo or abuse of discretion standard of review should be applied by a court of appeals. Compare *Curreys of Neb., Inc. v. United Producers, Inc.* (*In re United Producers, Inc.*), 526 F.3d 942, 946–47 (6th Cir.2008) (reviewing determination of equitable mootness de novo), *Liquidity Solutions, Inc. v. Winn–Dixie Stores, Inc.* (*In re Winn–Dixie Store, Inc.*), 286 Fed.Appx. 619, 622 & n. 2 (11th Cir.2008) (same), and *United States v. Gen. Wireless, Inc.* (*In re GWI PCS I Inc.*), 230 F.3d 788, 799–800 (5th Cir.2000) (same), with *Search Mkt. Direct, Inc. v. Jubber* (*In re Paige*), 584 F.3d 1327, 1334–1335 (10th Cir.2009) (reviewing determination of equitable mootness for abuse of discretion), and *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 182 (3d Cir.2001) (same).

We join those circuits that apply an abuse-of-discretion standard, finding it significant that we are reviewing the district court's own exercise of discretion as to whether it is practicable to grant relief. A somewhat analogous situation arises when Article III mootness turns on the defendant's voluntary cessation of allegedly illegal conduct. There, the voluntary cessation “bear[s] on whether the court should, in the exercise of its discretion, dismiss the case

as moot.” *Harrison & Burrowes Bridge Constructors, Inc. v. Cuomo*, 981 F.2d 50, 59 (2d Cir.1992). In such a case, because dismissal “lies within the sound discretion of the district court,” we review for abuse of discretion.

Id.; *Granite State Outdoor Adver., Inc. v. Zoning Bd. of Stamford*, 38 Fed.Appx. 680, 683 (2d Cir.2002); *cf.*

In re Paige, 584 F.3d at 1334–35 (reviewing equitable mootness for abuse of discretion in part because of its similarities to prudential mootness, reviewed in the Tenth Circuit for abuse of discretion). More generally, equitable mootness determinations involve “a discretionary balancing of equitable and prudential factors,” the type of determination we usually review for abuse of discretion. *In re Cont'l Airlines*, 91 F.3d 553, 560 (3d Cir.1996) (en banc). Accordingly, we will review the district court's decision for abuse of discretion.

III. Objections to the Allen Settlement and Third-Party Releases are Equitably Moot

[9] R² and LDT both challenge the compensation Paul Allen received under the Allen Settlement as contravening the absolute priority rule and Delaware's entire fairness standard. They further argue that the third-party releases, which originated in the Allen Settlement and *484 were incorporated into the confirmed Plan, do not comply with *SEC v. Drexel Burnham Lambert Group, Inc.* (*In re Drexel Burnham Lambert Group, Inc.*), 960 F.2d 285, 293 (2d Cir.1992), limiting third-party releases to unique circumstances. Appellants claim that these legal errors can be redressed through a prospective monetary award, without undoing the Allen Settlement or reopening the bankruptcy proceedings. LDT suggests that Allen be required to disgorge some or all of his \$180 million in settlement consideration or that Charter pay a similar amount directly to LDT. R² presents a different alternative: that the bankruptcy court determine the lowest payout Allen would have been willing to accept, and order him to disgorge the excess. And R² maintains that the third-party releases can be surgically excised from the Allen Settlement and the Plan.

[10] We begin by noting that LDT and R² have met their burden with respect to several of the *Chateaugay* factors. First, it is not impossible to grant LDT and R² relief, in the sense that the appeals are not constitutionally moot (factor 1). See *Dean v. Blumenthal*, 577 F.3d 60, 66 (2d Cir.2009)

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(claims for monetary relief automatically avoid constitutional mootness). Next, LDT and R² were diligent in seeking a stay of the confirmation order (factor 5).³ That LDT and R² were not granted a stay does not affect the analysis under *Chateaugay II*, which looks only to diligence in seeking a stay. *Chateaugay II*, 10 F.3d at 954; *In re Metromedia*, 416 F.3d at 144–45.

[11] Next, LDT and R² are correct that the relief they seek would not adversely affect parties without an opportunity to participate in the appeal (factor 4). See *Chateaugay II*, 10 F.3d at 953. Even assuming that the relief requested would send Charter back into bankruptcy, the parties most affected would be Charter itself, Allen, and Charter's creditors, all of whom are either parties to this appeal or participated actively in the bankruptcy proceedings. Cf. *Kenton Cnty. Bondholders Comm. v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.)*, 374 B.R. 516, 524 (S.D.N.Y.2007) (finding appeal of a settlement equitably moot in part because distributions under the settlement had been made to innocent third parties that were not participating in the appeal). In any event, if the Allen Settlement were unlawful, it would not be inequitable to require the parties to that agreement to disgorge their ill-gotten gains, participation in the appeal or not. See *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869, 882 (9th Cir.2012) (“[T]he question is not whether ... no third party interests are affected” but whether any effects on third parties would be inequitable.). Likewise, striking the third-party releases from the Plan would affect only those third parties that benefited from the releases. See *Hilal v. Williams (In re Hilal)*, 534 F.3d 498, 500 (5th Cir.2008); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 210 (3d Cir.2000) (finding appeal of third-party releases not equitably moot where the defendant presented no arguments that investors or creditors relied on the presence of releases in supporting the plan). Less direct effects may be felt by reorganized Charter's shareholders, since either a limited remand or a payout would affect the value of the company. However, Charter has regularly and fully disclosed the existence *485 of this appeal and the possibility of an adverse ruling as a risk factor in publicly filed annual and quarterly reports. See, e.g., Charter Communications, Inc., Annual Report (Form 10-K), at 29 (Mar. 1, 2011). A prudent investor would take this information into account before purchasing shares in

Charter. See *In re Cont'l Airlines*, 91 F.3d at 572 (Alito, J., dissenting).

[12] However, LDT and R² have failed to establish that the relief they request would not affect Charter's emergence as a revitalized entity and would not require unraveling complex transactions undertaken after the Plan was consummated (factors 2 and 3). See *Chateaugay II*, 10 F.3d at 953. R² and LDT are correct that any disgorgement by Allen would not impact reorganized Charter's financial health. And, as Appellants stress, reorganized Charter has been quite successful, with substantial assets and cash flow, access to an \$800 million revolving line of credit, and long-term debt structured on favorable terms. Charter makes no claim that a payment in the range of \$200 million would send it spiraling back into bankruptcy. LDT and R² ignore, however, that we must also consider the heavy transactional costs associated with the monetary relief they seek. Modifying the terms of the Allen Settlement, including striking the releases, would be no ministerial task. The Allen Settlement was the product of an intense multi-party negotiation, and removing a critical piece of the Allen Settlement—such as Allen's compensation and the third-party releases—would impact other terms of the agreement and throw into doubt the viability of the entire Plan. See *In re Metromedia*, 416 F.3d at 145.

[13] [14] [15] LDT and R² maintain that in refusing to alter the Allen Settlement, the district court gave too much weight to the nonseverability clause contained in the Settlement and the Plan. See *In re Charter Commc'ns*, 449 B.R. at 20, 24–25, 25 n. 22, 28–29, 30. We agree with LDT and R² that normally a nonseverability clause standing on its own cannot support a finding of equitable mootness. Allowing a boilerplate nonseverability clause, without more, to determine the equitable mootness question would give the debtor and other negotiating parties too much power to constrain Article III review. See *Nordhoff Invs., Inc.*, 258 F.3d at 192 (Alito, J., concurring in the judgment) (expressing concern that the “equitable mootness doctrine can easily be used as a weapon to prevent any appellate review of bankruptcy court orders confirming reorganization plans”). Given the ubiquity of nonseverability clauses in prenegotiated plans, such a rule could moot virtually every appeal where a stay had not been granted. See R² Br. at 41–42 & 42 n.10 (noting that of the top ten prenegotiated bankruptcies filed in 2010 by value of the debtor's assets, each contained

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a nonseverability clause in either the confirmation order or in the reorganization plan). More importantly, equitable mootness is a practical doctrine that requires courts to consider the actual effects of the relief requested on a debtor's emergence from bankruptcy. While a nonseverability clause may be one indication that a particular term was important to the bargaining parties, a district court cannot rely on such a clause to the exclusion of other evidence.⁴ See *Trans World Airlines, Inc. v. Texaco, Inc.* (In re *Texaco, Inc.*), 92 B.R. 38, 47–49 (S.D.N.Y.1988) (looking to both nonseverability clause and testimony about the importance of release provisions to determine that severing the provisions “would undermine both the Settlement Agreement and the Reorganization Plan”); see also *Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704, 713–14 (4th Cir.2011) (finding an appeal of a release provision not equitably moot where the bankruptcy court concluded that the releases were “important” to the Plan without adequate factual support).

In these appeals, however, the district court did not rest its decision exclusively on the nonseverability clause. The bankruptcy court found that the compensation to Allen and the third-party releases were critical to the bargain that allowed Charter to successfully restructure and that undoing them, as the plaintiffs urge, would cut the heart out of the reorganization. Crediting multiple witnesses, it also found that Allen was in a unique position to create a successful arrangement because only through his forbearance of exchange rights and agreement to maintain voting power could Charter reinstate its senior debt and preserve valuable net operating losses. See Findings of Fact, Conclusions of Law, and Order Confirming Debtors' Joint Plan of Reorganization (“Conf. Order”) ¶¶ 32, 43; see also JA 462, 589, 605, 611. The releases, like the compensation, were important in inducing Allen to settle. See Conf. Order ¶ 32; see also JA 463, 589, 605, 611. In the face of witnesses representing that the releases and compensation were important to Allen, LDT and R² can point to no evidence that the settlement consideration paid to Allen or the third-party releases were simply incidental to the bargain that was struck. Compare *In re Metromedia*, 416 F.3d at 145 (request to strike third-party releases equitably moot because “it [was] as likely as not that the bargain struck by the debtor and the released parties might have been different without the releases”) with *In re Cont'l Airlines*, 203 F.3d at 210–11 (appeal of third-party releases not equitably moot where there was “[n]o evidence or arguments ... that Plaintiffs' appeal, if

successful, would necessitate the reversal or unraveling of the entire plan of reorganization”).

Even if LDT and R² are correct that the settlement consideration and releases are legally unsupportable, these provisions could not be excised without seriously threatening Charter's ability to re-emerge successfully from bankruptcy.⁵ Nor could the monetary relief requested be achieved by a quick, surgical change to the confirmation order. Allen may not be willing to give up the benefit he received from the Allen Settlement without also reneging on at least part of the benefit he bestowed on Charter. Thus the parties would have to enter renewed negotiations, casting uncertainty over Charter's operations until the issue's resolution. We therefore find no abuse of discretion in the district court's conclusion that these claims relating to the Allen Settlement are equitably moot.

IV. R²'s Claim for the Revaluation of CCI is Equitably Moot

[16] R²'s next claim of error relates to the valuation of Charter. The bankruptcies *487 of Charter's 131 affiliated entities were consolidated for procedural, not substantive, purposes. *Id.* 419 B.R. at 269–70. The Plan, however, values all Charter entities as one. *Id.* R², an equity holder in CCI, argues that CCI should have been valued separately, taking into account the value of the net operating losses, which R² argues “belong” to CCI. Here again, R² claims that simple relief is available: remand the case to the bankruptcy court for a limited valuation of CCI as a stand-alone entity, and distribute any surplus to CCI's shareholders, R² among them.

[17] As with challenges to the Allen Settlement, R² has met the *Chateaugay* factors relating to ability to grant effective relief, diligence in seeking a stay, and effect on third parties. However, we could not grant the relief R² seeks without requiring a significant revision of Charter's reorganization. R²'s argument is, in effect, an attack on the bankruptcy court's determination that it was appropriate for the Plan to consider all the Charter entities together, even though the bankruptcies were never substantively consolidated. In order to grant a separate valuation of CCI, the district court would have had to overturn the bankruptcy court's determination that a joint Plan was appropriate. That legal conclusion would require not just that CCI be separately valued, but

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that all the Charter subsidiaries be revalued and the proceeds of the bankruptcy distributed accordingly. See *Compania Internacional Financiera S.A. v. Calpine Corp. (In re Calpine Corp.)*, 390 B.R. 508, 519–20 (S.D.N.Y.2008) (holding that the debtor's valuation was a “key issue” in a reorganization, and therefore even if a remand resulted in a higher valuation, the plan would need to be substantially changed), *aff'd* 354 Fed.Appx. 479 (2d Cir.2009). This is not the type of relief that can be undertaken without knocking the props out from under completed transactions or affecting the re-emergence of the debtor from bankruptcy.⁶ See *Chateaugay II*, 10 F.3d at 952–53. Thus, the district court did not abuse its discretion in dismissing this claim for revaluation of CCI as equitably moot.

V. LDT's Claim that the Plan Violates 11 U.S.C. § 1129's Cramdown Provisions is Equitably Moot

[18] LDT appeals the bankruptcy court's determination that the Plan complies with the cramdown provisions of 11 U.S.C. § 1129. First, LDT argues that, as a creditor of CCI, it had a more senior claim to the value of the net operating losses than the Crossover Committee members, who held the debt of other Charter entities. See § 1129(b)(2)(B) (ii). Second, LDT argues that creditors were “gerrymandered” into separate classes to satisfy the provisions of § 1129(a)(10), which requires that at least one class of impaired creditors accept a plan. It further argues that the bankruptcy court erred by holding that § 1129(a)(10) was satisfied if an impaired class of *any* of the debtors accepted

the Plan. As relief for all these alleged errors, LDT seeks the payment in full of the CCI notes, at a cost to Charter of about \$330 million. 449 B.R. at 29 n. 38.

As with R²'s claims regarding valuation, LDT may be correct that the simple payment of \$330 million would satisfy the *Chateaugay* factors. However, as with R²'s revaluation claim, the legal conclusions required to find for LDT would require much more than simply paying the CCI Noteholders' claims in full. The legal errors that LDT alleges, if proven, would require unwinding the Plan and reclassifying creditors.

This is the opposite of a surgical change to the Plan. See *In re Pac. Lumber*, 584 F.3d at 251 (finding claims of artificial impairment and misclassification of creditors equitably moot because “no remedy ... is practicable other than unwinding the plan”). We therefore affirm the district court's exercise of its discretion in dismissing the claim that the cramdown provisions were violated as equitably moot as well.

CONCLUSION

For the foregoing reasons, the district court's order dismissing LDT and R²'s appeals as equitably moot is AFFIRMED.

All Citations

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Footnotes

- * The Clerk of the Court is directed to amend the official captions as set forth above, which reflects the true status of the parties.
- 1 Charter's corporate structure consisted of a publicly traded parent holding company, CCI, sitting atop a chain of subsidiaries. See Br. of Debtors–Appellees at 10. Charter's publicly traded debt was issued by eight holding companies stacked between CCI and Charter Communications Operating, LLC, the primary operating company. *Id.*
- 2 No published Second Circuit decision has addressed this question directly. In a non-precedential summary order we determined that abuse of discretion review was appropriate. See *Ad Hoc Comm. of Kenton Cnty. Bondholders v. Delta Air Lines, Inc.*, 309 Fed.Appx. 455, 457 (2d Cir.2009). In prior decisions we have described the general standard of review in bankruptcy cases involving de novo review of legal conclusions and then proceeded to address equitable mootness without further discussion or application of a particular standard of review. See, e.g., *In re Metromedia*, 416 F.3d at 139; *South St. Seaport Ltd. P'ship v. Burger Boys, Inc. (In re Burger Boys, Inc.)*, 94 F.3d 755, 759 (2d Cir.1996); *Resolution Trust Corp. v. Best Prods. Co. (In re Best Prods. Co.)*, 68 F.3d 26, 29 (2d Cir.1995). To the extent these cases suggested that de novo review may apply to district court determinations regarding equitable mootness, they did so in dicta.

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- 3 Although no stay was sought from this court, under the circumstances we do not fault LDT and R² for the omission: the district court denied a stay on the evening of Wednesday November 25, 2009, the day before Thanksgiving, and this court was closed until the following Monday when the Plan became effective and was substantially consummated, leaving no time to move this court for a stay.
- 4 Reliance on the nonseverability clause alone would be particularly inappropriate here with respect to the third-party releases because the “term sheet” incorporated into the Allen Settlement expressly provided that the debtors' failure to secure the releases as part of the approved Plan would not breach the Allen Settlement. These dueling contractual provisions only underscore the need to examine the totality of evidence to determine the importance of a particular provision.
- 5 This risk—supported in the record—that the parties might be unable to compromise if the bankruptcy proceedings were reopened, is what we understand the district court to have meant when it wrote that relief would “nullify the plan.” See  449 B.R. at 24, 25, 26, 27 n. 29, 28. Technically speaking, any vacatur of a confirmation order, no matter how limited, would “nullify” the plan, at least temporarily and in part, but we understand the district court's use of “nullification” to have referred to a nullification of the ability to reorganize at all.
- 6 The district court erred, however, when it held that the relief requested could not be granted because the confirmation order rendered R2's claims “cancelled, released, and extinguished” with the holders “receiving no distribution under the Plan.”  449 B.R. at 28 (internal quotation marks and alteration omitted). When the confirmation order is on appeal, the legal effects of that order—such as extinguishing equity—cannot themselves preclude review. See *Chateaugay II*, 10 F.3d at 953–54, (rejecting the argument that because the confirmation order provided that certain assets were to re-vest in the debtor “free and clear of all claims and interests” we could not correct a legal error in their distribution (internal quotation marks omitted)). Nevertheless, the district court's alternative holding that equitable mootness barred the appeal notwithstanding the this provision was independently sufficient to support its judgment.

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In re One2One Communications, LLC, 805 F.3d 428 (2015)

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Declined to Extend by [In re Millennium Lab Holdings II, LLC](#), D.Del., March 17, 2017

805 F.3d 428

United States Court of Appeals,
Third Circuit.In re ONE2ONE COMMUNICATIONS, LLC, Debtor
Quad/Graphics, Inc., Appellant.

No. 13–3410.

Argued: Oct. 29, 2014.

Filed: July 21, 2015.

Synopsis

Background: Order was entered by the United States Bankruptcy Court for the District of New Jersey confirming debtor's proposed Chapter 11 plan, and creditor appealed. The District Court, J., [2013 WL 3864056](#), dismissed appeal as equitably moot. Creditor appealed.

[Holding:] The Court of Appeals, [Greenaway, Jr.](#), Circuit Judge, held that district court abused its discretion in dismissing, as equitably moot, an appeal from unstayed order of bankruptcy court confirming debtor's proposed Chapter 11 plan, though debtor, following confirmation of plan, had transferred all of the property required to be transferred, and plan had been substantially consummated.

Reversed and remanded.

[Krause](#), Circuit Judge, filed concurring opinion.**Procedural Posture(s):** On Appeal.

West Headnotes (16)

[1] Bankruptcy

Review

Court of Appeals reviews for abuse of discretion a district court's decision that bankruptcy appeal is equitably moot.

1 Cases that cite this headnote**[2] Courts**

Number of judges concurring in opinion, and opinion by divided court

Panel of Court of Appeals may decline to follow its own prior decision without necessity of an en banc decision only where the prior decision conflicts with Supreme Court decision.

3 Cases that cite this headnote**[3] Federal Courts**

Bankruptcy

Once bankruptcy appeal has been filed, appellate court has a virtually unflagging obligation to exercise the jurisdiction conferred on it.

[4] Bankruptcy

Moot questions

Before equitable mootness doctrine applies to permit bankruptcy appellate court to avoid reaching the merits of appeal, appellate court must first determine that granting the requested relief is almost certain to produce a perverse outcome, i.e., significant injury to third parties and/or chaos in bankruptcy court from a plan in tatters.

[5] Bankruptcy

Effect of want of stay; conclusiveness of sale

Bankruptcy

Moot questions

Bankruptcy appellate court decides whether to dismiss appeal as equitably moot by considering the following prudential factors: (1) whether reorganization plan has been substantially consummated, (2) whether stay has been obtained, (3) whether relief requested will affect rights of parties not before the court, (4) whether relief requested will affect success of plan, and (5) public policy of affording finality to bankruptcy judgments.

[1 Cases that cite this headnote](#)

[6] **Bankruptcy**

🔑 Moot questions

Depending on the circumstances, each of the prudential factors bearing on whether bankruptcy appeal should be dismissed as equitably moot is given varying weight.

[1 Cases that cite this headnote](#)

[7] **Bankruptcy**

🔑 Moot questions

Equitable mootness doctrine must be applied only to prevent bankruptcy appellate court from unscrambling complex bankruptcy reorganizations where the appealing party should have acted before the plan became extremely difficult to retract.

[7 Cases that cite this headnote](#)

[8] **Bankruptcy**

🔑 Moot questions

Party seeking to dismiss bankruptcy appeal as equitably moot bears burden of demonstrating that, weighing the relevant factors, dismissal is warranted.

[9] **Bankruptcy**

🔑 Moot questions

In practice, determination whether to dismiss bankruptcy appeal as equitably moot proceeds in two analytical steps, by considering (1) whether confirmed plan has been substantially consummated, and if so, then (2) whether granting the relief requested in the appeal will fatally scramble the plan and/or significantly harm third parties who have justifiably relied on confirmation of plan.

[3 Cases that cite this headnote](#)

[10] **Bankruptcy**

🔑 Moot questions

If confirmed plan has been substantially consummated, bankruptcy appellate court, in deciding whether to dismiss appeal from confirmation order as equitably moot, should next determine whether granting relief will require undoing the plan, as opposed to modifying it in manner that does not cause its collapse, and should also consider extent to which a successful appeal, by altering the plan or otherwise, will harm third parties who have acted reasonably in reliance on finality of plan confirmation.

[2 Cases that cite this headnote](#)

[11] **Bankruptcy**

🔑 Moot questions

Equitable mootness doctrine must be construed narrowly and applied in limited circumstances.

[6 Cases that cite this headnote](#)

[12] **Bankruptcy**

🔑 Moot questions

Judge-made origin of equitable mootness doctrine, coupled with the responsibility of federal courts to exercise their jurisdictional mandate, obliges bankruptcy appellate court to proceed most carefully before dismissing appeal as equitably moot.

[7 Cases that cite this headnote](#)

[13] **Bankruptcy**

🔑 Effect of want of stay; conclusiveness of sale

Bankruptcy

🔑 Moot questions

District court abused its discretion in dismissing, as equitably moot, an appeal from unstayed order of bankruptcy court confirming debtor's proposed Chapter 11 plan, though debtor, following confirmation of plan, had transferred all of the property required to be transferred, and though plan had been substantially consummated, where debtor's reorganization involved only a single secured creditor and 17 unsecured creditors that were not insiders, where

plan did not involve intricate transactions that it would be difficult to unravel, where no publicly traded securities or debt had been issued pursuant to plan that third parties could have purchased on open market, and where debtor failed to present evidence of any detrimental third-party reliance on finality of plan confirmation order beyond that present in nearly all bankruptcy reorganizations.

[2 Cases that cite this headnote](#)

[14] **Bankruptcy**

 Presumptions and burdens of proof

On motion to dismiss, as equitably moot, an appeal from bankruptcy court order confirming debtor's proposed Chapter 11 plan, it was not appellant's burden to show that it was possible for appellate court to grant effective relief without unscrambling the plan entirely; rather, it was debtor's burden, as the party seeking dismissal, to demonstrate that prudential factors weighed in its favor.

[1 Cases that cite this headnote](#)

[15] **Bankruptcy**

 Moot questions

In deciding whether to dismiss bankruptcy appeal as equitably moot, bankruptcy appellate courts are obligated to consider, not only whether granting the requested relief will require reversal of plan, but also whether the plan can be retracted without great difficulty and inequity.

[16] **Federal Courts**

 Presumptions and burden of proof

Presumption is that federal courts should hear and decide the merits cases properly before them.

[4 Cases that cite this headnote](#)

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Before: [McKEE](#), Chief Judge, [GREENAWAY, JR.](#), and [KRAUSE](#), Circuit Judges.

***431 OPINION**

[GREENAWAY, JR.](#), Circuit Judge.

Appellant Quad/Graphics Inc. appeals from the judgment of the District Court affirming the Bankruptcy Court's confirmation of One2One Communications, LLC's (the "Debtor") Chapter 11 plan of reorganization and dismissing Appellant's bankruptcy appeal as equitably moot. Appellant contends that the District Court abused its discretion in dismissing its appeal as equitably moot. Appellant also asks us to use this appeal to overrule our adoption of equitable mootness in  [In re Continental Airlines](#), 91 F.3d 553, 560 (3d Cir.1996) (en banc) ("*Continental*"), contending that the doctrine is unconstitutional and contrary to the Bankruptcy Code. *Continental* remains the law of this circuit. This panel is not free to overturn a precedential opinion. In the absence of an en banc reversal, we are bound by *Continental*. Because the District Court abused its discretion under *Continental*, we will reverse the District Court's judgment and remand for consideration of the merits of Appellant's bankruptcy appeal.

I. Background

The Debtor, a billing services technology company, is a limited liability business and its sole member is Joli, Inc. Joanne Heverly owns seventy-five percent of Joli, Inc., and Richard Brammer, a former officer of the Debtor, owns

the remaining twenty-five percent. Appellant, a printing company, holds the single largest claim against the Debtor and the Debtor's CEO, Bruce Heverly, husband of Joanne Heverly, for \$9,359,630.91, which stems from a judgment entered in the District Court for the Eastern District of Wisconsin.¹ The Court of Appeals for the Seventh Circuit has since affirmed that judgment. See *Quad/Graphics, Inc. v. One2One Commc'ns, LLC*, 529 Fed.Appx. 784, 793 (7th Cir.2013).

The Debtor filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101 et seq. (the "Bankruptcy Code"), in the Bankruptcy Court for the District of New Jersey (the "Bankruptcy Court"). Thereafter, the Office of the United States Trustee formed an official unsecured creditors committee (the "Committee") consisting of Appellant, Ricoh Production Print Solutions, LLC, and Enterprise Group.

Between September 2012 and January 2014, the Debtor filed the First,² Second, and Third Amended Plans of Reorganization. After the Bankruptcy Court denied confirmation of the First Amended Plan of Reorganization, Bela Szigethy ("Szigethy") agreed to make an investment in the Debtor.³ The Debtor filed a Fourth Amended Plan of Reorganization (the "Plan") on January 25, 2013, under which a third-party, One2One Holdings, LLC ("Plan Sponsor") would acquire a membership interest in the Debtor. The Plan incorporated a Plan Support Agreement which provided the Plan Sponsor with the exclusive right to purchase 100% of the Debtor's equity for \$200,000. Neither the Plan *432 Sponsor nor any third-party was to contribute any additional capital to fund the Plan. The Plan also incorporated the terms of the Committee Agreement with respect to distributions and the waiver of preference actions against unsecured creditors.

On March 5, 2013, after holding a five-day confirmation hearing, and over the objection of Appellant, Bankruptcy Judge Winfield entered an order (the "Confirmation Order") confirming the Plan.⁴ The Confirmation Order was automatically stayed for fourteen days pursuant to *Federal Rule of Bankruptcy Procedure* 3020(e). Appellant moved for a stay pending appeal, which was denied. The Bankruptcy Court also denied a request by the Debtor to shorten the automatic fourteen-day stay.⁵ The parties briefed the merits of the appeal, but the District Court never reached those issues, as it granted the Debtor's motion to dismiss the appeal as equitably moot on June 24, 2013.

II. Jurisdiction and Standard of Review

The Bankruptcy Court had jurisdiction under 28 U.S.C. § 157(b). The District Court had jurisdiction under 28 U.S.C. § 158(a). We have jurisdiction under 28 U.S.C. §§ 158(d) and 1291.

[1] We review for abuse of discretion a district court's decision that a bankruptcy appeal is equitably moot.

Continental, 91 F.3d at 560.

III. Analysis

a. Appellant's Challenge to the Equitable Mootness Doctrine

[2] As an initial matter, Appellant asserts that the equitable mootness doctrine is unconstitutional and contrary to the Bankruptcy Code. Because we have already approved the doctrine of equitable mootness in *Continental*,⁶ only the Court *433 sitting en banc would have the authority to reevaluate our prior holding. See *United States v. White*, 748 F.3d 507, 512–13 (3d Cir.2014).⁷ This Court may only decline to follow a prior decision of our Court without the necessity of an en banc decision when the prior decision conflicts with a Supreme Court decision. See *Chester ex rel. N.L.R.B. v. Grane Healthcare Co.*, 666 F.3d 87, 94 (3d Cir.2011); see also *Morrow v. Balaski*, 719 F.3d 160, 179 (3d Cir.2013) (en banc) (Smith, J., concurring) (" '[E]ven in constitutional cases' ..., the doctrine of stare decisis 'carries such persuasive force' that departing from it has 'always required' some 'special justification.' ") (quoting *Arizona v. Rumsey*, 467 U.S. 203, 212, 104 S.Ct. 2305, 81 L.Ed.2d 164 (1984)).

Appellant argues that our equitable mootness jurisprudence should be reevaluated in light of the Supreme Court's decision in *Stern v. Marshall*, — U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). Appellant contends that after *Stern*, a bankruptcy court's ability to enter binding, final judgments in "core" bankruptcy proceedings—like plan confirmations—must be subject to district court review on appeal under traditional appellate standards. *Stern* alone does not permit us to depart from *Continental*.

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In *Stern*, the Supreme Court granted certiorari to resolve the question of whether 28 U.S.C. § 157(b)(2)(C) is unconstitutional because it gives non-Article III judges the power to render final judgments on common law compulsory counterclaims that are not necessarily resolved in the process of allowing or disallowing the defendant's proof of claim. The Court in *Stern* found that the provision unconstitutionally delegated the judicial power of the United States to non-Article III bankruptcy judges. Justice Roberts's opinion relied heavily on *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 284, 18 How. 272, 15 L.Ed. 372 (1855), which stated that with the exception of certain “public rights,” Congress cannot “withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at common law, or in equity, or admiralty.” Because the counterclaim at issue in *Stern* was a tort claim at common law, the Court held that “[t]he Bankruptcy Court below lacked the constitutional authority to enter a final judgment on [this] state law counterclaim.” *Stern*, 131 S.Ct. at 2620.

Thus, the Court in *Stern* made clear that non-Article III bankruptcy judges do not have the constitutional authority to adjudicate a claim that is exclusively based upon a legal right grounded in state law despite appellate review of the bankruptcy judge's decision by an Article III judge. However, *Stern* did not consider the authority of bankruptcy judges to make final determinations regarding other kinds of claims and counterclaims brought by debtors and creditors, nor did *Stern* consider whether Article III requires appellate review of a bankruptcy judge's decisions by an Article III judge. Accordingly, we are obligated to apply this Court's equitable mootness doctrine notwithstanding *Stern*.

b. Equitable Mootness Analysis

[3] [4] Following confirmation of a reorganization plan by a bankruptcy court, an aggrieved party has the statutory right to appeal the court's ruling. Once a bankruptcy appeal has been filed, federal courts have a “‘virtually unflagging obligation’” to exercise the jurisdiction conferred on *434 them. *In re Semcrude, L.P.*, 728 F.3d 314, 320 (3d Cir.2013) (quoting *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 817, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976)). Before there is a basis to avoid deciding the merits of an appeal, we must first determine that granting the requested relief is almost certain to produce a “perverse”

outcome—significant “injury to third parties” and/or “chaos in the bankruptcy court” from a plan in tatters. *In re Phila. Newspapers, LLC*, 690 F.3d 161, 168 (3d Cir.2012). Only in such circumstances is equitable mootness a valid consideration.

[5] [6] A court decides to dismiss an appeal as equitably moot through the consideration of the following “prudential” factors:

- (1) whether the reorganization plan has been substantially consummated,
- (2) whether a stay has been obtained,
- (3) whether the relief requested would affect the rights of parties not before the court,
- (4) whether the relief requested would affect the success of the plan, and
- (5) the public policy of affording finality to bankruptcy judgments.

Id. (citing *Continental*, 91 F.3d at 560). Depending on the circumstances, each factor is given varying weight. *Id.* (citing *In re PWS Holding Corp.*, 228 F.3d 224, 236 (3d Cir.2000)).

These factors are interconnected and overlapping. *Semcrude*, 728 F.3d at 320 (citing *Phila. Newspapers*, 690 F.3d at 168–69). “The second factor principally duplicates the first in the sense that a plan cannot be substantially consummated if the appellant has successfully sought a stay.” *Phila. Newspapers*, 690 F.3d at 169 (internal quotation marks omitted). In analyzing the first factor, courts have considered “whether allowing an appeal to go forward will undermine the plan, and not merely whether the plan has been substantially consummated under the Bankruptcy Code's definition.”⁸ *Id.* at 168–69. This collapses the first and fourth factors. The third factor adds an additional consideration—whether granting relief will undermine “the reliance of third parties, in particular investors, on the finality of the transaction.” *Id.* at 169 (internal quotation marks omitted). “Finally, the fifth factor supports the other four by encouraging investors and others to rely on confirmation orders, thereby facilitating successful

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reorganizations by fostering confidence in the finality of confirmed plans.” *Id.*

[7] [8] Taken together, these factors require that the equitable mootness doctrine be applied only to “prevent[] a court from unscrambling complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract.”

 *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir.2001). The party seeking dismissal bears the burden to demonstrate that, weighing the relevant factors, dismissal is warranted.  *Semcrude*, 728 F.3d at 321.

[9] In practice, equitable mootness proceeds in two analytical steps: “(1) whether a confirmed plan has been substantially consummated; and (2) if so, *435 whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on the plan’s confirmation.” *Id.* “Satisfaction of [the] statutory standard indicates that implementation of the plan has progressed to the point that turning back may be imprudent.” *Id.*

[10] If the confirmed plan has been substantially consummated, a court should next determine whether granting relief will require undoing the plan as opposed to modifying it in a manner that does not cause its collapse.

See  *In re Zenith Elecs. Corp.*, 329 F.3d 338, 346–47 (3d Cir.2003) (appeal not equitably moot where disgorgement of professional fees would not unravel plan);  *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 228 (3d Cir.2003) (appeal not equitably moot where striking indemnification provision would leave the plan otherwise intact);  *PWS*, 228 F.3d at 236 (appeal not equitably moot where plan could go forward even if certain releases were stricken). A court should also consider the extent a successful appeal, by altering the plan or otherwise, will harm third parties who have acted reasonably in reliance on the finality of plan confirmation.  *Semcrude*, 728 F.3d at 321.

c. Application of the Equitable Mootness Doctrine

[11] [12] Since this Court’s adoption of the equitable mootness doctrine in *Continental*, we have emphasized that the doctrine must be construed narrowly and applied in limited circumstances. In *Philadelphia Newspapers*, this

Court emphasized “that a court only should apply the equitable mootness doctrine ... ‘[in] complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract.’ ”

 690 F.3d at 169 (quoting  *Nordhoff*, 258 F.3d at 185). “The doctrine is quite rightly ‘limited in scope’ and ‘cautiously applied.’ ” *Id.* (quoting  *Continental*, 91 F.3d at 559). Further, the doctrine’s “judge-made origin, coupled with the responsibility of federal courts to exercise their jurisdictional mandate, obliges us ... to proceed most carefully before dismissing an appeal as equitably moot.”  *Semcrude*, 728 F.3d at 318.

Our prior dismissals pursuant to the equitable mootness doctrine are inapposite here. Those prior applications of the doctrine involved complex bankruptcy reorganizations that included multiple related debtors, hundreds of millions of dollars in assets, liabilities and claims, and hundreds or thousands of creditors. For example, *Continental* involved the merger of fifty-three debtors with Continental, a \$110 million investment in the reorganized debtor, the transfer by foreign governments of route authorities, and the assumption of leases

and executory contracts worth over five billion dollars.  91 F.3d at 567. Similarly, in *Nordhoff*, the reorganization plan required eighteen months of preparation between several parties, the exchange of over \$100 million in bonds, the issuance of new stock, the extension of a sixty million dollar credit facility, and the exchange and cancellation of over \$100 million of debt.  258 F.3d at 182, 186.

[13] In contrast here, the Debtor’s reorganization involved a \$200,000 investment in the reorganized debtor and only one secured creditor that held a blanket lien on the Debtor’s assets for less than \$100,000. Further, the Debtor had only seventeen unsecured creditors, not including insiders. In addition, the Plan did not provide for new financing, mergers or dissolutions of entities, issuance of stock or bonds, name change, change of business location, change in management or any *436 other significant transactions. The record illustrates that this case did not involve a sufficiently complex bankruptcy reorganization such that dismissal on the basis of equitable mootness would be appropriate.

Consideration of the prudential factors also demonstrates that the District Court abused its discretion. The District Court found that the Plan was substantially consummated. The Debtor transferred all property required to be transferred on or

shortly after the effective date of the Plan, and the reorganized debtor commenced distributions under the Plan. See 11 U.S.C. § 1101(2)(C) (requiring only the “commencement of distribution under the plan”). The District Court observed that Appellant failed to obtain a stay. We do not dispute those determinations. However, the District Court also found that granting relief to Appellant would lead to a perverse outcome by causing the Plan to be fully unraveled, resulting in significant harm to third parties. We disagree. In our judgment, the proper application of the prudential factors does not permit dismissal on equitable mootness grounds.

[14] As noted, the first and fourth prudential factors require that a court consider whether allowing an appeal to go forward will undermine the plan. *Semcrude*, 728 F.3d at 321. In finding that these factors weigh in favor of equitable mootness, the District Court found that Appellant “offered no options which would allow the Court to grant it relief without [unscrambling the Plan] entirely.” *In re One 2 One Commc'ns, LLC*, No. 13–1675, 2013 WL 3864056, at *6 (D.N.J. July 24, 2013). In reaching this conclusion, the District Court erred in two fundamental respects: it placed the burden on Appellant to demonstrate that this factor weighed in its favor, and it concluded that because granting Appellant's requested relief would reverse the Plan, this factor necessarily favored the Debtor.

[15] To the contrary, it was the Debtor's burden, as the party seeking dismissal, to demonstrate that the prudential factors weighed in its favor. See *Semcrude*, 728 F.3d at 321. Further, courts are obligated to consider not only whether granting the requested relief would require reversal of the plan, but also whether the plan could be retracted without great difficulty and inequity. See *Nordhoff*, 258 F.3d at 186. We have noted in prior cases that reversal of a confirmation order is more likely to lead to an inequitable result “where the reorganization involves intricate transactions or where outside investors have relied on the confirmation of the plan.” *Continental*, 91 F.3d at 560–61 (citations omitted); see also *Nordhoff*, 258 F.3d at 186 (finding that plan that involved hundreds of millions of dollars, the issuance of unretractable bonds, and restructuring the debt, assets, and management of a major corporation “could [not] be reversed without great difficulty and inequity”). We have most frequently found that a plan could not be retracted

when the reorganized debtor issued publically traded debt or securities. See, e.g., *Nordhoff*, 258 F.3d at 186.

Here, the Plan did not involve intricate transactions and the Debtor did not present sufficient evidence that the Plan would be difficult to unravel. Instead, the Debtor identified various post-confirmation transactions entered into in the ordinary course of the reorganized Debtor's business. These routine transactions, including the investment by the Plan Sponsor, the commencement of distributions, the hiring of new employees and entering into various agreements with existing and new customers are likely to transpire in almost every bankruptcy reorganization where the appealing party is unsuccessful in obtaining *437 (or fails to seek) a stay. Further, the Plan did not involve the issuance of any publicly traded securities, bonds, or other circumstances that would make it difficult to retract the Plan. Accordingly, the District Court abused its discretion in finding that the first and fourth factors favored the Debtor.

Furthermore, under the third factor, “the reliance by third parties, in particular investors, on the finality of the [Plan's confirmation]” is minimal. *Continental*, 91 F.3d at 562. The District Court articulated no specific harm that would inure to the detriment of third parties and instead stated that, “One2One argues that the relief Appellant seeks would unravel the Plan in its entirety and call into question the continued viability of One2One to the detriment of third parties.” *One 2 One Commc'ns*, 2013 WL 3864056, at *8.⁹ However, as the District Court noted, “[t]his is not a case where a debtor issued publicly traded securities or debt pursuant to a plan that third parties to the bankruptcy case could have purchased on the open market.” *Id.* at *7 (alteration in original) (internal quotation marks omitted). Nevertheless, the Debtor now argues that allowing Appellant's appeal to be heard on the merits would inevitably affect the rights of parties not before the court such as creditors, employees, and third-party workers.

This type of minimal third-party reliance is present in nearly all bankruptcy reorganizations and cannot be characterized as almost certain to cause significant injury to third parties. *Cf.* *Continental*, 91 F.3d at 556 (emphasizing that the record was replete with evidence that investing parties not before the court relied on the confirmation order in making decision to enter into a \$450 million investment agreement under a complex arrangement). In light of the limited evidence of

potential third-party injury, the District Court also abused its discretion in determining that this factor favored the Debtor.

[16] Finally, the prudential consideration of public policy weighs in favor of providing Appellant with appellate review of its bankruptcy appeal. “Though the finality of the Bankruptcy Court’s decision necessarily will be disturbed,” this Court has recognized an appealing party’s “statutory right to review of the [Bankruptcy] Court’s decision.” *Phila. Newspapers*, 690 F.3d at 171. Further, “[t]he presumptive position remains that federal courts should hear and decide on the merits cases properly before them.” *Semcrude*, 728 F.3d at 326.

Here, Appellant has repeatedly advanced the contention that it is entitled to appellate review. Appellant objected to the Plan, applied for a stay, filed an appeal of the Confirmation Order and sought emergency appellate review. In light of the other prudential factors, denying Appellant review now would be distinctly inequitable.¹⁰

IV. Conclusion

Absent en banc reconsideration, we cannot entertain Appellant’s challenge to equitable *438 mootness, as *Continental* remains the law of this circuit. Because the District Court abused its discretion under *Continental*, we will reverse the District Court’s dismissal and remand for its consideration of Appellant’s bankruptcy appeal on its merits.

KRAUSE, Circuit Judge, concurring:

I agree wholeheartedly with the majority’s equitable mootness analysis, which we are compelled to undertake under our controlling precedent. I write separately, however, because I do not believe we should persist in our failed attempts to cabin this legally ungrounded and practically unadministrable “judge-made abstention doctrine.” *In re Semcrude, L.P.*, 728 F.3d 314, 317 (3d Cir.2013). Rather, the time has come to reconsider whether it should exist at all, and, if we conclude it should, to reform it substantially.

Although we adopted equitable mootness en banc in *In re Continental Airlines*, 91 F.3d 553 (3d Cir.1996) (en banc), neither the constitutional nor the statutory basis for the doctrine were challenged in that case, and the Court was still nearly evenly divided—with then-Judge Alito leading

the dissent. See *id.* at 568 (Alito, J., dissenting). The doctrine was designed to be “limited in scope and cautiously applied,” specifically in highly complex cases where limited relief was not feasible and upsetting a reorganization would cause substantial harm to numerous third parties. *Id.* at 559 (majority opinion). In the nearly twenty years since we launched that experiment, it has proved highly problematic, with district courts continuing to dismiss appeals in the simplest of bankruptcies. Further, as courts and litigants (including Appellees) have struggled to identify a statutory basis for the doctrine, it has become painfully apparent that there is none. Moreover, a series of Supreme Court decisions since our adoption of the doctrine makes clear that, whatever doubts we set aside twenty years ago to embrace the doctrine, it cannot survive constitutional scrutiny today. I therefore urge our Court to consider eliminating, or at the very least, reforming, equitable mootness.

I.

I begin with our experience with the doctrine. Equitable mootness was intended to “provide[] a vehicle whereby the court can prevent substantial harm to numerous parties,” namely where “the reorganization involves intricate transactions or where outside investors have relied on the confirmation of the plan.” *Cont’l Airlines*, 91 F.3d at 559–60 (citations omitted). What *Continental Airlines* spawned is a different species altogether. We have repeatedly admonished that the doctrine applies only to attempts to “unscrambl[e] complex bankruptcy reorganizations,” *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir.2001) (emphasis added),¹ and even then “‘is limited in scope and should be cautiously applied,’” *id.* (quoting *In re PWS Holding Corp.*, 228 F.3d 224, 236 (3d Cir.2000)),² as well as that it is inapplicable when limited relief is available on appeal, *Semcrude*, 728 F.3d at 323.³ Yet district courts have continued to invoke the doctrine in modest, non-complex *439 bankruptcies and where appellants have sought limited relief.

We have also rejected invitations to extend equitable mootness outside its intended context, i.e., appeals from confirmation orders. See *In re Diet Drugs*, 582 F.3d 524, 552 n. 55 (3d Cir.2009) (declining to decide whether

equitable mootness applied to class settlement); [id.](#) at 557 (Ambro, J., dissenting) (cautioning that extending “the controversial doctrine of equitable mootness, which applies only to attempts to unscrambl[e] complex bankruptcy reorganizations,” to class settlement was inappropriate (alteration in original) (internal quotation marks omitted)). But our district courts have not been so discriminating. See *In re Jevic Holding Corp.*, Nos. 13–104 & 13–105, 2014 WL 268613, at *4 (D.Del. Jan. 24, 2014) (applying equitable mootness to dismiss an appeal from an order approving a settlement and structured dismissal). In fact, the doctrine has even been invoked by bankruptcy courts to dismiss motions to revoke reorganization plans. See, e.g., [In re Innovative Clinical Solutions, Ltd.](#), 302 B.R. 136, 140–42 (Bankr.D.Del.2003); cf. [In re Machne Menachem, Inc.](#), 371 B.R. 63, 73–75 (Bankr.M.D.Pa.2006) (applying equitable mootness factors but declining to dismiss on equitable mootness grounds).

Since *Continental Airlines*, we have reversed findings of equitable mootness or declined to dismiss appeals as equitably moot no less than seven times. See [In re SCH Corp.](#), 569 Fed.Appx. 119, 122 (3d Cir.2014) (not precedential) (reversing a finding of equitable mootness); [Semcrude](#), 728 F.3d 314 at 323 (same); [Phila. Newspapers](#), 690 F.3d at 170 (same); [Zenith Elecs. Corp.](#), 329 F.3d at 346 (same); [United Artists](#), 315 F.3d at 228 (declining to dismiss as equitably moot an appeal from a district court exercising original jurisdiction over a bankruptcy case); [PWS](#), 228 F.3d at 237 (same); [In re Cont'l Airlines \(Continental II\)](#), 203 F.3d 203, 210 (3d Cir.2000) (declining to dismiss appeal as equitably moot because the debtor had not preserved the issue, but noting that equitable mootness did not apply).

This case is only the most recent example, but it epitomizes the problem. As the majority explains, what we have is a small, garden-variety bankruptcy. Quad's appeal did not implicate intricate transactions that would be difficult to unravel, nor did it pose a significant risk of injuring third parties. Further, in the event the Plan could not be undone, Quad urged the District Court to grant the limited relief of striking third-party releases from the Plan. The District Court nonetheless dismissed Quad's timely and repeated requests for appellate review on “equitable mootness” grounds. That yet another thoughtful and diligent District Judge has misconstrued our case law as permitting the abdication of

jurisdiction in these circumstances reflects a doctrine adrift and in need of reconsideration by our Court.

II.

So what is the constitutional or statutory anchor for declining to exercise jurisdiction over bankruptcy appeals dubbed “equitably moot”? Simply put, there is none.

The mandate that federal courts hear cases within their statutory jurisdiction is a bedrock principle of our judiciary. As Chief Justice Marshall wrote long ago, “[w]e have no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given. The one or the other would be treason to the [C]onstitution.” *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 404, [5 L.Ed. 257 \(1821\)](#). Dismissing appeals in the name of equitable mootness violates this “virtually unflagging obligation of the federal courts to exercise the jurisdiction given them.” [Colo. River *440 Water Conservation Dist. v. United States](#), 424 U.S. 800, 817, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976). Then–Judge Alito recognized as much in *Continental Airlines*, rebuking the majority for “throw[ing] [the appellants] out of court without reaching the merits of their arguments ... even though (a) th[e] case [was] clearly not ‘moot’ in any proper sense of the term, (b) we unquestionably ha[d] statutory jurisdiction, and (c) we have a ‘virtually unflagging obligation’ to exercise the jurisdiction that we have been given.” [Cont'l Airlines](#), 91 F.3d at 568 ([Alito, J., dissenting](#)) (quoting *Colo. River*, 424 U.S. at 817, 96 S.Ct. 1236).

While we have referred to equitable mootness as a “judge-made abstention doctrine,” [Semcrude](#), 728 F.3d at 317, it is not among the handful of narrow and deeply rooted abstention doctrines recognized by the Supreme Court, namely, *Pullman*, *Burford*, *Younger*, and *Colorado River*.⁴ Those doctrines, much like the doctrine of *forum non conveniens*, proceed from the premise that “[i]n rare circumstances, federal courts can relinquish their jurisdiction *in favor of another forum*.”

[Quackenbush v. Allstate Ins. Co.](#), 517 U.S. 706, 722, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996) (emphasis added).⁵ Moreover, the Supreme Court has “on several occasions explicitly recognized that abstention ‘does not, of course, involve the abdication of federal jurisdiction, but only the *postponement* of its exercise.’ ” [England v. La. State](#)

Bd. of Med. Exam'rs, 375 U.S. 411, 84 S.Ct. 461, 465, 11 L.Ed.2d 440 (1964) (emphasis added) (quoting *Harrison v. NAACP*, 360 U.S. 167, 177, 79 S.Ct. 1025, 3 L.Ed.2d 1152 (1959)). But where there is no other forum and no later exercise of jurisdiction, as in the case of equitable mootness, relinquishing jurisdiction is not abstention; it's abdication. In short, there is no analogue for equitable mootness among the abstention doctrines.

Nor is there a likely prospect of the Supreme Court either taking an expansive view of an existing doctrine to encompass equitable mootness or recognizing equitable mootness as a wholly new abstention doctrine. On the contrary, the Court has repeatedly endeavored to narrow the scope of the abstention doctrines, particularly within the past few years.

In *Sprint Communications, Inc. v. Jacobs*, — U.S. —, 134 S.Ct. 584, 187 L.Ed.2d 505 (2013), for instance, the Court refused to extend the three “exceptional” situations where *Younger* abstention is appropriate, reaffirming Chief Justice Marshall's “early and famous[]” assertion of federal courts' obligation to hear and decide cases within their jurisdiction. *441 *Sprint Commc'ns*, 134 S.Ct. at 590–91 (citing *Cohens*, 6 Wheat. at 404). The Court relied on that assertion again when declining to expand the political question doctrine in *Zivotofsky ex rel. Zivotofsky v. Clinton*, — U.S. —, 132 S.Ct. 1421, 182 L.Ed.2d 423 (2012), explaining that “the Judiciary has a responsibility to decide cases properly before it, even those it ‘would gladly avoid.’” *Id.* at 1427 (quoting *Cohens*, 6 Wheat. at 404).

And just last year, in *Lexmark International, Inc. v. Static Control Components, Inc.*, — U.S. —, 134 S.Ct. 1377, 188 L.Ed.2d 392 (2014), the Court confirmed its disapproval of doctrines that permit courts to decline to decide claims on “prudential” rather than statutory or constitutional grounds, admonishing that such doctrines conflict with the Court's “recent reaffirmation [in *Sprint Communications*] of the principle that a federal court's obligation to hear and decide cases within its jurisdiction is virtually unflagging.” *Id.* at 1386 (quoting *Sprint Commc'ns*, 134 S.Ct. at 591) (internal quotation marks omitted). After concluding the plaintiff's claim “present[ed] a case or controversy that [was] properly within federal courts' Article III jurisdiction,” the Court refused to frame the question before it, which was whether the plaintiff had a cause of action under a federal statute, as

a question of “prudential standing” despite using that label in the past. *Id.* at 1386–87. The Court reasoned:

We do not ask whether in our judgment Congress *should* have authorized [the plaintiff's] suit, but whether Congress in fact did so. Just as a court cannot apply its independent policy judgment to recognize a cause of action that Congress has denied, it cannot limit a cause of action that Congress has created merely because “prudence” dictates.

Id. at 1388 (citation omitted).

These recent decisions counsel that equitable mootness is not a logical extension of the narrow abstention doctrines recognized by the Court and will not be viewed favorably as a relatively new prudential one. See *New Orleans Pub. Serv., Inc. v. Council of City of New Orleans*, 491 U.S. 350, 358, 109 S.Ct. 2506, 105 L.Ed.2d 298 (1989) [hereinafter “*NOPSI*”] (explaining that the Court's cases “have long supported the proposition that federal courts lack the authority to abstain from the exercise of jurisdiction that has been conferred”). Rather, this judge-made doctrine can survive only if grounded in the Bankruptcy Code or the federal statutes conferring bankruptcy jurisdiction—the subject to which we now turn.

III.

A.

The majority opinion in *Continental Airlines* did not engage with any statutory arguments in favor of equitable mootness because none were raised. A review of the statutory language, however, reveals that the Bankruptcy Code and related jurisdictional statutes provide no support for equitable mootness and actually undermine it.

Title 28 outlines federal courts' bankruptcy jurisdiction. Section 1334 gives district courts original jurisdiction over bankruptcy cases, while § 157 allows them to refer cases

to bankruptcy courts. 28 U.S.C. §§ 157(a), 1334(a). The statute explicitly makes the bankruptcy court's authority to enter orders, including confirmation orders, "subject to review" by the referring district court. *Id.* § 157(b)(1). In turn, § 158 provides that the district courts "shall have jurisdiction to hear appeals" from bankruptcy courts. *Id.* § 158(a). Neither § 157 nor § 158 states or implies that district courts may decline to exercise that jurisdiction by dismissing an appeal as equitably moot.

*442 Appellees point to § 1334(c)(1), which provides that "nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." *Id.* § 1334(c)(1). That provision, however, provides no support for equitable mootness. To begin, § 1334 cannot be read to authorize district courts to abstain from exercising their appellate jurisdiction when it refers to the *original jurisdiction* of the district courts, not to appellate jurisdiction at all. See *id.* § 1334(a); *In re Mystic Tank Lines Corp.*, 544 F.3d 524, 528 (3d Cir.2008).

Moreover, § 1334 allows abstention "in the interest of justice, or in the interest of comity with State courts or respect for State law." Equitable mootness no doubt does not involve the latter. As to the former, it could be argued that preserving a reorganization plan may serve the "interest of justice." But how is it "just" to bar a potentially meritorious appeal when an appellate court—*after* hearing the merits of the appeal—instead could use its equitable authority to fashion a limited remedy while still protecting third parties that may be harmed if a plan is undone? See *Semcrude*, 728 F.3d at 324–25 (citing *Cont'l Airlines*, 91 F.3d at 571–72 (Alito, J., dissenting)) ("[T]he feared consequences of a successful appeal are often more appropriately dealt with by fashioning limited relief at the remedial stage than by refusing to hear the merits of an appeal at its outset."); see also *NOPSI*, 491 U.S. at 358–59, 109 S.Ct. 2506 (noting that while federal courts "lack the authority to abstain from the exercise of jurisdiction that has been conferred," they retain "discretion in determining whether to grant certain types of relief").

Additionally, if § 1334(c) were the basis for equitable mootness, our construction of the doctrine (and every other Circuit's) would violate § 1334(d), which provides: "Any decision to abstain or not to abstain made under subsection (c) ... is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title." 28 U.S.C. § 1334(d) (emphasis added).⁶ Yet we have never interpreted § 1334 to bar our review of district court orders dismissing bankruptcy appeals on equitable mootness grounds. On the contrary, dating back to *Continental Airlines*, we have not only reviewed such decisions, but have often reversed them. Thus, interpreting § 1334(c) as the statutory basis for equitable mootness would be incompatible with our case law, as well as the language and structure of § 1334.

Finally, the legislative history of § 1334(c) is devoid of any mention of equitable mootness. It indicates the provision was enacted to respond to the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), and to avoid constitutional concerns with having state law claims resolved in federal courts. See H.R.Rep. No. 98–882 H.R.Rep. No. 98–882 (1984), reprinted in 1984 U.S.C.C.A.N. 576, 1984 WL 37391. The Supreme Court's interpretation of § 1334 in *Stern v. Marshall*, — U.S. —, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), reinforces that *443 Congress's intent was to authorize bankruptcy courts to abstain from hearing state law claims in certain circumstances—not to allow district courts to abdicate their appellate jurisdiction:

[T]he framework Congress adopted in the 1984 Act ... contemplates that certain state law matters in bankruptcy cases will be resolved by judges other than those of the bankruptcy courts. Section 1334(c)(2), for example, requires that bankruptcy courts abstain from hearing specified non-core, state law claims that "can be timely adjudicated[] in a State forum of appropriate jurisdiction."

Section 1334(c)(1) similarly provides that bankruptcy courts may abstain from hearing any proceeding, including core matters, "in the interest of comity with State courts or respect for State law."

Id. at 2619–20 (second alteration in original). Thus, the language, structure, and legislative history of § 1334, as well as its interpretation by the Supreme Court, indicate that Congress did not intend an equitable mootness exception to the federal courts' appellate jurisdiction in bankruptcy cases.

Appellees urge that the “most plausible” basis for the doctrine is that the Bankruptcy Code “express[es] a policy favoring the finality of bankruptcy decisions” through 11 U.S.C. §§ 363(m),⁷ 364(e),⁸ and 1127(b),⁹ and equitable mootness fills a gap in the Code created by the absence of a provision limiting appellate review of plan confirmation orders. *Semcrude*, 728 F.3d at 317–18. But then-Judge Alito aptly explained why we should reject this argument in his *Continental Airlines* dissent: “[N]arrow provisions” such as §§ 363(m) and 364(e), “which merely prevent the upsetting of certain *specific* transactions if stays are not obtained,” cannot support the broad doctrine of equitable mootness. 91 F.3d at 570 (Alito, J., dissenting) (emphasis added). By their terms, §§ 363(m) and 364(e) do not prevent an appellate court from *hearing* an appeal, or even from granting a particular remedy; they simply prevent the appellate court's remedy from affecting certain transactions. See *Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490, 499 (3d Cir.1998). Section 1127(b) provides even less support for equitable mootness, as it only restricts a *party's* ability to modify a plan before confirmation; it says nothing about the *444 powers of bankruptcy courts or appellate courts.

Moreover, rather than establish a general “policy” supporting equitable mootness, these provisions weigh *against* the doctrine. Because Congress specified certain orders that cannot be disturbed on appeal absent a stay, basic canons of statutory construction compel us to presume that Congress did *not* intend for other orders to be immune from appeal. See *Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983); *Andrus v. Glover Const. Co.*, 446 U.S. 608, 616–17, 100 S.Ct. 1905, 64 L.Ed.2d 548 (1980). While the federal courts must fill statutory gaps in some exceptional circumstances, see, e.g., *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 593, 93 S.Ct. 2389, 37 L.Ed.2d 187 (1973), we may not stretch a statute to create such gaps, and we generally acknowledge gaps to provide

relief, not to deny relief which is the consequence of denying appellate review.

B.

Even if there were a reading of the statute that supported equitable mootness, we would be compelled to reject it because of the serious constitutional questions that reading would raise. See *Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575, 108 S.Ct. 1392, 99 L.Ed.2d 645 (1988); *Sandoval v. Reno*, 166 F.3d 225, 237 (3d Cir.1999).

Article III of the Constitution imposes certain requirements on officials who exercise the judicial power of the United States, U.S. Const. art. III § 1, but Congress often charges officials who are not required to meet those criteria with ruling on certain kinds of claims. Adjudication by such non-Article III tribunals, including bankruptcy courts, raises two distinct constitutional concerns. The first is the infringement on a litigant's “entitlement to an Article III adjudicator,” a personal right recently reaffirmed in *Wellness International Network, Ltd. v. Sharif*, — U.S. —, 135 S.Ct. 1932, 1944, 191 L.Ed.2d 911 (2015). While that right can be waived, *id.*, bankruptcy appellants whose appeals are dismissed as equitably moot clearly do not do so. Moreover, because they lack an alternative forum in which to pursue their claims against a debtor, most creditors do not truly consent to bankruptcy adjudication in the first place, see *Stern*, 131 S.Ct. at 2614, let alone adjudication without any appellate review.

The second is a non-waivable, structural concern that a “congressional decision to authorize the adjudication of Article III business in a non-Article III tribunal” would “impermissibly threaten[] the institutional integrity of the Judicial Branch.” *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 851, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986); see *Wellness Int'l*, 135 S.Ct. at 1944. In determining whether such an intrusion occurs, the Court scrutinizes among other things “the extent to which the ‘essential attributes of judicial power’ are reserved to Article III courts.” *Schor*, 478 U.S. at 851, 106 S.Ct. 3245. Appellate review by an Article III judge is crucial to that determination. See, e.g., *id.* at 853, 106 S.Ct. 3245.¹⁰

Accordingly, over eighty years ago in  *Crowell v. Benson*, 285 U.S. 22, 52 S.Ct. 285, 76 L.Ed. 598 (1932), the Supreme *445 Court upheld a system of adjudication by an administrative agency on the rationale that “the reservation of full authority to [an Article III] court to deal with matters of law provide [d] for the appropriate exercise of the judicial function.”  *Id.* at 54, 52 S.Ct. 285. The availability of Article III review was also essential to the Court’s approvals of agency adjudications in  *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 593, 105 S.Ct. 3325, 87 L.Ed.2d 409 (1985), and  *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833, 853, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986). Similarly, in  *United States v. Raddatz*, 447 U.S. 667, 100 S.Ct. 2406, 65 L.Ed.2d 424 (1980), the Court upheld decision-making by magistrate judges only because “the ultimate decision is made by the district court.”  *Id.* at 683, 100 S.Ct. 2406; see also  *Northern Pipeline*, 458 U.S. at 83, 102 S.Ct. 2858 (“Critical to the Court’s decision to uphold the Magistrates Act was the fact that the ultimate decision was made by the district court.”).

Applying these principles in the bankruptcy context, the Supreme Court held in *Northern Pipeline* and *Stern* that because a bankruptcy court is not an Article III court, it may not enter final judgments regarding certain kinds of claims (which have since been dubbed “*Stern* claims”) even when the bankruptcy judge’s decision will be reviewed on appeal by an Article III judge. See  *Stern*, 131 S.Ct. at 2620;  *Northern Pipeline*, 458 U.S. at 86–87, 102 S.Ct. 2858 (plurality opinion); see also  *id.* at 91, 102 S.Ct. 2858 (Rehnquist, J., concurring in the judgment). Most recently, in *Wellness International*, the Court approved adjudication of *Stern* claims by bankruptcy judges where the parties consent, but explicitly premised its decision on the existence of appellate review by Article III courts, reasoning that “allowing Article I adjudicators to decide claims submitted to them by consent does not offend the separation of powers so long as Article III courts retain supervisory authority over the process.”  135 S.Ct. at 1944 (emphasis added).

Equitable mootness drastically weakens that supervisory authority, and therefore threatens a far greater “impermissibl[e] intru[sion] on the province of the judiciary,”  *Schor*, 478 U.S. at 851–52, 106 S.Ct. 3245, than the

Court confronted in *Northern Pipeline*, *Stern*, or *Wellness International*. The doctrine not only prevents appellate review of a non-Article III judge’s decision; it effectively delegates the power to prevent that review to the very non-Article III tribunal whose decision is at issue. Although Article III judges decide whether an appeal is equitably moot, bankruptcy courts control nearly all of the variables in the equation, including whether a reorganization plan is initially approved, whether a stay of plan implementation is granted, whether settlements or releases crucial to a plan are approved and executed, whether property is transferred, whether new entities (in which third parties may invest) are formed, and whether distributions (including to third parties) under the plan begin—all before plan challengers reach an Article III court.

Put another way, whereas magistrate judges’ and administrative agencies’ decisions are at least subject to appellate review, equitable mootness not only allows bankruptcy court decisions to avoid review, but also enables bankruptcy judges to insulate their decisions from review at their discretion. In turn, opportunistic plan proponents can (and as discussed below, regularly do) use this to their advantage. As then-Judge Alito warned in *Nordhoff Investments*, “our court’s equitable mootness doctrine can easily be used as a weapon to prevent any appellate review of bankruptcy court orders confirming reorganization *446 plans. It thus places far too much power in the hands of bankruptcy judges.”  258 F.3d at 192 (Alito, J., concurring in the judgment).

While historical precedent can justify a delegation of judicial power to a non-Article III tribunal,¹¹ equitable mootness cannot lay claim to such historical support. Despite the doctrine’s recent acceptance by district courts and courts of appeals, the decisions of bankruptcy commissioners, referees, and, most recently, judges have always been subject to review in courts of law or equity.¹² Abdicating that review is a modern trend not started by Congress or the Supreme Court.

At the very least, equitable mootness raises serious constitutional concerns by failing to provide appellate review of bankruptcy judges’ decisions in an Article III court—a protection that was present, yet ultimately insufficient to cure similar concerns in *Northern Pipeline* and *Stern*. With no indication that Congress or the Supreme Court has authorized an exception to our “virtually unflagging obligation” to exercise our jurisdiction that supports equitable mootness, it

is not hard to see why the six dissenting members of our Court in *Continental Airlines* were “puzzled and troubled” by our adoption of the doctrine without any analysis of its origins.

 [91 F.3d at 568](#) (Alito, J., dissenting).

IV.

Beyond the issues with equitable mootness's legitimacy, I also question its efficacy. The doctrine was intended to promote finality, but it has proven far more likely to promote uncertainty and delay. Ironically, as Chief Judge McKee noted at oral argument in this case, a motion to dismiss an appeal as equitably moot has become “part of the Plan.”¹³ Proponents of reorganization plans now rush to implement them so they may avail themselves of an equitable mootness defense, much like Appellees did here.¹⁴ Rather than litigate the merits *447 of an appeal, parties then litigate equitable mootness. And even if an appeal is dismissed as equitably moot by a district court, that dismissal is appealed to our Court, often resulting, in turn, in a remand and further proceedings.

This appeal proves the point. The Bankruptcy Court approved the Plan on March 5, 2013. Quad then made multiple unsuccessful attempts to obtain a stay from the Bankruptcy Court and the District Court, eventually filing its brief on appeal in the District Court on May 23, about two months after the Plan took effect. One2One filed its brief in response about two weeks later, and then filed its motion to dismiss the appeal as equitably moot the next day. All of the briefing on both the merits and the motion to dismiss was complete by June 25, 2013. Because the appeal was dismissed on equitable mootness grounds, however, we find ourselves, nearly two years later and after the parties have expended considerable resources on full briefing and argument before this Court, concluding that the District Court improperly applied the equitable mootness factors and remanding for a ruling on the merits—a ruling that itself eventually may be appealed.

How, then, does refusing to hear the merits of the appeal achieve finality? Even if we were affirming the District Court's finding of equitable mootness, there would not have been finality until this point, as the possibility of reversal has loomed all along. Without the equitable mootness doctrine, on the other hand, the District Court would have ruled on the merits long ago.

Even if the doctrine worked as intended and consistently promoted finality, its deleterious effect on our system of bankruptcy adjudication presents an independent reason to reject it. By excising appellate review, equitable mootness not only tends to insulate errors by bankruptcy judges or district courts, but also stunts the development of uniformity in the law of bankruptcy.¹⁵ Moreover, the significant consequences of a confirmation order, as recently recited by the Supreme Court, necessitate appellate review:

[P]lan confirmation ... alters the status quo and fixes the rights and obligations of the parties. When the bankruptcy court confirms a plan, its terms become binding on debtor and creditor alike. Confirmation has preclusive effect, foreclosing relitigation of any issue actually litigated by the parties and any issue necessarily determined by the confirmation order. Subject to certain exceptions, confirmation vests all of the property of the bankruptcy estate in the debtor, and renders that property free and clear of any claim or interest of any creditor provided for by the plan. Confirmation also triggers the Chapter 13 trustee's duty to distribute to creditors those funds already received from the debtor.

 [Bullard v. Blue Hills Bank](#), — U.S. —, 135 S.Ct. 1686, 1692, 191 L.Ed.2d 621 (2015) (alterations, citations, and internal quotation marks omitted).

Particularly troubling are dismissals of appeals challenging plans that “classify similar claims differently in order to gerrymander” *448 an affirmative vote on reorganization.”

 [In re Pac. Lumber Co.](#), 584 F.3d 229, 251 (5th Cir.2009)

(quoting  [In re Greystone III Joint Venture](#), 995 F.2d 1274, 1279 (5th Cir.1991)) (internal quotation mark omitted). Even if appellants challenging such violations can demonstrate “apparent arbitrariness” in the treatment of different creditors, courts are likely to find their appeals equitably moot, as often “no remedy ... is practicable other than unwinding the plan.”

Id.; accord  [In re Charter Commc'ns](#), 691 F.3d 476, 487–88 (2d Cir.2012). Under such circumstances, equitable mootness merely serves as part of a blueprint for implementing a questionable plan that favors certain creditors over others without oversight by Article III judges.¹⁶ In short, even equitable and prudential concerns weigh against equitable mootness.

V.

We must consider whether to end or endure the mischief of equitable mootness. Although the doctrine has been accepted de facto across the Circuits, its legitimacy has rarely been scrutinized,¹⁷ and this appeal appears to be the first in our Circuit in which an appellant has properly preserved and disputed the validity of equitable mootness under the Bankruptcy Code, the federal statutes conferring bankruptcy jurisdiction, and the Constitution. In fact, aside from numerous petitions for certiorari, the doctrine has gone virtually unchallenged.¹⁸ This may be because litigants—and bankruptcy attorneys—wield the weapon of equitable mootness just as often as they suffer its blows. But it is time for the challenge, and I am not alone in urging it. A coalition of bankruptcy law professors *449 and the United States Government have both urged the Supreme Court to hear challenges to equitable mootness.¹⁹ In any event, the doctrine's widespread acceptance, standing alone, does not establish its validity. After all, the system of bankruptcy adjudication struck down in *Stern* had been unanimously upheld by district courts and courts of appeals.²⁰

Moreover, principles of stare decisis do not compel us to continue on this course. “Revisiting precedent is particularly appropriate where, as here, ... the precedent consists of a judge-made rule that was recently adopted to improve the operation of the courts, and experience has pointed up the precedent's shortcomings,” *Pearson v. Callahan*, 555 U.S. 223, 233, 129 S.Ct. 808, 172 L.Ed.2d 565 (2009), and where “subsequent legal developments have unmoored the case from its doctrinal anchors,” *Morrow v. Balaski*, 719 F.3d 160, 180 (3d Cir.2013) (en banc) (Smith, J., concurring); see *Dickerson v. United States*, 530 U.S. 428, 443, 120 S.Ct. 2326, 147 L.Ed.2d 405 (2000) (“[W]e have overruled our precedents when subsequent cases have undermined their doctrinal underpinnings.”); see also *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 900, 127 S.Ct. 2705, 168 L.Ed.2d 623 (2007) (quoting *Dickerson* and collecting cases). Considering that equitable mootness barely had doctrinal anchors to begin with, our dismal experience with it obliges us to reconsider *Continental Airlines*.

While proponents of the doctrine will emphasize its practical importance to the administration of bankruptcy estates,

there are effective alternatives that do not suffer from the prudential, statutory, and constitutional defects of equitable mootness. For instance, in an appropriate case, parties can deploy the equitable defense of laches, which requires “establish[ing] (1) an inexcusable delay in bringing the action and (2) prejudice.” *In re Mushroom Transp. Co.*, 382 F.3d 325, 337 (3d Cir.2004) (quoting *U.S. Fire Ins. Co. v. Asbestospray, Inc.*, 182 F.3d 201, 208 (3d Cir.1999)) (internal quotation mark omitted). Similarly, where an appellant's bad faith delay prejudices other parties, courts have discretion to impose an appropriate remedy, including dismissal. See *In re Harris*, 464 F.3d 263, 273 (2d Cir.2006) (Sotomayor, J.); *In re SPR Corp.*, 45 F.3d 70, 74 (4th Cir.1995); *In re Comer*, 716 F.2d 168, 177 (3d Cir.1983); see also Fed. R. Bankr.P. 8003(a)(2) (“An appellant's failure to take any step other than the timely filing of a notice of appeal does not affect the validity of the appeal, but is ground only for the district court or BAP to act as it considers appropriate, including dismissing the appeal.”). And, of course, appellate courts can expedite briefing schedules and issue orders with necessary instructions for the parties and bankruptcy courts in advance of full opinions.

More broadly, courts can address the concerns behind equitable mootness, including the extent to which granting requested relief will “fatally scramble” an otherwise lawful plan or “significantly harm third parties who have justifiably relied on the plan's confirmation,” in fashioning an appropriate remedy, rather than abstaining from exercising their jurisdiction. *Semcrude*, 728 F.3d at 321; see also *id.* at 324–25 (citing **450 Cont'l Airlines*, 91 F.3d at 571–72 (Alito, J., dissenting)) (“As then-Judge Alito explained, the feared consequences of a successful appeal are often more appropriately dealt with by fashioning limited relief at the remedial stage than by refusing to hear the merits of an appeal at its outset.”).

In many cases, district courts may conclude that all or substantially all of the relief requested is feasible despite the plan's consummation. See *In re Res. Tech. Corp.*, 430 F.3d 884, 886–87 (7th Cir.2005) (Easterbrook, J.) (“Unscrambling a transaction may be difficult, but it can be done. No one (to our knowledge) thinks that an antitrust or corporate-law challenge to a merger becomes moot as soon as the deal is consummated. Courts can and do order divestiture or damages in such situations.”); *In re Kmart Corp.*,

359 F.3d 866 (7th Cir.2004) (Easterbrook, J.) (“Money had changed hands and, we are told, cannot be refunded. But why not? Reversing preferential transfers is an ordinary feature of bankruptcy practice, often continuing under a confirmed plan of reorganization.” (citation omitted));  *Matter of Envirodyne Indus., Inc.*, 29 F.3d 301, 304 (7th Cir.1994) (Posner, J.) (“We could order the bankruptcy judge to modify the plan of reorganization to reallocate \$20 million worth of the stock that the 14% noteholders received to the appellants, the 13.5% noteholders. Some of the 14% noteholders, it is true, have already sold their stock, but they could be ordered to surrender some or all of the proceeds to the appellants.”).

In other cases, the interests of finality and protecting third parties will weigh against granting an appellant's requested relief in its entirety. The availability of only limited relief, however, should not prevent adjudication on the merits. “[T]otal relief ... is not essential to jurisdiction,” as “relatively few plaintiffs get *all* they are seeking in their lawsuit.”

 *Envirodyne*, 29 F.3d at 304. Even if a “bankruptcy court might determine that full relief is no longer available to [appellants] after substantial consummation,” certainly appellants “would readily accept some fractional recovery that does not impair feasibility or affect parties not before this Court, rather than suffer the mootness of [their] appeal as a whole.” *In re Chateaugay Corp.*, 10 F.3d 944, 954 (2d Cir.1993).

Accordingly, several courts have analyzed equitable mootness only after addressing the merits, including the Seventh Circuit in *Envirodyne*, a decision written by Judge Posner. There, following Judge Easterbrook's decision in  *In re UNR Industries, Inc.*, 20 F.3d 766, 769 (7th Cir.1994), which banished the term “equitable mootness” from that Circuit, the court reasoned that the “[t]he now nameless doctrine is perhaps best described as merely an application of the age-old principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties” and “not a jurisdictional doctrine.”  *Envirodyne*, 29 F.3d at 304 (citing  *Int'l Brotherhood of Teamsters v. United States*, 431 U.S. 324, 375, 97 S.Ct. 1843, 52 L.Ed.2d 396 (1977)). As such, the court “elide[d] the question of [the doctrine's] applicability” and affirmed the bankruptcy appeal before it on the merits. *Id.* ²¹

*451 At least two courts have followed Judge Posner's lead. In  *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir.2005), a Second Circuit panel analyzed the merits of an appeal before equitable mootness, reasoning that “[b]ecause equitable mootness bears only upon the proper remedy, and does not raise a threshold question of our power to rule, a court is not inhibited from considering the merits before considering equitable mootness.”  *Id.* at 144 (citing  *Envirodyne*, 29 F.3d at 303–04). The court further observed that “[o]ften, an appraisal of the merits is essential to the framing of an equitable remedy.” *Id.* And the Fourth Circuit, in its most recent equitable mootness decision, cited *Metromedia* in adopting the same approach.  *Behrmann v. Nat'l Heritage Foundation*, 663 F.3d 704, 713 n. 3 (4th Cir.2011).

Considering the equities after the merits, at the remedial stage, offers several advantages over abstaining from hearing the appeal altogether. In many cases, deciding the merits of a bankruptcy appeal may require the same if not less effort than deciding equitable mootness, especially given that a bankruptcy judge's findings of fact are reviewed for clear error. If so, a court can conserve resources by ruling first on the merits, as the court did in  *Envirodyne*. See 29 F.3d at 304. If not, requiring a ruling on the merits can at least prevent one cycle of appeals (as a ruling by the District Court on the merits of Quad's appeal might have obviated the need for a remand here). ²²

Even in an exceptional case, like *Continental Airlines*, where a court arguably cannot grant any relief without inequitably harming innocent parties, having a decision on the merits is beneficial. In *Metromedia*, for instance, the Second Circuit determined that the bankruptcy court had improperly approved certain nondebtor releases, but ultimately concluded it would be inequitable to grant relief considering that the appellants had not sought a stay and “none of the completed transactions c[ould] be undone without violence to the overall arrangements.”  416 F.3d at 144–45. Nevertheless, the court's decision on the merits has been cited numerous times by courts analyzing similar provisions in reorganization plans. See, e.g.,  *In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1061 (5th Cir.2012) (relying on *Metromedia* in analyzing nondebtor releases); *In re Genco Shipping & Trading Ltd.*, 513 B.R. 233, 269 (Bankr.S.D.N.Y.2014) (same). Thus, a ruling on the merits of

a bankruptcy appeal will promote accuracy and uniformity in the law of bankruptcy even if the reviewing court finds it impossible to fashion an appropriate remedy.

*452 Such cases should be exceedingly rare, however, because as long as any remedy, including monetary relief, is available, an appellant's claims are "not 'moot' in any proper sense of the term," *Cont'l Airlines*, 91 F.3d at 568 (Alito, J., dissenting), and should be heard on their merits. See *Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1*, 551 U.S. 701, 720, 127 S.Ct. 2738, 168 L.Ed.2d 508 (2007) (reasoning that a case is not moot where a plaintiff seeks monetary relief in their complaint); *Church of Scientology v. United States*, 506 U.S. 9, 12, 113 S.Ct. 447, 121 L.Ed.2d 313 (1992) (explaining that a case is not moot where, although "a court may not be able to return the parties to the *status quo ante*," it "can fashion some form of meaningful relief"); see also 13C Charles Alan Wright et al., *Federal Practice & Procedure* § 3533.3 (3d ed. 2015) ("Untold numbers of cases illustrate the rule that a claim for money damages is not moot....").

VI.

Even if we decide not to revisit equitable mootness, we should delineate its contours more precisely and provide clearer guidance to the district courts on its appropriate use. We made valiant efforts in *Semcrude*, where we placed the burden of demonstrating equitable mootness on the party seeking dismissal, emphasized that speculative "Chicken Little" statements prophesizing harm to a plan or to third parties cannot fulfill that burden, and stressed that "[t]he presumptive position remains that federal courts should hear and decide on the merits cases properly before them." 728 F.3d at 321–22, 324–26. But the persistent problems in the doctrine's application by district courts reflect that more must be done, and there are at least four reforms we could consider if we opted to maintain equitable mootness as an abstention doctrine.

First, we could place greater weight on an appellant's attempts to obtain a stay, perhaps permitting dismissal only where an appellant does not seek one.²³ In such cases, we can fairly say "the appealing party should have acted before the plan became extremely difficult to retract." *Nordhoff Invs.*, 258 F.3d at 185 (majority opinion). Indeed, every time we have

affirmed a finding of equitable mootness after *Continental Airlines*, the appellant failed to file a motion for a stay. See *In re SemCrude L.P.*, 456 Fed.Appx. 167, 171 (3d Cir.2012) (not precedential) (appellant made an oral motion for a stay in the bankruptcy court, but never filed a written motion or made any other attempts to obtain a stay); *In re Genesis Health Ventures, Inc.*, 204 Fed.Appx. 144, 146 (3d Cir.2006) (not precedential) (appellant made no attempt to obtain a stay); *In re SGPA, Inc.*, 34 Fed.Appx. 49, 52 (3d Cir.2002) (not precedential) (same); *Nordhoff Invs.*, 258 F.3d at 185 (same); see also *id.* at 191–92 (Alito, J., concurring in the judgment) (agreeing that an appeal was equitably moot "primarily" because the appellants had failed to seek a stay).

Second, we could clarify what constitutes "significant[] harm" to "third parties who have justifiably relied on plan confirmation." *Semcrude*, 728 F.3d at 321. Specifically, who is a "third party," and when is their reliance "justifiable"? While *453 we should be hesitant to grant relief where the effects on third parties would be inequitable, we may be less concerned where purported third parties have had the opportunity to participate in the bankruptcy proceedings or on appeal. Just as opponents of a reorganization plan must diligently pursue their claims, so must plan proponents. See *Charter Commc'ns*, 691 F.3d at 484 ("[T]he relief [Appellants] seek would not adversely affect parties without an *opportunity* to participate in the appeal.... Even assuming that the relief requested would send Charter back into bankruptcy, the parties most affected... are either parties to this appeal or participated actively in the bankruptcy proceedings." (emphasis added) (citation omitted)); *Paige*, 584 F.3d at 1344 ("[B]ecause of ConsumerInfo's pivotal role in the bankruptcy proceedings, it is hard to consider it a 'third party' or at least an innocent third party.").

And we should be even less solicitous of parties who act opportunistically or advocate unlawful plan provisions during confirmation. See *Charter Commc'ns*, 691 F.3d at 484 ("[I]f the Allen Settlement were unlawful, it would not be inequitable to require the parties to that agreement to disgorge their ill-gotten gains, participation in the appeal or not."); *Paige*, 584 F.3d at 1343 ("[W]here ... the parties attempting to convince the court not to reach the merits have accelerated the consummation of the plan despite their knowledge of a pending appeal ... we are less inclined to

grant their wish that the court abstain from reaching the merits on appeal.”); [Pac. Lumber Co.](#), 584 F.3d at 244 (“That there might be adverse consequences to MRC/Marathon is not only a natural result of any ordinary appeal—one side goes away disappointed—but adverse appellate consequences were foreseeable to them as sophisticated investors who opted to press the limits of bankruptcy confirmation and valuation rules.”); [id.](#) at 244 n. 19 (“Equitable mootness should protect legitimate expectation of parties to bankruptcy cases but should not be a shield for sharp or unauthorized practices.”).

Third, we could reconsider our standard of review of determinations of equitable mootness. While we opted for abuse of discretion review in *Continental Airlines*, several Circuits apply de novo review instead. See [In re United Producers, Inc.](#), 526 F.3d 942, 946 (6th Cir.2007); [In re GWI PCS 1 Inc.](#), 230 F.3d 788, 799–800 (5th Cir.2000); [In re Baker & Drake, Inc.](#), 35 F.3d 1348, 1351 (9th Cir.1994); [In re Club Assocs.](#), 956 F.2d 1065, 1069 (11th Cir.1992).²⁴ The *Continental Airlines* dissent argued that we chose the wrong side of this split, as “there is an unbroken and well-established line of authority from this court holding that ‘[b]ecause the district court sits as an appellate court in bankruptcy cases, our review of the district court’s decision is plenary.’ ” [91 F.3d at 568 n. 4](#) (Alito, J., dissenting) (alteration in original) (quoting [In re Visual Indus., Inc.](#), 57 F.3d 321, 324 (3d Cir.1995)). Then–Judge Alito added that de novo review is appropriate because “[w]e are essentially called on to review whether the district court properly decided not to reach the merits of [an] appeal,” and “[w]e are in just as good a position to make this determination as [a] district court.” *Id.* Further, equitable mootness is intended to be “limited in scope and cautiously applied,” and “plenary review would better serve th[o]se ends.” *Id.* (internal quotation *454 marks omitted). Then–Judge Alito repeated his criticisms in his [Nordhoff Investments](#) opinion, see 258 F.3d at 192, and we echoed his concerns in [Semcrude](#), see 728 F.3d at 320 n. 6 (“We are inclined to agree with this criticism, but nonetheless are bound to review for abuse of discretion.”). Our repeated reversals of district courts’ equitable mootness decisions indicate a more stringent standard of review would be a helpful reform.

Finally, we could incorporate into our equitable mootness test “a quick look at the merits of [an] appellant’s challenge” to determine if it is “legally meritorious or equitably compelling.” [Paige](#), 584 F.3d at 1339. While no substitute for full consideration on the merits that could provide guidance for future courts and litigants, a brief look at the merits of an appeal and the importance of the issues raised is better than none. See [In re Stephens](#), 704 F.3d 1279, 1283 (10th Cir.2013) (observing that until a novel legal question at issue on appeal was resolved, “debtors and creditors in every individual Chapter 11 case must anticipate the possibility of the expense and delay associated with litigation over this issue”). Merits review is particularly important for complex questions, like whether a plan comports with the Bankruptcy Code’s cram down provisions, an issue that “often cries out for appellate review,” [Pac. Lumber Co.](#), 584 F.3d at 244, or claims involving conflicts of interest or preferential treatment that “go to the very integrity of the bankruptcy process,” [Paige](#), 584 F.3d at 1348; see also [Pac. Lumber Co.](#), 584 F.3d at 251 (quoting [In re Hilal](#), 534 F.3d 498, 500 (5th Cir.2008)) (“[E]quity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process.” (alteration in original) (internal quotation marks omitted)). Further, even a preliminary consideration of the merits can guide the court’s assessment of the effects of granting different forms of relief. See [Metromedia](#), 416 F.3d at 144 (“Often, an appraisal of the merits is essential to the framing of an equitable remedy.”).

What we should not do is ignore the serious problems with equitable mootness that are squarely and properly raised by this appeal. Indeed, waiting to resolve the questions surrounding the doctrine will only lead other parties and district courts, like those in this case, to waste resources litigating equitable mootness. In sum, while I agree with the majority’s application of the precedent that binds our panel, that precedent is ripe for reconsideration, and we should revisit or at least reform the equitable mootness doctrine.

All Citations

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Footnotes

- 1 The Debtor's unsecured claims, not including Appellant's claim, total less than \$1.3 million.
- 2 The First Amended Plan incorporated an agreement with the Committee (the "Committee Agreement") providing for: (i) a distribution to unsecured creditors of \$1.25 million over seven years, (ii) a non-compete clause binding the Heverlys and their relatives until all payments were made to unsecured creditors, and (iii) waiver of preference actions against unsecured creditors.
- 3 Szigethy is the founder, co-owner, and Co-CEO of The Riverside Company, a global private equity firm holding over \$3 billion in assets.
- 4 Appellant, the sole objector to the Plan, opposed confirmation on the basis that, inter alia, the Plan violated the absolute priority rule under [11 U.S.C. § 1129\(b\)](#) by allowing equity holders to retain property without paying unsecured creditors in full.
- 5 On March 18, 2013, Appellant filed Notices of Appeal from the Bankruptcy Court's Confirmation Order and the Bankruptcy Court's Order denying Appellant's motion for a stay pending appeal. On March 19, 2013, the final day of the automatic stay, Appellant filed an emergency application pursuant to [Federal Rule of Bankruptcy Procedure 8005](#) seeking to temporarily stay the Confirmation Order, and requesting that the Court order appellees to show cause as to why a stay pending appeal should not issue. Once the District Court denied its application, Appellant appealed that decision to the Third Circuit, which upheld the denial of the stay. Appellant subsequently sought injunctive relief from the District Court, which was denied pursuant to the law of the case doctrine.
- 6 It should be noted that nearly all of the other Courts of Appeals with jurisdiction to hear bankruptcy appeals have endorsed some form of the equitable mootness doctrine. See [In re Healthco Int'l, Inc.](#), 136 F.3d 45, 48 (1st Cir.1998); [In re Charter Commc'ns, Inc.](#), 691 F.3d 476, 481 (2d Cir.2012); [Behrmann v. Nat'l Heritage Found.](#), 663 F.3d 704, 713–14 (4th Cir.2011); [In re Scopac](#), 624 F.3d 274, 281–82 (5th Cir.2010); [In re Am. HomePatient, Inc.](#), 420 F.3d 559, 563–65 (6th Cir.2005); [In re UNR Indus., Inc.](#), 20 F.3d 766, 769 (7th Cir.1994); [In re Thorpe Insulation Co.](#), 677 F.3d 869, 879–83 (9th Cir.2012); [In re Paige](#), 584 F.3d 1327, 1337–38 (10th Cir.2009); [In re Lett](#), 632 F.3d 1216, 1225–26 (11th Cir.2011); [In re AOV Indus., Inc.](#), 792 F.2d 1140, 1147–48 (D.C.Cir.1986). The Eighth Circuit has yet to address the merits of the doctrine's applicability in a precedential opinion. Compare [In re Nevel Props. Corp.](#), 765 F.3d 846, 848 & n. 3 (8th Cir.2014) (affirming on the merits and denying as moot appellee's motion to dismiss the appeal as equitably moot), with [In re President Casinos, Inc.](#), 409 Fed.Appx. 31, 31–32 (8th Cir.2010) (per curiam) (affirming district court's dismissal of bankruptcy appeal as equitably moot).
- 7 See also 3d Cir. I.O.P. 9.1 (2010) ("[N]o subsequent panel overrules the holding in a precedential opinion of a previous panel. Court en banc consideration is required to do so.").
- 8 Substantial consummation is defined in the Bankruptcy Code to mean the
 - (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
 - (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
 - (C) commencement of distribution under the plan.[11 U.S.C. § 1101](#).
- 9 Indeed, the Debtor concedes on appeal that the risk of harm is speculative: "granting the Appellant's requested relief would potentially jeopardize the Reorganized Debtor's successful emergence from chapter 11 and seriously threaten the viability of its ongoing business." Appellee's Br. 42 (quoting App. 3161) (internal quotation marks omitted).
- 10 Appellant also argues on appeal that the District Court abused its discretion by dismissing its appeal of the third-party releases in the Plan. In light of our finding that the District Court abused its discretion in dismissing Appellant's entire appeal as equitably moot, we need not consider Appellant's separate argument as to the third-party releases.
- 1 See also [In re Phila. Newspapers](#), 690 F.3d 161, 169 (3d Cir.2012) (reciting *Nordhoff Investments*); [In re Zenith Elecs. Corp.](#), 329 F.3d 338, 340 (3d Cir.2003) (same).
- 2 See also [Phila. Newspapers](#), 690 F.3d at 170 (reciting the same proposition as stated in *Cont'l Airlines*); [Zenith Elecs. Corp.](#), 329 F.3d at 343 (same).

- 3 See also  *Phila. Newspapers*, 690 F.3d at 170;  *Zenith Elecs. Corp.*, 329 F.3d at 346;  *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 228 (3d Cir.2003);  *PWS*, 228 F.3d at 236.
- 4 See  *Colo. River*, 424 U.S. at 818, 96 S.Ct. 1236 (abstaining from hearing cases that are duplicative of a pending state proceeding);  *Younger v. Harris*, 401 U.S. 37, 49–54, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971) (abstaining from hearing cases that would interfere with a pending state criminal proceeding);  *Burford v. Sun Oil Co.*, 319 U.S. 315, 333–34, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943) (abstaining where adjudication in federal court would unduly intrude into the processes of state government or undermine the state's ability to maintain desired uniformity);  *R.R. Comm'n of Tex. v. Pullman Co.*, 312 U.S. 496, 501, 61 S.Ct. 643, 85 L.Ed. 971 (1941) (abstaining from cases in which the resolution of a federal constitutional question might be obviated if the state courts were given the opportunity to interpret ambiguous state law); see also  *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 716–23, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996) (explaining the contours of the abstention doctrines).
- 5 See generally David L. Shapiro, *Jurisdiction and Discretion*, 60 N.Y.U. L.Rev. 543, 548–57, 579–87 (1985) (describing practices of judicial abstention sounding in justiciability, comity, *forum non conveniens*, separation of powers, and other principles and explaining that the range of judges' equitable discretion is affected by governing statutes).
- 6  Section 1334(d) operates much like § 1447(d), which precludes review of orders remanding removed cases to state court. See  28 U.S.C. § 1447(d) (“An order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise....”).
- 7  Section 363(m) provides: “The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.”  11 U.S.C. § 363(m).
- 8  Section 364(e) provides: “The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.”  11 U.S.C. § 364(e).
- 9 Section 1127(b) provides: “The proponent of a plan or the reorganized debtor may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified, under  section 1129 of this title.” 11 U.S.C. § 1127(b).
- 10 One prominent commentator has argued that review by an Article III judge is both necessary and sufficient to uphold adjudication by any non-Article III judge. See Richard H. Fallon, Jr., *Of Legislative Courts, Administrative Agencies, and Article III*, 101 Harv. L.Rev. 915, 916 (1988).
- 11 See  *Northern Pipeline*, 458 U.S. at 70, 102 S.Ct. 2858 (plurality opinion) (“In sum, this Court has identified three situations in which Art. III does not bar the creation of legislative courts. In each of these situations, the Court has recognized certain exceptional powers bestowed upon Congress by the Constitution or by historical consensus. Only in the face of such an exceptional grant of power has the Court declined to hold the authority of Congress subject to the general prescriptions of Art. III.”); see also  *Stern*, 131 S.Ct. at 2621 (Scalia, J., concurring) (citing Thomas E. Plank, *Why Bankruptcy Judges Need Not and Should Not Be Article III Judges*, 72 Am. Bankr.L.J. 567, 607–09 (1998)) (positing that “[p]erhaps historical practice permits non-Article III judges to process claims against the bankruptcy estate,” but declining to reach the issue).
- 12 See Plank, *supra* note 11, at 574.
- 13 Oral Argument at 48:05–49:35, available at <http://www.ca3.uscourts.gov/oral-argument-recordings>.

- 14 Appellees closed the transactions contemplated by the Plan and began distributions under the Plan the day the Plan took effect, March 21, 2013. App. 1522. Even before that, however, Appellees advised the District Court that they intended to move to dismiss Quad's appeal as equitably moot, specifically, two days before the Plan took effect during a hearing on Quad's emergency motion for a stay pending appeal. App. 1519; *see also* Oral Argument at 48:05–48:40, *available at* <http://www.ca3.uscourts.gov/oral-argument-recordings>. One month later, Appellees again argued the appeal was equitably moot during a hearing on Quad's preliminary injunction motion, which was before the appeal had been briefed. App. 3226. This is the same kind of opportunistic conduct that worried then- Judge Alito in *Nordhoff Investments*. *See* 258 F.3d at 191 (Alito, J., concurring in the judgment) (“It is disturbing that Zenith, in a seeming attempt to moot any appeal prior to filing, succeeded in implementing most of the plan before the appellants even received notice that the plan had been confirmed.”).
- 15 Indeed, the desire for clarity and uniformity led Congress to enact  28 U.S.C. § 158(d)(2), the “new statutory provision for certification of bankruptcy appeals directly to the courts of appeals.” *See*  *In re Pac. Lumber Co.*, 584 F.3d 229, 241 (5th Cir.2009). “The twin purposes of the provision were to expedite appeals in significant cases and to generate binding appellate precedent in bankruptcy, whose caselaw has been plagued by indeterminacy.”  *Id.* at 241–42 (citing H.R.Rep. No. 109–31 pt. I, at 148 (2005), *as reprinted in* 2005 U.C.C.A.N. 88, 206).
- 16 *See* Brief of Bankruptcy Law Professors in Support of Granting the Petition for Certiorari at 5, *Law Debenture Trust Co. of N.Y. v. Charter Commc'ns, Inc.*, — U.S. —, 133 S.Ct. 2021, 185 L.Ed.2d 905 (2013) [hereinafter “*Brief of Bankruptcy Law Professors*”] (“[S]ophisticated parties have learned that a ‘pre-packaged’ reorganization plan that is designed to be consummated over a weekend may be insulated from review by an Article III court even though the plan contains terms that would be determined to be unlawful if the plan were subjected to judicial review, and those parties are increasingly exploiting that opportunity.”); Ryan M. Murphy, *Equitable Mootness Should Be Used as a Scalpel Rather than an Axe in Bankruptcy Appeals*, 19 J. Bankr.L. & Prac. 1 Art. 2 (2010) (“[T]he importance of substantial consummation in rendering a claim equitably moot raises concerns that a debtor can ‘stack the deck’ in its favor to expedite implementation of its plan and foreclose review of questionable plan components.”).
- 17 *See*  *Semcrude*, 728 F.3d at 317 (“Courts have rarely analyzed the source of their authority to refuse to hear an appeal on equitable mootness grounds.”); Murphy, *supra* note 16 (“In light of the analysis provided by the dissent in *Continental Airlines* and the scarcity of opinions that tackle the question of the origin of equitable mootness, it is difficult to discern a coherent underlying rationale that justifies such a radical concept.” (footnote omitted)).
- 18 It is therefore not surprising that the Supreme Court has denied those petitions, as the courts of appeals have rarely grappled with the doctrine's constitutional and statutory underpinnings. Regardless, there is no basis for Appellees' contention that the Supreme Court's denial of certiorari reflects the Court's tacit approval of the equitable mootness doctrine. As the Court “ha[s] often stated, the denial of a writ of certiorari imports no expression of opinion upon the merits of the case. The variety of considerations [that] underlie denials of the writ counsels against according denials of certiorari any precedential value.”  *Teague v. Lane*, 489 U.S. 288, 296, 109 S.Ct. 1060, 103 L.Ed.2d 334 (1989) (second alteration in original) (citations and internal quotation marks omitted); *accord* *United States ex rel. Smith v. Baldi*, 192 F.2d 540, 544 (3d Cir.1951) (reciting the “well established rule that a denial of certiorari does not prove anything except that certiorari was denied”).
- 19 *See* *Brief of Bankruptcy Law Professors*, *supra* note 16, at 2; Petition for a Writ of Certiorari, *United States v. GWI PCS 1, Inc.*, 533 U.S. 964, 121 S.Ct. 2623, 150 L.Ed.2d 776 (2001).
- 20 *See* Brook E. Gotberg, *Restructuring the Bankruptcy System: A Strategic Response to Stern v. Marshall*, 87 Am. Bankr.L.J. 191, 205 & n.74 (2013).
- 21 *See also*  *SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 332 (7th Cir.2010) (affirming on the merits rather than analyzing equitable mootness);  *UNR*, 20 F.3d at 770 (considering whether plan challengers had demonstrated a “powerful reason” to alter a reorganization plan); *cf.* *United States v. Buchman*, 646 F.3d 409, 411 (7th Cir.2011) (Easterbrook, C.J.) (“Circuits that use [the equitable mootness] doctrine dismiss an appeal once a bankruptcy auction has been completed or a plan of reorganization confirmed and implemented without a stay. But this circuit does not follow that approach. We have held that the possibility of financial adjustments among the parties keeps a proceeding alive even if the sale cannot be upset and rights under a plan of reorganization cannot be revised.”); *United States v. Segal*, 432 F.3d 767, 774 (7th Cir.2005) (“[W]hile we are concerned about trying to unwind the settlement, it is difficult to determine the precise effects

In re One2One Communications, LLC, 805 F.3d 428 (2015)

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of such an action.... This prevents us from conclusively holding that the settlement was so complex or that the changes after the settlement have been so sweeping that it would be foolish for us to even consider reversing the deal. Therefore, with some reservations, we move on.”).

22 As a recent example, in  *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir.2015), the district court there ruled on both the merits of the appeal before it and equitable mootness. We did not address equitable mootness, but rather affirmed on the merits. Had the district court not ruled on the merits, we might have had to remand for further proceedings. See  *id.* at 184–85; see also  *id.* at 186–87 (Scirica, J., concurring in part and dissenting in part) (agreeing that equitable mootness did not apply).

23 The inequity of granting relief where an appellant has been less than diligent in obtaining a stay motivated the earliest equitable mootness decisions. See, e.g.,  *In re Roberts Farms, Inc.*, 652 F.2d 793, 798 (9th Cir.1981). More recent decisions from other Circuits have also placed great weight on a failure to seek a stay. See, e.g.,  *In re Thorpe Insulation Co.*, 677 F.3d 869, 881 (9th Cir.2012);  *In re Paige*, 584 F.3d 1327, 1341 (10th Cir.2009);  *Metromedia*, 416 F.3d at 144.

24 Of course, the fact “[t]hat the courts are creating a doctrine unmoored to the Code is illustrated by their divergence concerning the appropriate test for equitable mootness.” *Brief of Bankruptcy Law Professors*, *supra* note 16, at 11 & n. 3 (citing  *Phila. Newspapers*, 690 F.3d at 168–69;  *In re Paige*, 584 F.3d 1327, 1338–39 (10th Cir.2009)).

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In re Thorpe Insulation Co., 677 F.3d 869 (2012)

67 Collier Bankr.Cas.2d 437, 12 Cal. Daily Op. Serv. 3749...



KeyCite Yellow Flag - Negative Treatment

Declined to Extend by [Citizens Development Corp., Inc. v. County of San Diego](#), S.D.Cal., October 28, 2015

677 F.3d 869

United States Court of Appeals,
Ninth Circuit.

In the Matter of THORPE
INSULATION COMPANY, Debtor,
Motor Vehicle Casualty Company; [Central
National Insurance Company of Omaha](#);
Century Indemnity Company, successor to
[Cigna Specialty Insurance Company](#), FKA
California Union Insurance Company, Appellants,
v.

Thorpe Insulation Company; Pacific
Insulation Company, Appellees,
National Fire Insurance Company of Hartford, as
successor by merger to Transcontinental Insurance
Company; Continental Insurance Company, as
successor in interest to certain policies issued by
Harbor Insurance Company; Official Committee
of Unsecured Creditors, of Thorpe Insulation
Company and Pacific Insulation Company;
Charles B. Renfrew, Real Parties in Interest.

In the Matter of Thorpe
Insulation Company, Debtor,
National Fire Insurance Company of Hartford, as
successor by merger to Transcontinental Insurance
Company; Continental Insurance Company, as
successor in interest to certain policies issued
by Harbor Insurance Company, Appellants,
v.

Thorpe Insulation Company; Pacific
Insulation Company, Appellees,
[Central National Insurance Company of
Omaha](#); Motor Vehicle Casualty Company;
Century Indemnity Company, successor
to [Cigna Specialty Insurance Company](#),
FKA California Union Insurance Company;
Official Committee of Unsecured Creditors,
of Thorpe Insulation Company and Pacific
Insulation Company; Charles B. Renfrew,
Administrative Law Judge, Real Parties in Interest.

Nos. 10–56543, 10–56622.

Argued and Submitted Aug. 30, 2011.

Filed Jan. 24, 2012.

Amended April 3, 2012.

Synopsis

Background: Debtors, as parent and wholly-owned subsidiary that installed asbestos insulation products, sought Chapter 11 bankruptcy protection. The United States Bankruptcy Court for the Central District of California confirmed plan of reorganization, under Bankruptcy Code's special provision for reorganization of companies facing substantial asbestos-related liability. On appeal, the United States District Court for the Central District of California, [Dale S. Fischer](#), J., affirmed and determined that non-settling insurers lacked standing to challenge plan and that insurers' state law contract rights were preempted. Insurers appealed, and appeals were consolidated.

Holdings: On denial of rehearing en banc, the Court of Appeals, [Gould](#), Circuit Judge, held that:

[1] appeal was not constitutionally moot;

[2] appeal was not equitably moot;

[3] insurers had statutory standing;

[4] insurers had constitutional standing;

[5] insurers had prudential standing; and

[6] insurers' state law anti-assignment contract rights were preempted.

Reversed and remanded with instructions.

Opinion, 671 F.3d 980, amended and superseded.

Procedural Posture(s): On Appeal.

West Headnotes (49)

[1] **Bankruptcy**

🔑 Conclusions of law; de novo review

Court of Appeals reviews de novo the district court's decision on appeal from the bankruptcy court, applying the same standards applied by the district court, without deference to the district court.

[18 Cases that cite this headnote](#)

[2] **Bankruptcy**

🔑 Conclusions of law; de novo review

Bankruptcy

🔑 Clear error

The bankruptcy court's conclusions of law are reviewed de novo, and its findings of fact are reviewed for clear error.

[10 Cases that cite this headnote](#)

[3] **Bankruptcy**

🔑 Moot questions

Court of Appeals will not entertain an appeal if the case is moot.

[3 Cases that cite this headnote](#)

[4] **Federal Courts**

🔑 Weight and sufficiency

The party moving for dismissal on mootness grounds bears a heavy burden.

[12 Cases that cite this headnote](#)

[5] **Federal Courts**

🔑 Mootness

Federal Courts

🔑 Prudential mootness

There are two mootness doctrines, one deriving from Article III of the Constitution, and one from equity. U.S.C.A. Const. Art. 3, § 2, cl. 1.

[1 Cases that cite this headnote](#)

[6] **Bankruptcy**

🔑 Moot questions

Under Article III case or controversy requirements, the test for mootness of an appeal is whether the appellate court can give the appellant any effective relief in the event that the court decides the matter on the merits in his favor; if the court can grant such relief, the matter is not moot. U.S.C.A. Const. Art. 3, § 2, cl. 1.

[30 Cases that cite this headnote](#)

[7] **Bankruptcy**

🔑 Effect of want of stay; conclusiveness of sale

Bankruptcy

🔑 Moot questions

Non-settling asbestos insurers' appeal of district court's affirmance of bankruptcy court's confirmation of Chapter 11 plan of reorganization for insured debtors was not rendered moot, under Article III case or controversy requirements, by insurers' failure to obtain stay and by plan's substantial consummation, since insurers could obtain effective relief on appeal by reversal of plan confirmation or by requiring modifications to plan. U.S.C.A. Const. Art. 3, § 2, cl. 1.

[1 Cases that cite this headnote](#)

[8] **Bankruptcy**

🔑 Moot questions

The doctrine commonly known as equitable mootness has some sway in bankruptcy cases where public policy values the finality of bankruptcy judgments because debtors, creditors, and third parties are entitled to rely on a final bankruptcy court order.

[13 Cases that cite this headnote](#)

[9] **Bankruptcy**

🔑 Moot questions

In re Thorpe Insulation Co., 677 F.3d 869 (2012)

67 Collier Bankr.Cas.2d 437, 12 Cal. Daily Op. Serv. 3749...

“Equitable mootness” of an appeal from confirmation of a bankruptcy reorganization plan occurs when a comprehensive change of circumstances has occurred so as to render it inequitable for Court of Appeals to consider the merits of the appeal; the question is whether the case presents transactions that are so complex or difficult to unwind that the doctrine of equitable mootness would apply.

[42 Cases that cite this headnote](#)

[10] **Bankruptcy**

🔑 Effect of want of stay; conclusiveness of sale

Bankruptcy

🔑 Moot questions

To determine whether an appeal from confirmation of a bankruptcy reorganization plan is equitably moot, Court of Appeals will look first at whether a stay was sought, for absent that a party has not fully pursued its rights, and if a stay was sought and not gained, then the court will look to whether substantial consummation of the plan has occurred, next the court will look to the effect a remedy may have on third parties not before the court, and finally the court will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court. 11 U.S.C.A. § 1101(2).

[60 Cases that cite this headnote](#)

[11] **Bankruptcy**

🔑 Effect of want of stay; conclusiveness of sale

Bankruptcy

🔑 Moot questions

Non-settling asbestos insurers' appeal from district court's affirmance of bankruptcy court's confirmation of Chapter 11 plan of reorganization for insured debtors was not rendered equitably moot by insurers' failure to obtain stay and by plan's alleged substantial consummation; insurers used due diligence in seeking stay but were refused by both Court

of Appeals and Circuit Justice, plan was not substantially consummated as all or substantially all of the property the plan proposed to transfer had not been transferred, remedies short of reversing confirmation would not inequitably affect interests of third-party asbestos claimants and lender that extended credit to reorganized debtor in reliance on plan, and remedy could be effectively and equitably fashioned for insurers by multitude of options other than complete plan reversal. 11 U.S.C.A. §§ 524(g), 1101(2).

[11 Cases that cite this headnote](#)

[12] **Bankruptcy**

🔑 Effect of want of stay; conclusiveness of sale

Bankruptcy

🔑 Moot questions

A failure to seek a stay can render an appeal from confirmation of a bankruptcy plan of reorganization equitably moot; however, failure to obtain a stay does not require a conclusion of equitable mootness where parties use due diligence in seeking the stay.

[14 Cases that cite this headnote](#)

[13] **Bankruptcy**

🔑 Moot questions

Where a party has done nothing by its own inaction to encourage or permit developments to proceed without its participation, appellate courts should be cautious about reaching a conclusion of equitable mootness of an appeal from confirmation of a bankruptcy reorganization plan.

[1 Cases that cite this headnote](#)

[14] **Bankruptcy**

🔑 Moot questions

To say that a party's claims, although diligently pursued, are equitably moot because of the passage of time, before the party had a chance to present views on appeal, would alter the doctrine

In re Thorpe Insulation Co., 677 F.3d 869 (2012)

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of equitable mootness to be one of “inequitable” mootness.

[12 Cases that cite this headnote](#)

[15] Bankruptcy

 Moot questions

Under the equitable mootness doctrine, although practicalities necessarily may take center stage in a particular case, the Court of Appeals declines in every case to elevate expediency over the justice of the situation.

[16] Bankruptcy

 Effect of want of stay; conclusiveness of sale

The failure to gain a stay is one factor to be considered in assessing equitable mootness of an appeal, but is not necessarily controlling.

[4 Cases that cite this headnote](#)

[17] Bankruptcy

 Moot questions

In determining whether an appeal from confirmation of a bankruptcy reorganization plan is equitably moot, if the plan was substantially consummated, that would not be the end of the inquiry; rather, the Court of Appeals could still assess whether effective relief might be given without fully impairing the prior plan and other pertinent circumstances. 11 U.S.C.A. § 1101(2).

[10 Cases that cite this headnote](#)

[18] Bankruptcy

 Moot questions

In determining whether an appeal from confirmation of a bankruptcy reorganization plan is equitably moot, Court of Appeals must evaluate whether modification of the plan would bear unduly on the innocent; an important consideration is whether all the parties affected by the appeal are before the court.

[7 Cases that cite this headnote](#)

[19] Bankruptcy

 Moot questions

In determining whether an appeal from confirmation of a bankruptcy reorganization plan is equitably moot, the question is not whether it is possible to alter a plan such that no third party interests are affected, but whether it is possible to do so in a way that does not affect third party interests to such an extent that the change is inequitable.

[11 Cases that cite this headnote](#)

[20] Bankruptcy

 Moot questions

Where equitable relief, though incomplete, is available, an appeal from confirmation of a bankruptcy reorganization plan is not equitably moot.

[11 Cases that cite this headnote](#)

[21] Bankruptcy

 Right of review and persons entitled; parties; waiver or estoppel

Appellate standing to challenge a district court's ruling affirming an order of the bankruptcy court requires that a party be directly and adversely affected by the bankruptcy court's order, in that the order has diminished the appellant's property, increased its burdens, or detrimentally affected its rights.

[17 Cases that cite this headnote](#)

[22] Bankruptcy

 Right of review and persons entitled; parties; waiver or estoppel

A party denied standing in the bankruptcy court has appellate standing to challenge that determination.

[9 Cases that cite this headnote](#)

[23] Bankruptcy

 Parties

Bankruptcy

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 Reorganization cases; right to be heard

To have standing in bankruptcy court, three requirements must be met: (1) statutory party in interest requirements of the Bankruptcy Code, (2) Article III constitutional requirements, and (3) federal court prudential requirements. U.S.C.A. Const. Art. 3, § 2, cl. 1; 11 U.S.C.A. § 1109(b).

6 Cases that cite this headnote

[24] Bankruptcy **Reorganization cases; right to be heard**

Generally, the party in interest standard for statutory standing under the Bankruptcy Code is construed broadly. 11 U.S.C.A. § 1109(b).

6 Cases that cite this headnote

[25] Bankruptcy **Reorganization cases; right to be heard**

Courts must determine on a case by case basis whether the prospective party to a bankruptcy proceeding has a sufficient stake in the proceeding so as to require representation. 11 U.S.C.A. § 1109(b).

2 Cases that cite this headnote

[26] Bankruptcy **Reorganization cases; right to be heard****Bankruptcy** **Confirmation; Objections****Bankruptcy** **Modification or revocation**

Non-settling asbestos insurers had party in interest standing, under Bankruptcy Code, as required for insurers to be heard in bankruptcy court concerning their challenge to confirmation of Chapter 11 reorganization plan for insured debtors, since plan could have substantial economic impact on insurers, and thus plan was not insurance neutral, as plan allowed direct actions against insurers, allowed trust created by plan to pay out claims and then seek indemnification from insurers, terminated insurers' ability to collect claims from

settling insurers, and affected nature of insurers' contracts. 11 U.S.C.A. §§ 524(g), 1109(b), 1128(b).

4 Cases that cite this headnote

[27] Bankruptcy **Contents in general****Bankruptcy** **Confirmation; Objections**

Even if there is a super-preemptory provision in a Chapter 11 bankruptcy plan of reorganization, providing that nothing in the plan or any plan documents impairs an insurer's legal, equitable, or contractual rights in any way, care must be taken to ensure that, in fact, the insurer's rights are completely unaffected by the plan; if the insurer's rights are affected in any way, the insurer will have standing to object to the alteration of its rights.

[28] Bankruptcy **Parties****Bankruptcy** **Parties**

Generally, parties with potential responsibility to pay claims against debtors have standing to participate in bankruptcy cases.

[29] Federal Civil Procedure **Causation; redressability**

To have constitutional standing under Article III, the party seeking standing must demonstrate an injury in fact that is traceable to the challenged action and that is likely to be redressed by a favorable decision. U.S.C.A. Const. Art. 3, § 2, cl. 1.

5 Cases that cite this headnote

[30] Bankruptcy **Parties**

As applied in the Chapter 11 bankruptcy context, Article III standing exists where the participant holds a financial stake in the outcome of

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the proceeding such that the participant has an appropriate incentive to participate in an adversarial form to protect his or her interests. U.S.C.A. Const. Art. 3, § 2, cl. 1.

2 Cases that cite this headnote

[31] **Bankruptcy**

🔑 Confirmation; Objections

Bankruptcy

🔑 Modification or revocation

Non-settling asbestos insurers suffered injury in fact that was traceable to insured debtors' Chapter 11 reorganization plan and that would be redressed by judicial action, as required for Article III standing to challenge confirmation of plan, since plan affected insurers' contractual rights, financial interests, and possibly their litigation rights, such injury could be traced to plan as insurers' contractual rights and expectations were only changed because of plan, and injury could be redressed by bankruptcy or district court reversing confirmation of plan or altering plan. U.S.C.A. Const. Art. 3, § 2, cl. 1;

📄 11 U.S.C.A. §§ 524(g), 1128(b).

[32] **Federal Civil Procedure**

🔑 In general; injury or interest

In addition to the immutable requirements of Article III, the federal judiciary also adheres to a set of prudential principles that bear on the question of standing. U.S.C.A. Const. Art. 3, § 2, cl. 1.

1 Cases that cite this headnote

[33] **Federal Civil Procedure**

🔑 In general; injury or interest

The prudential principle of standing is a judicially self-imposed limit on the exercise of federal jurisdiction and is founded in concern about the proper, and properly limited, role of the courts in a democratic society.

[34] **Federal Civil Procedure**

🔑 In general; injury or interest

One of the prudential requirements for standing is that plaintiff's grievance must arguably fall within the zone of interests protected or regulated by the statutory provision or constitutional guarantee invoked in the suit.

[35] **Federal Civil Procedure**

🔑 In general; injury or interest

The zone of interests requirement for prudential standing is analogous to statutory standing.

3 Cases that cite this headnote

[36] **Bankruptcy**

🔑 Reorganization cases; right to be heard

Bankruptcy

🔑 Confirmation; Objections

Bankruptcy

🔑 Modification or revocation

Non-settling asbestos insurers satisfied prudential requirements for standing to participate in bankruptcy proceedings to challenge confirmation of insured debtors' Chapter 11 reorganization plan, since insurers had statutory standing as parties in interest to bankruptcy proceedings, and debtors' insurers were within zone of interests protected or regulated by statute conferring party in interest standing. 📄 11 U.S.C.A. §§ 524(g), 1109(b), 1128(b).

5 Cases that cite this headnote

[37] **States**

🔑 State police power

Court of Appeals must be cautious about conflict preemption where a federal statute is urged to conflict with state law regulations within the traditional scope of the state's police powers, and the court begins with a presumption against preemption.

[38] **States**

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✚ Conflicting or conforming laws or regulations

Supremacy Clause invalidates state laws that interfere with, or are contrary to, federal law. U.S.C.A. Const. Art. 6, cl. 2.

[39] **States**

✚ Congressional intent

In determining whether preemption exists, the purpose of Congress is the ultimate touchstone.

2 Cases that cite this headnote

[40] **States**

✚ Preemption in general

Preemption can occur either expressly or impliedly.

[41] **Bankruptcy**

✚ Application of state or federal law in general

Express and implied preemption under the Bankruptcy Code are two distinct concepts.

[42] **States**

✚ Congressional intent

Congress may indicate preemptive intent through a statute's express language or through its structure and purpose.

1 Cases that cite this headnote

[43] **States**

✚ Conflicting or conforming laws or regulations

In the absence of express preemption, Congressional preemptive intent can be inferred where it is impossible for a private party to comply with both state and federal requirements, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

3 Cases that cite this headnote

[44] **Bankruptcy**

✚ "Ipso facto" clauses

Bankruptcy

✚ Construction, execution, and performance

Non-settling insurers' contract rights, under California law, pursuant to anti-assignment clauses in asbestos policies covering insured debtors whose Chapter 11 reorganization plan assigned debtors' insurance rights to trust that was part of bankruptcy estate, were expressly preempted by federal bankruptcy law, providing that debtor's interest in property became property of bankruptcy estate notwithstanding any provision in agreement, transfer instrument, or nonbankruptcy law that restricted or conditioned transfer of debtor's interest, where plan excluded from insurers' defenses any defense based upon violation of anti-assignment clauses. 11 U.S.C.A. § 541(c)(1)(A).

4 Cases that cite this headnote

[45] **Bankruptcy**

✚ Application of state or federal law in general

It is possible for there to be no express preemption under a particular provision of the Bankruptcy Code, but nonetheless to be implied preemption under the Code.

[46] **States**

✚ Conflicting or conforming laws or regulations

Even where Congress has not completely displaced state regulation in a specific area, state law is preempted to the extent that it actually conflicts with federal law.

[47] **States**

✚ Congressional intent

In analyzing conflict preemption implied by Congressional intent, Court of Appeals discerns congressional objectives by examining the federal statute as a whole and identifying its purpose and intended effects.

[48] **Bankruptcy**

🔑 Settlement, adjustment, or enforcement of claims

Bankruptcy

🔑 Construction, execution, and performance

Non-settling insurers' contract rights, under California law, pursuant to anti-assignment clauses in asbestos policies with insured debtors whose Chapter 11 reorganization plan assigned debtors' insurance rights to trust that was part of bankruptcy estate, were impliedly preempted by federal bankruptcy law, requiring establishment of trust to assume debtors' asbestos liabilities, since enforcing anti-assignment clauses would stand as obstacle to objectives of Congress by effectively subjecting plan to insurers' veto, due to insurers' disincentive to settle that would result in lack of sufficient funding of trust from insurers' contribution. 📄 11 U.S.C.A. § 524(g) (2)(B)(i).

[4 Cases that cite this headnote](#)

[49] **Bankruptcy**

🔑 In general; nature and purpose

Simply making a Chapter 11 bankruptcy reorganization more difficult for a particular debtor does not rise to the level of an obstacle to the accomplishment of the full purposes and objectives of Congress as would require Bankruptcy Code's preemption of state law.

[2 Cases that cite this headnote](#)

Attorneys and Law Firms

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Appeal from the United States District Court for the Central District of California, [Dale S. Fischer](#), District Judge, Presiding. D.C. No. 2:10-cv-01493-DSF.

Before: [MARY M. SCHROEDER](#) and [RONALD M. GOULD](#), Circuit Judges, and [RICHARD SEEBORG](#), District Judge.*

ORDER

The opinion in the above-captioned matter filed on January 24, 2012, and found at 2012 WL 178998, 55 Bankr.Ct. Dec. 278, is amended as follows:

At slip opinion page 671, line 29, delete the following two sentences:

<Further, the trust has only distributed \$44.7 million for pre-petition claims, claims submitted directly to the trust, the Business Loss Allocation, operating expenses, and contingent and professional fees—only \$15 million of this has been to asbestos claimants. This is not half, let alone “substantially all,” of the property proposed to be transferred by the plan.>

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Judge Gould has voted to deny the Petition for Rehearing En Banc, and Judges Schroeder and Seeborg have so recommended. The full court has been advised of the Petition for Rehearing En Banc and no judge has requested a vote on whether to rehear the matter en banc. [Fed. R.App. P. 35](#). The Petition for Rehearing En Banc is denied.

No future petitions for rehearing or rehearing en banc will be entertained.

IT IS SO ORDERED.

*876 OPINION

[GOULD](#), Circuit Judge:

The district court affirmed a bankruptcy court's confirmation of a Chapter 11 plan of reorganization under [11 U.S.C. § 524\(g\)](#), a special provision for the reorganization of companies facing substantial asbestos-related liability. Appellants are several insurance companies that did not reach settlements with Thorpe Insulation Company (Thorpe) and Pacific Insulation Company (Pacific), together the Debtors in bankruptcy court, and who were denied standing to challenge the reorganization plan. The district court held that the reorganization plan was insurance neutral, and so Appellants did not have standing to object to the plan; and it also held that the plan preempted Appellants' state law contract rights. We affirm the district court's conclusion that the plan preempted Appellants' state law contract rights. We disagree with the position of Debtors that the appeal is equitably moot, and, reaching the merits, we reverse the district court's conclusion that Appellants lacked standing. We remand to the district court with instructions that it return the case to the bankruptcy court to give Appellants the opportunity to present their proof and argument.

I. Background

A

Thorpe is a California company that distributed, installed, and repaired asbestos insulation products between 1948 and 1972. This led to substantial asbestos-related litigation. In the past thirty years, Thorpe has faced about 12,000

claims and lawsuits for personal injury or wrongful death based on asbestos exposure. Robert and Linda Fults owned Thorpe until 2008, when they transferred their shares to their sons Eric and David Fults. In 2000, Thorpe incorporated Pacific as a wholly-owned subsidiary and conveyed to it the assets associated with its materials division. Robert and Linda Fults were the sole shareholders of Pacific. Pacific, a profitable business, has been named in asbestos-related lawsuits as a successor-in-interest to Thorpe. In 2004, Thorpe sold its remaining assets to Farwest Insulation Contracting ("Farwest"), owned by Eric and David Fults, in a private foreclosure sale. Farwest is also a party to many asbestos-related lawsuits and insurance coverage litigation.

Thorpe purchased insurance policies with many companies that covered "products claims" (or "products/completed operations," for injuries caused by asbestos exposure after a product is relinquished or an operation completed), which are subject to aggregate limits, and "operations claims" (or "nonproducts," for injuries caused by asbestos exposure before a product is relinquished or an operation completed), which are not subject to aggregate limits. Since 1978, Thorpe's many insurers have handled the defense and settlement of asbestos suits. Thorpe's insurers paid more than \$180 million defending and indemnifying Thorpe until, in their view, the policies' aggregate limits were exhausted.¹

B

Debtors Thorpe and Pacific filed for protection under Chapter 11 of the Bankruptcy Code on October 15, 2007 and October 31, 2007, respectively. Thorpe estimated that, at the time of the bankruptcy filing, 2,000 asbestos cases were pending against *877 it, and Thorpe anticipated that many more suits would be filed in the future.

Thorpe applied to employ the law firms of Snyder Miller & Orton LLP and Morgan Lewis & Bockius LLP as special insurance counsel. Appellants objected that the firms had conflicts of interest because they represented asbestos claimants against Thorpe, but the bankruptcy court approved the employment of the law firms, taking the view that Appellants lacked standing to object. The issue was appealed, the district court remanded for fact-finding, and the bankruptcy court again approved the firms' retention without input from Appellants.

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In May 2008, Thorpe, Pacific, the appointed Official Committees of Unsecured Creditors, and the appointed legal representative for holders of future asbestos-related claims (“Appellees”) filed a § 524(g) joint plan of reorganization. The current and Fifth Amended Plan of reorganization was filed in December 2009. It is that plan, approved by the bankruptcy court and the district court, that is the subject of this appeal.

Section 524(g) allows a bankruptcy court to issue sweeping channeling injunctions in Chapter 11 cases involving asbestos claims. § 524(g); 4 COLLIER ON BANKRUPTCY ¶ 524.07. The statute was enacted to adopt the approach taken in the *Johns–Manville* bankruptcy case, wherein a trust (the “Manville Trust”) was established together with a series of injunctions to channel asbestos-related claims to the trust. See *Kane v. Johns–Manville Corp.*, 843 F.2d 636 (2d Cir.1988). Because of the often lengthy latency period of asbestos-related injuries, the § 524(g) injunction aims to “control the future litigation of all asbestos-related claims against the parties it protects” by preventing “any entity from taking legal action to collect a claim or demand that is to be paid in whole or in part by a trust created through a qualifying plan of reorganization.” COLLIER ON BANK. ¶ 524.07. The injunction may bar actions against the debtor itself as well as claims against the debtor directed at third parties who are directly or indirectly liable—such as where a third party has insured the debtor. *Id.*; § 524(g)(4)(A)(ii). The bankruptcy court may establish such an injunction if it determines that (1) “the debtor is likely to be subject to substantial future demands for payment arising out of” asbestos-related claims; (2) “the actual amounts, numbers, and timing of such future demands cannot be determined”; and (3) “pursuit of such demands outside the [trust] is likely to threaten the [reorganization] plan’s purpose to deal equitably with claims and future demands.” § 524(g)(2)(B)(ii).

The requirements for a § 524(g) injunction include: (1) there must be a notice and a hearing and the 524(g) plan must be in connection with the confirmation of a Chapter 11 plan of reorganization; (2) there must be a trust established to assume the liabilities of the debtor that has been named in asbestos-related actions; (3) the trust must be funded in whole or in part by the securities of at least one debtor and by the obligation of the debtor to make future payments;

(4) the trust must own, or be entitled to own, a majority of the voting shares of the debtor, its parent corporation, and any subsidiary; (5) the court must find that the debtor meets certain criteria related to the significance of the threats posed by potential asbestos liability; (6) the court must appoint a legal representative to protect the rights of future claimants against the debtor; and (7) the court must determine that the injunction is fair and equitable with respect to future claims (including a determination that third parties like insurers that come within the protection of the injunction have contributed adequate amounts to the trust). § 524(g).

The Fifth Amended Plan filed by Debtors provided for the issuance of injunctions to channel certain asbestos-related liabilities to a newly-created trust, with sole responsibility for distributions to present and future holders of asbestos-related claims. The plan merges Thorpe and Pacific into the “Reorganized Debtor” and discharges Thorpe, Pacific, and the Reorganized Debtor from all debts. It creates a trust, controlled by the Trust Advisory Committee, to oversee how claims are allowed, valued, and distributed. The Trust uses “trust distribution procedures” to evaluate claims.

In establishing the plan and trust, Thorpe reached settlements with thirteen insurers (“settling insurers”) (in addition to four insurers that settled, contingent on a bankruptcy filing, before Thorpe filed). The settlements provided for more than \$600 million in cash and securities to fund the Trust in exchange for releases of claims and protection of 524(g) injunctions. The Debtors contributed the following to the plan: their indemnity claim against the Johns–Manville asbestos trust; the proceeds of the settlements with the Settling Insurers; the “Asbestos Insurance Rights” as defined in the plan; \$500,000 cash; and two promissory notes in the amount of \$1.25 million, secured by 51% of the common stock of Reorganized Debtor. Appellants received from the trust a “Business Loss Allocation;” the trust pays to them a percentage of the money contributed to the trust by the insurance companies up to \$5.25 million.

The plan creates three injunctions. First, the Channeling Injunction bars the assertion of any asbestos-related claim against any protected party and allows for asbestos-related claims only against the trust, the Reorganized Debtor, and non-settling insurers. Second, the Settling Asbestos Insurer Injunction protects settling insurers by preventing the assertion of contribution claims held by non-settling insurers.² Instead, the trust absorbs the cost of those barred contributions and reduces dollar-for-dollar any judgment

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obtained against non-settling insurers holding contribution claims. *Id.* Third, the Asbestos Insurer Injunction prohibits actions against asbestos insurers without permission by the trust; the trust may not allow such actions unless asbestos claimants agree to the same judgment reduction that is binding on the trust before proceeding against non-settling insurers.

The plan contains a valuation matrix. The Matrix gives a way for the trust to value claims consistently across time because of the lengthy latency period of asbestos-related injuries. The value given a claim depends on, *inter alia*, the disease the claimant has, age, work history, and personal history factors.

The plan assigns Debtors' insurance rights to the trust, including policies with the non-settling insurers. The plan contains a section stating that it is "insurance neutral," preserving all "Asbestos Insurance Defenses." However, in apparent contradiction of the neutrality characterization, the plan includes four exceptions to the otherwise preserved defenses. It does not permit a defense:

(a) that is based on the assertion that the transfer of the Asbestos Insurance Rights to the Trust ... is invalid, unenforceable or otherwise breaches the terms of any Asbestos Insurance Policy, *879 Asbestos Insurance Settlement, or any other agreement with any Asbestos Insurer, (b) that has been released, waived, altered or otherwise resolved, in full or in part, in any Asbestos Insurance Settlement, or any other agreement with any Asbestos Insurer, (c) to the extent affected by application of principles of res judicata, collateral estoppel, claim preclusion or issue preclusion, or (d) premised upon the commencement of Chapter 11 Cases under [Section 301 of the Bankruptcy Code](#).

The plan allows claimants either to bring their claim against the trust or to get permission from the trust to sue non-settling insurers directly under Thorpe's insurance policies.

Without giving Appellants the opportunity to be heard fully on all relevant issues, the bankruptcy court affirmed the Fifth Amended Joint Plan of Reorganization on February 1, 2010.

C

After confirmation of the plan by the bankruptcy court, Appellants appealed the order confirming the Fifth Amended Joint Plan of Reorganization. Under [§ 524\(g\)](#), the district court must affirm a plan and its injunctions for them to be valid and enforceable. [§ 524\(g\)\(3\)\(A\)](#). The district court affirmed the plan, modifying the trust distribution procedures slightly, and entered an order issuing and affirming the plan on September 21, 2010.

Two groups of non-settling insurers appeal the district court decision. These are: (1) Continental Insurance Company and National Fire Insurance Company of Hartford (together, "CNA"); and (2) Motor Vehicle Casualty Company, Central National Insurance Company of Omaha, and Century Indemnity Co. (together, "ACE") (both groups together, "Appellants"). Appellants contend that the courts below erred in their preemption rulings, that the plan does not comply with [§ 524\(g\)](#), that the plan was not proposed in good faith, that the plan was developed by conflicted counsel, and that they have standing to object to the plan and to appeal.

We denied Appellants' emergency motion for a stay pending appeal but consolidated the two appeals and granted expedited briefing. The plan became effective on October 22, 2010, and implementation of the plan began. Appellees filed a motion to dismiss as moot in February 2011, which the motions panel referred to us.

II. Standard of Review

[1] [2] We have jurisdiction under [28 U.S.C. § 158\(d\)](#) (1). We review de novo the district court's decision on appeal from the bankruptcy court, applying the same standards applied by the district court, without deference to the district court. [Decker v. Tramiel \(In re JTS Corp.\)](#), 617 F.3d 1102, 1109 (9th Cir.2010). The bankruptcy court's conclusions of law are reviewed de novo, and its findings of fact are reviewed for clear error. *Id.* The preemption, standing, and insurance neutrality rulings present questions of law reviewed de novo.

III. Discussion

A. Mootness

[3] [4] [5] Appellees contend that the appeal is moot because Appellants did not obtain a stay and there has been substantial consummation of the plan.³ We will *880 not entertain an appeal if the case is moot. The “party moving for dismissal on mootness grounds bears a heavy burden.”

 *Jacobus v. Alaska*, 338 F.3d 1095, 1103 (9th Cir.2003). There are two mootness doctrines to consider—one deriving from Article III of the Constitution, and one from equity. We address these in turn.

[6] [7] The jurisdiction of federal courts is limited to actual cases and controversies. U.S. CONST. art. III, § 2, cl. 1. “The test for mootness of an appeal is whether the appellate court can give the appellant any effective relief in the event that it decides the matter on the merits in his favor. If it can grant such relief, the matter is not moot.”

 *Felster Publ'g v. Burrell (In re Burrell)*, 415 F.3d 994, 998 (9th Cir.2005) (quoting  *Garcia v. Lawn*, 805 F.2d 1400, 1402 (9th Cir.1986)). We conclude that the appeal is not constitutionally moot because we could reverse plan confirmation or require modification of the plan, thereby giving relief to Appellants.

[8] [9] We next address whether this appeal is moot under the doctrine commonly known as “equitable mootness,” which has some sway in bankruptcy cases where public policy values the finality of bankruptcy judgments because debtors, creditors, and third parties are entitled to rely on a final bankruptcy court order. *See, e.g.*,  *In re Onouli-Kona Land Co.*, 846 F.2d 1170, 1172 (9th Cir.1988) (noting the need for finality in bankruptcy); 13B FEDERAL PRACTICE & PROCEDURE § 3533.2.3 (3d ed.) (“Bankruptcy appeals provide numerous examples of the need to protect third party interests arising from substantial implementation of a reorganization plan pending appeal.”). Equitable mootness occurs when a “comprehensive change of circumstances” has occurred so “as to render it inequitable for this court to consider the merits of the appeal.”  *In re Roberts Farms*, 652 F.2d 793, 798 (9th Cir.1981). The question is whether the case “present[s] transactions that are so complex or difficult

to unwind that the doctrine of equitable mootness would apply.”  *Lowenschuss v. Selnick (In re Lowenschuss)*, 170 F.3d 923, 933 (9th Cir.1999). The Second, Third, and Fifth Circuits have developed tests to determine whether an appeal is equitably moot.⁴ We have not yet expressly *881 articulated a comprehensive test, but our precedents have looked at whether a stay was sought, whether the plan has been substantially consummated, whether third party rights have intervened, and, if so, whether any relief can be provided practically and equitably.  *Baker & Drake*, 35 F.3d at 1351 (1994) (“moot if a party opposing a reorganization plan has failed to obtain a stay pending appeal, and the plan has been carried out to ‘substantial [culmination].’ ”);  *In re Roberts Farms, Inc.*, 652 F.2d at 797–98 (1981) (moot if plan has been so far implemented that impossible to fashion effective relief or where party challenging plan fails to use due diligence to seek a stay);  *In re Spirtos*, 992 F.2d at 1006 (1993) (moot if no stay and rights of third parties have intervened, but not if able to fashion relief that is both effective and equitable).

[10] We endorse a test similar to those framed by the circuits that have expressed a standard: We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court. For reasons explained below, we conclude that this appeal is not equitably moot.⁵

[11] [12] [13] [14] [15] [16] First, this is not a case where Appellants sat on their rights; they sought a stay and were refused both by us and by the Circuit Justice. A failure to seek a stay can render an appeal equitably moot.  *In re Roberts Farms*, 652 F.2d at 797–98. However, failure to obtain a stay does not require a conclusion of equitable mootness where parties use due diligence in seeking the stay.  *In re Lowenschuss*, 170 F.3d at 933 (not equitably moot where sought stay but bankruptcy court refused to grant it). In such a circumstance, where a party has done nothing by its own inaction to encourage or permit developments to proceed without its participation, courts should be cautious about reaching a conclusion of equitable mootness. To say that

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a party's claims, although diligently pursued, are equitably moot because of the passage of time, before the party had a chance to present views on appeal, would alter the doctrine to be one of "inequitable mootness." Although practicalities necessarily may take center stage in a particular case, we decline in every case to elevate expediency over the justice of the situation. If Appellants here have presented appellate claims that can be remedied by some reasonable means without totally dislodging the § 524(g) plan, it would be inequitable to dismiss their appeal on equitable mootness grounds merely because the reorganization has proceeded. The failure to gain a stay is one factor to be considered in *882 assessing equitable mootness, but is not necessarily controlling.

[17] Second, we next determine whether substantial consummation of the plan has occurred. The Bankruptcy Code defines substantial consummation as: (a) transfer of all or substantially all of the property proposed by the plan to be transferred; (b) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (c) commencement of distribution under the plan. 11 U.S.C. § 1101(2). Here, though distribution under the plan has commenced, all or substantially all of the property the plan proposes to transfer has not been transferred. The plan involves \$600 million in settlement proceeds, and, per the current record, only \$135 million has been transferred to the trust.⁶ We conclude that the plan has not been substantially consummated.⁷

[18] [19] Third, we must evaluate "whether modification of the plan of reorganization would bear unduly on the innocent." *In re 203 N. LaSalle St. Pshp.*, 126 F.3d 955, 961 (7th Cir.1997), judgment rev'd on other grounds, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). An important consideration is whether all the parties affected by the appeal are before the court. *See, e.g., In re Arnold & Baker Farms*, 85 F.3d 1415, 1420 (9th Cir.1996); *In re Spirtos*, 992 F.2d at 1007. The plan has proceeded and third party rights have intervened to some extent because the trust has both made and received payments. Appellees argue that any changes made to the plan would be inequitable because asbestos claimants voted on the plan relying on the transactions it created, and any change would unfairly affect the bargain they received. However, in determining whether an appeal is equitably moot, the question is not whether it

is possible to alter a plan such that no third party interests are affected, but whether it is possible to do so in a way that does not affect third party interests to such an extent that the change is inequitable. If we followed Appellees' argument, no party that failed to obtain a stay in § 524(g) cases would ever be able to appeal, because third party rights would always be affected in some way. We reject that position. The Third Circuit has allowed changes to a 524(g) plan where the plan had already been approved by claimants. *Combustion Eng'g*, 391 F.3d at 201-02 (bankruptcy court added super-preemptory provision after approval by majority of asbestos claimants).

Also, the plan provides that it may be modified after confirmation with consent of the trust advisory committee and the Futures Representative but without a vote by asbestos claimants. While the claimants agreed to the plan, they did not agree to a plan that promised no future changes. Further, the appointed Futures Representative is a party to this appeal. The bankruptcy court and the Futures Representative can ensure that any changes to the plan after remand are made in a way that is equitable to all affected parties. Finally, the bankruptcy court could fashion remedies that would not impact the asbestos claimants in a negative way, such as *883 requiring the Debtor to contribute more money to the trust. Appellees argue that the plan is also equitably moot because the reorganized debtor received credit from California Bank & Trust, which creates third party reliance on the plan. But even if the bank extended credit to the reorganized debtor in reliance on the plan, we do not think that remedies short of reversing plan confirmation would affect the bank in an inequitable way.

[20] Fourth, and most importantly, we look to whether the bankruptcy court on remand may be able to devise an equitable remedy. Because traditional equitable remedies are extremely broad and vest great discretion in a court devising a remedy, we expect that if there is violation of Appellants' legal rights from the plan, the bankruptcy court should be able to find a remedy that is appropriate. The plan has thus far proceeded to a point where it may not be viable totally to upset the plan, to tip over the § 524(g) apple cart. Yet, that does not mean that there could not be plan modifications adequate to give remedy for any prior wrong. Where equitable relief, though incomplete, is available, the appeal is not moot. *Paulman v. Gateway Venture Partners III, L.P. (In Re Filtercorp, Inc.)*, 163 F.3d 570, 578 (9th Cir.1998).

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There are several ways here that Appellants could get some relief without completely upsetting the plan. First, Appellees challenge the sufficiency of plan funding. The district court, on appeal, could require Appellees to contribute more to the trust. As an example, the court could require Appellees to return the \$2.5 million they have received pursuant to the Business Loss Allocation.  *In re Spirtos*, 992 F.2d at 1007 (“We can fashion effective relief by ordering Debtor, who is a party to this appeal, to return the money to the estate.”); see also  *Platinum Capital, Inc. v. Sylmar Plaza, L.P.* (In re Sylmar Plaza, L.P.), 314 F.3d 1070, 1074 (9th Cir.2002) (finding appeal not equitably moot because remedy was monetary and debtors were solvent). Second, Appellants could receive relief from the bankruptcy court if it amends the plan to make clear that the trust distribution procedures are not binding on direct suits filed against Appellants; because a potentially binding effect is part of what gives the insurers a legally protected interest, see section III.B.1, *infra*, a remedy on these lines may be appropriate. See e.g.  *Combustion Eng'g*, 391 F.3d at 201–02 (bankruptcy court added super-preemptory provision after approval by majority of asbestos claimants and district court also made changes). Third, the bankruptcy court could allow Appellants to present evidence and argue for modification of the trust distribution procedure.

 *Varela v. Dynamic Brokers, Inc.* (In re Dynamic Brokers, Inc.), 293 B.R. 489, 494 (9th Cir. BAP 2003) (finding appeal not equitably moot where payments were to be made over twenty years and distribution could be adjusted over time). Fourth, the Appellants would receive relief by placing the trust under new governance if the bankruptcy court credits their argument that the trust is in the hands of biased parties.

If abandonment of the  § 524(g) plan were the only possible remedy, then there might be equitable mootness. However, we expect that there are many options open to the bankruptcy court other than complete plan reversal that can remedy some of Appellants' claims if proved valid. Therefore, we hold that this appeal is not equitably moot.

B. Standing

[21] [22] Two types of standing are at issue: (1) standing to object to the confirmation of the plan in bankruptcy court *884 (“bankruptcy standing”) and (2) standing to appeal that confirmation ruling (“appellate standing”). Appellate standing requires that a party be directly and adversely

affected by the order of the bankruptcy court—that it diminish the appellant's property, increase its burdens, or detrimentally affect its rights.  *Duckor Spradling & Metzger v. Baum Trust* (In re P.R.T.C., Inc.), 177 F.3d 774, 777 (9th Cir.1999). On bankruptcy standing, the interests in a fair plan are paramount, and the bankruptcy court is open to all “parties in interest.” 11 U.S.C. § 1109(b). A party denied standing in the bankruptcy court has appellate standing to challenge that determination. See, e.g.,  *In re Global Indus. Tech, Inc.* (In re GIT), 645 F.3d 201, 209 n. 23 (3rd Cir.2011) (en banc). All parties agree that Appellants have appellate standing to appeal the finding of insurance neutrality and to appeal the preemption holding. Because there is no real issue on appellate standing here, we turn to consider bankruptcy standing, and whether the bankruptcy court should have heard Appellants more fully on the issues of concern to them.

[23] To have standing in bankruptcy court, Appellants must meet three requirements: (1) they must meet statutory “party in interest” requirements under § 1109(b) of the bankruptcy code; (2) they must satisfy Article III constitutional requirements; and (3) they must meet federal court prudential standing requirements.

(1)

[24] [25] We first consider whether Appellants had statutory standing under § 1109(b), which provides that:

[a] party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.

§ 1109(b). The “party in interest” standard has generally been construed broadly. See  *In re GIT*, 645 F.3d at 210–11 (list not exclusive);  *Kaiser Aerospace & Elec. Corp. v. Teledyne Indus.* (In re Piper Aircraft Corp.), 244 F.3d 1289, 1304 n. 11 (11th Cir.2001) (party in interest is defined non-exclusively in § 1109(b));  *Hasso v. Mozsgai* (In re

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La Sierra Fin. Servs.), 290 B.R. 718, 728 (9th Cir. BAP 2002) (list is nonexclusive); *In re Shoen*, 193 B.R. 302, 311 (Bankr.D.Ariz.1996) (broad definition); *In re Standard Insulations, Inc.*, 138 B.R. 947, 950 (Bankr.W.D.Mo.1992) (party in interest not limited to examples listed). “[C]ourts must determine on a case by case basis whether the prospective party has a sufficient stake in the proceedings so as to require representation.” *In re Amatex Corp.*, 755 F.2d 1034, 1042 (3rd Cir.1985).

The Seventh Circuit determined that § 1109(b) was not intended to provide standing exclusively for the listed examples, but rather was meant to give standing to “anyone who has a legally protected interest that could be affected by a bankruptcy proceeding.” *In re James Wilson Assocs.*, 965 F.2d 160, 169 (7th Cir.1992). The Third Circuit agreed, finding that the list of potential parties in interest in § 1109(b) is not exclusive and adopting the “legally protected interest” test as a “helpful amplification” of its “sufficient stake in the proceeding[s]” test set out in *In re Amatex*. *In re GIT*, 645 F.3d at 210. Indeed, the Third Circuit noted that Article III standing and standing under the Bankruptcy code were effectively co-extensive. *Id.* at 211.

The bankruptcy court in this case approached the question of standing for Appellants as one of insurance neutrality, an *885 approach taken by other courts. *See, e.g., In re GIT*, 645 F.3d 201; *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir.2004); *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm.*, 321 B.R. 147 (D.N.J.2005). The bankruptcy court concluded that because the plan was insurance neutral, Appellants had no standing.⁸

[26] Appellants argue that the plan is not insurance neutral because of possible preclusive effects of the plan, because they are responsible for claims channeled to the trust, because the trust permits direct file suits against Appellants, because they are a contingent beneficiary of the trust, and because the plan and trust distribution procedure can be changed without court supervision.⁹ We conclude that the plan may economically affect Appellants in substantial ways. A plan is not insurance neutral when it may have a substantial economic impact on insurers.

First, Appellants claim that there is a possibility that the plan will have a preclusive effect in asbestos suits brought against them by claimants. We conclude this claim has merit. Though the plan recites that it is insurance neutral, this characterization in and of itself does not settle the issue. Instead, we must look to the real-world impacts of the plan to see if it increases insurance exposure and likely liabilities of Appellants.

The plan creates four exceptions to Appellants' insurance defenses. One such exception is that insurance defenses are not preserved “to the extent affected by application of principles of res judicata, collateral estoppel, claim preclusion or issue preclusion.” The bankruptcy court held that the plan was insurance neutral, but, at the same time, it held that “the Debtors' insurers may or may not be bound by the Trust's resolution of its claimed liability on an Asbestos Related Claim.” The bankruptcy court further provided that “[w]hether and to what extent the values generated by the Internal Procedures will bind a particular Non-Settling Asbestos Insurer will be resolved in the Coverage Litigation.”¹⁰

These conclusions appear to be contradictory, or at least in serious tension with each other. If the Appellants may be bound by the Trust's determination of an amount of liability on an asbestos claim, it would be hard to see how that would not *886 have a real impact on the appellant insurance companies. If the actual amount of payments due from insurance companies is increased by the plan from what those liabilities would be absent the plan, then the plan has monetary impact in the real world of insurance, and is not insurance neutral. Here Appellants reasonably complain that they were not permitted to participate in establishing the valuation matrix. That would be no problem if they could challenge amounts set by it, but it is a problem for them if they may be bound by it without prior participation.

[27] The language in the plan and in the bankruptcy court's order is different from the “super-preemptory” language contained in the plan in *In re Combustion Engineering*, where the court determined the plan had no impact on insurers. There, the plan stated:

Notwithstanding anything to the contrary in this Order, the Plan or any of the Plan Documents, nothing in this Order, the Plan or any of

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the Plan documents (including any other provision that purports to be preemptory or supervening), shall in anyway [sic] operate to, or have the effect of, impairing the insurers' legal, equitable or contractual rights, if any, in any respect.

 *In re Combustion Eng'g*, 391 F.3d at 209. Even if there is a super-preemptory provision, “care must be taken to ensure that, in fact, the insurer’s rights are completely unaffected. If the insurer’s rights are affected in any way, the insurer will have standing to object to the alteration of its rights.” COLLIER ON BANK. ¶ 1109.04. Here, the express exceptions to Appellants’ defenses signal that the plan is not insurance neutral.

Second, Appellants must indemnify payments made by the trust pursuant to settlements with asbestos claimants. Without participation by Appellants, the trust determines how much to pay to the claimants and then may seek payment from Appellants. For the same reasons discussed above, the plan would not necessarily permit the insurers to challenge settlement amounts as unreasonable.

[28] Third, under the plan, the trust can allow asbestos claimants to file direct suits against Appellants. “As a general matter, ... parties with potential responsibility to pay claims against debtors regularly have standing to participate in bankruptcy cases.”  *Baron & Budd*, 321 B.R. at 158. For this reason, each of the insurers who may be sued directly and may be liable to claimants should be viewed as a party in interest to the proceedings establishing the trust. Moreover, if the trust runs out of money because it is insufficiently funded or because the trust distribution procedures are insufficiently stringent, the likelihood of claims being brought against the non-settling insurers increases. If the trust runs out of money, the channeling injunctions will preclude claimants from seeking damages from any other insurers than the non-settling insurers. This would have a substantial economic impact on Appellants.

Fourth, the plan may have economic consequences for Appellants by affecting their reinsurance with settling insurers. Because the injunction protects the settling insurers, Appellants’ only recourse for any contribution, subrogation, or indemnification resulting from reinsurance is against the

trust making them beneficiaries. The order confirming the plan states that the trust may not permit a direct claim against a non-settling insurer unless the claimant agrees in writing to reduce the judgment by the amount the settling insurer owes to Appellants. The order further provides that in direct action litigation, if the non-settling insurer is found to have a claim against a settling insurer for *887 litigation costs, and they are unable to recover those costs through a judgment reduction, then the non-settling insurer can bring an action against the Trust for that amount. If the Trust runs out of money because it is insufficiently funded, then any costs that Appellants could have recovered against it will be lost. The right to recover costs is a right provided for by a contract negotiated between the settling insurer and the non-settling insurer. This right is a legally protected right. Any inadequacy in the trust threatens to diminish the value of Appellants’ claims. Therefore, the insurers’ allegations that the plan does not comply with the funding requirements of  § 524(g) are sufficient to establish standing.

In summary, the plan allows direct actions against Appellants. It allows the trust to pay out claims according to the trust distribution plan and then to seek indemnification from Appellants. It terminates Appellants’ ability to collect claims from settling insurers. It affects the nature of Appellants’ contracts with Appellees. Though  § 524(g) contemplates this kind of interference with insurers’ contracts, there is no doubt that the vast changes to the insurance policies and relationships have the potential substantially to impact Appellants economically. The plan is therefore not insurance neutral, which provides the non-settling insurers with party in interest standing under § 1109(b). We hold that appellants had bankruptcy standing and should have been permitted to be heard in challenging the plan, if they had Article III standing and satisfied prudential standing requirements.

(2)

[29] [30] Having found that Appellants are parties in interest under § 1109(b), we consider whether they also satisfy the requirements of Article III standing. To have constitutional standing under Article III, the party seeking standing must demonstrate an injury in fact that is traceable to the challenged action and that is likely to be redressed by a favorable decision.  *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992). As applied in the Chapter 11 context, Article III standing exists

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where “the participant holds a financial stake in the outcome of the proceeding such that the participant has an appropriate incentive to participate in an adversarial form to protect his or her interests.” COLLIER ON BANK. ¶ 1109.04; *see also*

United States v. 5208 Los Franciscos Way, 385 F.3d 1187, 1191 (9th Cir.2004).

[31] Appellants had Article III standing. As discussed above, the plan affects Appellants' contractual rights, affects their financial interests, and has the possibility of affecting their litigation rights in court. The plan potentially increases the liabilities of the insurance companies with real world economic impact, and, as such, Appellants have sufficiently alleged an injury in fact. This injury is traceable to the plan. It is only because of the plan that Appellants' contractual rights and expectations were changed. This injury would be redressed by judicial action, such as if the bankruptcy or district court reversed confirmation of the plan or altered the plan to make it insurance neutral. All three required elements of the *Lujan* test are satisfied, and Appellants have Article III standing.

(3)

[32] [33] [34] [35] “In addition to the immutable requirements of Article III, ‘the federal judiciary has also adhered to a set of prudential principles that bear on the question of standing.’ ” *Bennett v. Spear*, 520 U.S. 154, 162, 117 S.Ct. 1154, 137 L.Ed.2d 281 (1997) (quoting *Valley Forge Christian *888 Coll. v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 474–475, 102 S.Ct. 752, 70 L.Ed.2d 700 (1982)). This prudential principle is a “judicially self-imposed limit[] on the exercise of federal jurisdiction.” *Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 82 L.Ed.2d 556 (1984). It is “founded in concern about the proper—and properly limited—role of the courts in a democratic society.” *Warth v. Seldin*, 422 U.S. 490, 498, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975). One of these prudential requirements is that “[a] plaintiff's grievance must arguably fall within the zone of interests protected or regulated by the statutory provision or constitutional guarantee invoked in the suit.” *Bennett*, 520 U.S. at 162, 117 S.Ct. 1154. “The ‘zone of interests’ requirement is analogous to ‘statutory standing.’ ” *In re Chiu*, 266 B.R. 743, 749 (9th Cir. BAP 2001) (quoting

Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 669 n. 13 (7th Cir.1998)). “[T]he predecessor provisions of section 1109(b) of the Code, constituted an effort to encourage and promote greater participation in reorganization cases.... Section 1109(b) continues in this tradition and should be understood in the same way.” *In re Amatex*, 755 F.2d at 1042; *see also* 7 COLLIER ON BANK. ¶ 1109.04[2] [b] (“A fundamental purpose of section 1109(b) is to grant any party with a financial stake in the case the right, at the party's election, to participate with respect to the judicial determination of any issue bearing on the ultimate disposition of his or her interest.”).

[36] Appellants have § 1109(b) standing, or bankruptcy standing. Also, as insurers of the Debtors, they were within the “zone of interests” protected or regulated by the statutory provision. Congress intended § 1109(b) to confer broad standing so that those whose rights would be affected by reorganization proceedings could participate and protect their rights.

(4)

Having determined that Appellants met statutory (“party in interest”), constitutional (*Lujan* Article III test), and prudential (“zone of interests”) standing requirements, we next consider the extent of their standing in bankruptcy court. Section 1128(b) states that “[a] party in interest may object to the confirmation of a plan.” § 1128(b). Because Appellants are parties in interest, they should have had standing to object to confirmation of the plan. *In re GIT*, 645 F.3d at 211 (“Status as a party in interest is of particular relevance here because the Bankruptcy Code expressly provides that parties in interest ‘may object to confirmation of a plan.’ ”); *see also* COLLIER ON BANK. ¶ 1109.04[2][a] (“[E]very court would seem to agree that section 1109(b) applies in full force to a plan confirmation proceeding given the momentous nature of this proceeding in most cases.”). For this reason the nonsettling insurers had a right to be heard, to present evidence, and to participate in the proceedings culminating in approval of the § 524(g) plan.

C. Preemption

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Appellants also appeal the district court's determination that their anti-assignment contract rights were preempted by federal bankruptcy law. The plan assigns Thorpe's insurance rights to the trust and excludes from Appellants' defenses any defense based upon violation of the anti-assignment clauses. However, the policies under which Thorpe is insured contain language requiring Appellants' consent before an assignment or transfer of policy rights. Under California law, assignment of insurance benefits may violate an anti-assignment provision if the *889 claim against the policy has not been "reduced to a sum of money due or to become due under the policy."  *Henkel Corp. v. Hartford Accident and Indemnity Co.*, 29 Cal.4th 934, 944, 129 Cal.Rptr.2d 828, 62 P.3d 69 (2003). The bankruptcy and district courts determined that bankruptcy law preempted the anti-assignment clauses in the insurance policies.

[37] [38] [39] "We must be cautious about conflict preemption where a federal statute is urged to conflict with state law regulations within the traditional scope of the state's police powers," and we begin with a "presumption against preemption."  *Chae v. SLM Corp.*, 593 F.3d 936, 944 (9th Cir.2010). But, "[i]t is a familiar and well-established principle that the Supremacy Clause ... invalidates state laws that 'interfere with, or are contrary to,' federal law."  *Hillsborough Cnty. v. Automated Med. Laboratories, Inc.*, 471 U.S. 707, 712, 105 S.Ct. 2371, 85 L.Ed.2d 714 (1985). In determining whether preemption exists, "[t]he purpose of Congress is the ultimate touchstone...."  *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485, 116 S.Ct. 2240, 135 L.Ed.2d 700 (1996).

[40] [41] [42] [43] Preemption can occur either expressly or impliedly. "Express and implied preemption under the Bankruptcy Code are two distinct concepts."  *PG & E Co. v. Cal. ex rel. Cal. Dep't of Toxic Substances Control*, 350 F.3d 932, 948 (9th Cir.2003). "Congress may indicate preemptive intent through a statute's express language or through its structure and purpose."  *Altria Group, Inc. v. Good*, 555 U.S. 70, 129 S.Ct. 538, 543, 172 L.Ed.2d 398 (2008) In the absence of express preemption, Congressional intent can be inferred where "it is impossible for a private party to comply with both state and federal requirements, ... or where state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"  *Crosby v. Nat'l Foreign Trade*

Council, 530 U.S. 363, 372–73, 120 S.Ct. 2288, 147 L.Ed.2d 352 (2000) (quoting  *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 85 L.Ed. 581 (1941)).

(1)

[44] Here Congress has expressly preempted Appellants' contract rights. Section 541(c) provides that "an interest of the debtor in property becomes property of the estate ... notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law ... that restricts or conditions transfer of such interest by the debtor...." 11 U.S.C. § 541(c)(A). In *In re Combustion Engineering*, the Third Circuit held that the Bankruptcy Code "expressly contemplates the inclusion of debtor insurance policies in the bankruptcy estate."  *In re Combustion Eng'g*, 391 F.3d at 219 n. 27. The court held that § 541 "effectively preempts any contractual provision that purports to limit or restrict the rights of a debtor to transfer or assigns [sic] its interest in bankruptcy."  *Id.*; see also *In re Kaiser Aluminum Corp.*, 343 B.R. 88, 95 (D.Del.2006) (541(c) expressly preempts anti-assignment clauses).

Appellants argue that precedent precludes a finding that 541(c)(1)(A) preempts the contract provisions. They point to *In re Farmers Markets* and argue that § 541(c) does not preempt state laws that put limitations on transfers of property to third parties.  *In re Farmers Markets, Inc.*, 792 F.2d 1400, 1402 (9th Cir.1986). That case involved the question of whether § 541(c) preempted a state law that disallowed the transfer of a liquor license until the holder paid certain state taxes.  *Id.* at 1401. There, the court held that § 541(c) does not invalidate all transfer restrictions on property in which the debtor holds an *890 interest, but "avoids only those restrictions which prevent transfer of the debtor's property to the estate."  *Id.* at 1402. Therefore, the state could require the estate to pay the taxes before allowing the transfer of the license to a third party.  *Id.* at 1404. Here, however, the trust is not a third party. The order confirming the plan provides that the trust is appointed as the estate representative. The trust is part of the debtor's estate. Instead of attempting to sell or assign anything to third parties, the debtor was attempting to transfer its rights and property to the trust, part of the estate. Accordingly, *In re Farmers Markets* does not preclude

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a finding that 541(c) preempts Appellants' anti-assignment contract rights.

Appellants also argue that in *PG & E* we held that a reorganization plan may preempt nonbankruptcy law “only to the extent that such law ‘relates to financial condition.’ ”

 *PG & E*, 350 F.3d at 937. They argue that since Appellants' rights do not relate to a “financial condition” preemption is not appropriate here. In *PG & E* we dealt only with §§ 1123(a) and 1142(a), and issues of express preemption by those provisions, and did not interpret § 541(c) as we do here. *PG & E* is not applicable to the preemption issue in this case, as it doesn't tell us whether the anti-assignment clauses in the contracts between insurers and the debtors are preempted by § 541(c).

(2)

[45] [46] [47] Even if 541(c) did not expressly preempt the anti-assignment provisions, this would not end the inquiry because “[i]t is possible for there to be no express preemption under a particular provision of the Bankruptcy Code, but nonetheless to be implied preemption under the Code.”

 *PG & E*, 350 F.3d at 948. “Even where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law.”  *Hillsborough Cnty.*, 471 U.S. at 713, 105 S.Ct. 2371. “We discern congressional objectives by ‘examining the federal statute as a whole and identifying its purpose and intended effects.’ ”  *Chae*, 593 F.3d at 943 (quoting  *Crosby*, 530 U.S. at 373, 120 S.Ct. 2288).

[48] [49] Here, enforcing the anti-assignment clauses would stand as “an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”¹¹

 *English v. Gen. Elec. Co.*, 496 U.S. 72, 79, 110 S.Ct. 2270, 110 L.Ed.2d 65 (1990) (quoting  *Hines*, 312 U.S. at 67, 61 S.Ct. 399). As the district court noted, *Henkel* would bar any company with significant insurance contracts governed by California law from taking advantage of 524(g). For a plan to be approved, the trust must be sufficiently funded. As here, companies usually can do so only by settling with insurers and putting those funds in the trust. Yet, if we enforced the anti-assignment provisions, it would be to the detriment of

the potential efficacy of a  § 524(g) plan. After a debtor had filed for bankruptcy, no insurer would settle, with the

aim of funding a  § 524(g) plan, because by refusing to settle, the insurer could position itself to claim forfeiture of the insurance if a plan proceeded and there was a consequent breach of the anti-assignment provisions. “Simply making a reorganization more difficult for a particular *891 debtor, however, does not rise to the level of ‘standing as an obstacle to the accomplishment of the full purposes and objectives of Congress.’ ”  *In re Baker & Drake, Inc.*, 35 F.3d at 1354

(quoting  *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300, 108 S.Ct. 1145, 99 L.Ed.2d 316 (1988)). This is not the case here, because enforcing the anti-assignment provisions would subject virtually all  § 524(g) reorganizations to an insurer veto.

We are unconvinced by Appellants' argument that Appellees

are merely allowed to reorganize under  § 524(g) but not entitled to do so and accordingly preemption is not appropriate.  Section 524(g) was specifically designed to allow companies with large asbestos-related liabilities to use Chapter 11 to transfer those liabilities, along with substantial assets, to a trust responsible for paying future asbestos claims. See H.R.Rep. No. 103-835, at 46-47 (1994), 1994 U.S.C.C.A.N. 3340, 3354-3356. It requires that a trust be established that assumes the debtor's asbestos liabilities.  § 524(g)(2)(B)(I). Part of the “cornerstone” of the reorganization is contribution by the insurers to the trust.

 *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S.Ct. 2195, 2199, 174 L.Ed.2d 99 (2009). For such reasons we hold that the anti-assignment provisions contained in the contracts between Appellants and Appellees stand as an obstacle to completion of a successful  § 524(g) plan, and therefore are preempted by federal bankruptcy law.

IV. Conclusion

We reject Appellees' argument that this appeal should be dismissed as “equitably moot.” Although the plan has proceeded to a point where it may be inequitable to toss it out entirely, we also conclude that there are likely viable remedies available to Appellants, short of entirely tossing the plan out, within the broad remedial discretion of the bankruptcy court,

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if it determines that Appellants' claims (discussed in footnote one) have merit.

The bankruptcy court and district court erred by concluding that the proposed § 524(g) plan was insurance neutral and that Appellant insurers did not have party in interest standing to challenge the plan. Because the plan had likely effects that would increase economic exposure of the insurer Appellants to asbestos claimants, they had a right to be heard fully and fairly before the plan was finalized. Also, we affirm the bankruptcy court's and district court's conclusions that the anti-assignment clauses in the contracts between insurers and the Debtor were preempted by federal law.

There is no entirely tidy way to resolve this case because the plan has proceeded without stay and without full input from insurer parties who will be economically affected by the plan. But we have concluded that the starting place is for us to reverse the judgment of the district court, and to remand to the district court with instructions that it remand to the bankruptcy court to permit Appellants to submit their proof on all issues they previously preserved.

REVERSED AND REMANDED with instructions.

All Citations

677 F.3d 869, 67 Collier Bankr.Cas.2d 437, 12 Cal. Daily Op. Serv. 3749, 2012 Daily Journal D.A.R. 4299

Footnotes

- * The Honorable [Richard Seeborg](#), United States District Judge for the Northern District of California, sitting by designation.
- 1 It appears that the policies with Continental and Fireman's fund were exhausted in 1998, and the rest of the insurers contend that their policy limits were exhausted in 2005.
- 2 Some non-settling insurers have insurance policies with the settling insurers ("reinsurance"). This injunction prevents the non-settling insurers from filing claims under those policies.
- 3 Appellees' contention on equitable mootness is not asserted within its appellate brief, but was the subject of a separate motion to dismiss the appeal as moot, filed by Appellees, and referred to our panel. For the reasons that follow, we deny the motion to dismiss this appeal as moot.
- 4 The Second Circuit has developed a five part test to determine if constitutional and equitable considerations moot an appeal where there has been substantial consummation. "[S]ubstantial consummation will not moot an appeal if all of the following circumstances exist: (a) the court can still order some effective relief; (b) such relief will not affect the re-emergence of the debtor as a revitalized corporate entity; (c) such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court; (d) the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (e) the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order...." *In re Chateaugay Corp.*, 10 F.3d 944, 952–53 (2d Cir.1993) (internal citations and quotations omitted).
The Third Circuit considers the following five factors: "(1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of the parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments." *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir.2001).
The court gives the factors varying weight depending on the particularity of the plan, putting the most weight on whether the plan has been substantially consummated. *Id.*
The Fifth Circuit considers three factors: "(1) whether the complaining party has failed to obtain a stay, (2) whether the plan ... has been substantially consummated, and (3) whether the relief requested would affect the rights of parties not before the court or the success of the plan." *TNB Fin., Inc. v. James F. Parker Interests (In re Grimland, Inc.)*, 243 F.3d 228, 231 (5th Cir.2001).
- 5 We make no determination that Appellants' rights have necessarily been impaired, except in so far as they were not permitted to be heard on the relevant issues in the bankruptcy court, nor that the plan is necessarily deficient. We are remanding so that Appellants can have a full and fair opportunity to present evidence and be heard on those issues before the bankruptcy court.
- 6 Appellants object to the declaration offered by Appellees containing this information. We overrule the objection and consider the evidence.

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- 7 If the plan was substantially consummated, that would not be the end of the inquiry. We would agree with our sister circuits, see note 5 *supra*, that we could still assess whether effective relief might be given without fully impairing the prior plan and other pertinent circumstances.
- 8 Appellees argue that this case is indistinguishable from *In re Combustion Engineering* where the Third Circuit found that non-settling insurers had no standing because the plan was insurance neutral. Even if that case had been adopted as controlling Ninth Circuit precedent, it is distinguishable. *In re Combustion Engineering* was decided in the context of appellate standing and applied the more stringent “person aggrieved” standard, not the “party in interest” standard used in determining whether standing in bankruptcy is appropriate. Further, the plan in *In re Combustion Engineering* was vastly different. There, the plan explicitly preserved all insurance defenses except for the assignment clause in the insurance contracts. Here, the plan contains exceptions to insurance defenses that go beyond the anti-assignment clause exception. Thus, the standard in *In re Combustion Engineering* was different, as was the plan.
- 9 Appellants also argue that they had standing because of the preemption of their anti-assignment state rights. Appellants had standing on that issue. Further, assignment of the insurance contracts to the trust does not provide standing to challenge anything other than preemption as long as all other rights are preserved.  [Combustion Eng'g, 391 F.3d at 216](#). Preemption of anti-assignment clauses do not, alone, destroy the insurance neutrality of the plan.
- 10 The Coverage Litigation are cases in California state court in which some non-settling insurers and Thorpe are litigating the extent of coverage provided by the insurance policies.
- 11 Appellants argue primarily that enforcing the anti-assignment provisions does not make it impossible to reorganize. Even if we accept Appellants' premise, this does not wholly resolve preemption. Instead, we must assess whether the anti-assignment provisions stand as an obstacle to the objectives of Congress. See  [Crosby, 530 U.S. 363, 120 S.Ct. 2288](#);  [Chae, 593 F.3d 936](#).

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In re Transwest Resort Properties, Inc., 801 F.3d 1161 (2015)

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KeyCite Yellow Flag - Negative Treatment

Declined to Extend by In re Abengoa Bioenergy Biomass of Kansas, LLC, D.Kan., October 10, 2018

801 F.3d 1161
United States Court of Appeals,
Ninth Circuit.

In re TRANSWEST RESORT
PROPERTIES, INC., Debtor,
JPMCC 2007-C1 Grasslawn
Lodging, LLC, Appellant,

v.

Transwest Resort Properties Incorporated;
Southwest Value Partners Fund XV LLP; SWVP La
Paloma LLC; SWVP Hilton Head LLC, Appellees.

No. 12-17176.

|

Argued and Submitted Jan. 13, 2015.

|

Filed Sept. 15, 2015.

Synopsis

Background: Lender objected to debtor's Chapter 11 reorganization plan. The Bankruptcy Court overruled lender's objections and confirmed the plan, and then denied lender's motion for stay pending appeal. Lender appealed and moved for a stay. The United States District Court for the District of Arizona, [Raner C. Collins](#), Chief Judge, denied the motion for a stay and held that the appeal was equitably moot. Lender appealed.

Holdings: The Court of Appeals, [Friedland](#), Circuit Judge, held that:

[1] lender was diligent about seeking appellate review of its two objections to the plan;

[2] sole owner of operating Chapter 11 debtors was not innocent third party that equitable mootness doctrine was meant to protect;

[3] distribution of money from owner to lender and reinstatement of lender's liens on mortgaged real property would not affect innocent third parties; and

[4] equitable mootness did not prevent district court on appeal from considering lender's argument seeking elimination of exception to due-on-sale clause.

Reversed and remanded.

[M. Smith](#), Circuit Judge, filed dissenting opinion.

Opinion, 791 F.3d 1140, withdrawn.

Procedural Posture(s): On Appeal.

West Headnotes (14)

[1] Bankruptcy

Moot questions

Equitable mootness is a prudential doctrine by which a court elects not to reach the merits of a bankruptcy appeal.

[8 Cases that cite this headnote](#)

[2] Bankruptcy

Moot questions

An appeal is equitably moot if the case presents transactions that are so complex or difficult to unwind that debtors, creditors, and third parties are entitled to rely on the final bankruptcy court order.

[10 Cases that cite this headnote](#)

[3] Federal Courts

Mootness

Unlike Article III mootness, which causes federal courts to lack jurisdiction and so to have an inability to provide relief, equitable mootness is a judge-created doctrine that reflects an unwillingness to provide relief. [U.S.C.A. Const. Art. 3, § 2, cl. 1.](#)

[2 Cases that cite this headnote](#)

[4] Bankruptcy

Conclusions of law; de novo review

Bankruptcy

In re Transwest Resort Properties, Inc., 801 F.3d 1161 (2015)

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 Particular cases and issues

When evaluating a dismissal on equitable mootness grounds, the Court of Appeals reviews factual findings for clear error and legal conclusions de novo.

3 Cases that cite this headnote

[5] Bankruptcy Effect of want of stay; conclusiveness of sale**Bankruptcy** Moot questions

Courts must be cautious in applying equitable mootness when a party has been diligent about seeking a stay; to say that a party's claims, although diligently pursued, are equitably moot because of the passage of time, before the party had a chance to present views on appeal, would alter the doctrine to be one of 'inequitable mootness for it would be inequitable to dismiss their appeal on equitable mootness grounds merely because the reorganization has proceeded.

6 Cases that cite this headnote

[6] Bankruptcy Effect of want of stay; conclusiveness of sale

Lender was diligent about seeking appellate review of its two objections to the plan, which cut strongly in favor of appellate review of lender's claims, where four days after bankruptcy court confirmed Chapter 11 plan, lender filed notice of appeal and asked bankruptcy court to stay consummation of plan, and when bankruptcy court denied that motion, lender sought stay from the district court.

4 Cases that cite this headnote

[7] Bankruptcy Effect of want of stay; conclusiveness of sale**Bankruptcy** Moot questions

Although substantial consummation is a factor weighing in favor of a finding that an appeal is equitably moot, a court still must consider whether the relief sought would bear unduly on innocent third parties and whether the bankruptcy court could fashion equitable relief without completely undoing the plan.

11 Cases that cite this headnote

[8] Bankruptcy Effect of want of stay; conclusiveness of sale**Bankruptcy** Moot questions

When evaluating under equitable mootness doctrine whether the relief sought would bear unduly on innocent third parties, a court must ask whether it is possible to alter the plan in a way that does not affect third party interests to such an extent that the change is inequitable; third parties' reliance on the consummation of the plan is not enough.

1 Cases that cite this headnote

[9] Bankruptcy Moot questions

Sole owner of reorganized operating Chapter 11 debtors was not innocent third party that equitable mootness doctrine was meant to protect on appeal of plan's exception to due-on-sale clause that negated lender's election to have its entire allowed claim treated as secured claim, since owner had been involved in plan confirmation and appeal at every level and relief requested by lender affected only the division between lender and reorganized debtors of any appreciation in value of mortgaged real property or from any inaccurately low valuation of that property during bankruptcy proceeding. 11 U.S.C.A. § 1111(b).

[10] Bankruptcy Moot questions

Appellate consequences are a foreseeable result, when considering under the equitable mootness

doctrine whether an entity is an innocent third party, when a sophisticated investor helps craft a reorganization plan that presses the limits of the bankruptcy laws.

[1 Cases that cite this headnote](#)

[11] Bankruptcy

 Moot questions

Distribution of money from reorganized operating Chapter 11 debtors to lender and reinstatement of lender's liens on mortgaged real property would not affect innocent third parties, favoring finding that appeal was not equitably moot, since those proposed forms of relief would have altered only the relationship between reorganized debtors and lender.  [11 U.S.C.A. § 1129\(a\)\(10\)](#).

[12] Bankruptcy

 Moot questions

The most important consideration in the equitable mootness test is whether the bankruptcy court could fashion equitable relief without completely undoing the plan; even if the relief would be only partial, where equitable relief, though incomplete, is available, the appeal is not moot.

[14 Cases that cite this headnote](#)

[13] Bankruptcy

 Moot questions

Equitable mootness did not prevent district court on appeal from considering lender's argument seeking elimination of exception to due-on-sale clause that allowing sale of mortgaged real property subject to restructured loan frustrated intended purpose of election to have its entire allowed claim treated as secured claim, since exception to due-on-sale clause was not fundamental component of transaction and it could be eliminated or altered without unraveling Chapter 11 plan. [11 U.S.C.A. § 1111\(b\)](#).

[1 Cases that cite this headnote](#)

[14] Bankruptcy

 "Deemed" acceptance; unimpaired classes

A class of claims that is not impaired, meaning the Chapter 11 plan does not alter its rights, is deemed to automatically accept the plan. [11 U.S.C.A. § 1126\(f\)](#).

Attorneys and Law Firms

***1163** [David M. Neff](#) (argued) and [Eric E. Walker](#), Perkins Coie LLP, Chicago, IL, for Appellant.

[Susan G. Boswell](#) (argued), Quarles & Brady LLP, Tucson, AZ; [Kasey C. Nye](#), Mesch, Clark & Rothschild, Tucson, AZ; [E. King Poor](#), Quarles & Brady LLP, Chicago, IL, for Appellees.

Appeal from the United States District Court for the District of Arizona, [Raner C. Collins](#), Chief District Judge, Presiding. D.C. Nos. 4:12-cv-00024-RCC, 4:12-cv-00121-RCC.

Before: [J. CLIFFORD WALLACE](#), [MILAN D. SMITH, JR.](#), and [MICHELLE T. FRIEDLAND](#), Circuit Judges.

Order; Opinion by Judge [FRIEDLAND](#); Dissent by Judge [MILAN D. SMITH, JR.](#)

ORDER

The petition for panel rehearing is granted.  [The Opinion and Dissent filed on July 1, 2015, appearing at 791 F.3d 1140](#), are withdrawn. A new superseding Opinion and Dissent are being filed concurrently with this Order.

***1164** The petition for rehearing en banc is denied as moot. The parties may file additional petitions for rehearing or rehearing en banc.

The motion for leave to file a reply in support of the petition for rehearing is denied.

OPINION

In re Transwest Resort Properties, Inc., 801 F.3d 1161 (2015)

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FRIEDLAND, Circuit Judge:

We consider whether a lender that made colorable objections to a plan of reorganization in bankruptcy court and then diligently sought a stay in order to litigate those objections may obtain review of its objections on appeal even though the plan has been implemented. Because it would be possible to devise an equitable remedy to at least partially address the lender's objections without unfairly impacting third parties or entirely unraveling the plan, we hold that the lender's objections are not equitably moot and should be considered on appeal. We thus reverse the district court's decision dismissing the appeal on equitable mootness grounds and remand for further proceedings.

I.

A. Background

In 2007, five related entities acquired the Westin Hilton Head Resort and Spa and the Westin La Paloma Resort and Country Club. The five entities (collectively “Debtors”) were: Transwest Hilton Head Property, LLC, and Transwest Tucson Property, LLC (collectively “Operating Debtors”); Transwest Hilton Head II, LLC, and Transwest Tucson II, LLC (collectively “Mezzanine Debtors”); and Transwest Resort Properties, Inc. (“Holding Company Debtor”). The Holding Company Debtor was the sole owner of each of the Mezzanine Debtors. The Mezzanine Debtors, in turn, were each the sole owners of the Operating Debtors, which owned and operated the respective hotels.

The 2007 acquisition of the hotels was financed by two loans: first, a \$209 million loan to the Operating Debtors secured by liens on the two hotels (the “mortgage loan”); and, second, a \$21.5 million loan to the Mezzanine Debtors secured by liens on the ownership interests in the Operating Debtors (the “mezzanine loan”).

The Mezzanine Debtors and the Operating Debtors defaulted on the mezzanine and mortgage loans, respectively. In 2010, all five Debtors filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the District of Arizona. The bankruptcy cases for the five entities were jointly administered.

JPMCC 2007–C1 Grasslawn Lodging, LLC (“Lender”), which had acquired the mortgage loan before the Debtors filed for bankruptcy, filed a proof of claim in the bankruptcy proceeding for \$299 million.¹ PIM Ashford Subsidiary I LLC, which had acquired the mezzanine loan in 2008, filed two proofs of claim totaling \$39 million.² Debtors and Lender stipulated that the value of the two hotels was \$92 million.

B. Plan of Reorganization

Debtors filed a joint plan of reorganization. The plan proposed to cancel the Mezzanine Debtors' equity interest in the Operating Debtors and to dissolve the Mezzanine Debtors. Southwest Value Partners Fund XV, LP (“SWVP”) would *1165 invest no less than \$30 million and would become the new sole owner of the Operating Debtors.

Pursuant to 11 U.S.C. § 1111(b)(2), Lender elected to have its entire allowed claim, \$247 million, treated as a secured claim.³ The plan proposed to reinstate the loan, but to restructure the repayment requirements to comprise monthly interest-only payments and then a balloon payment of the remaining loan amount after 21 years.

The proposed restructured loan terms also included a due-on-sale clause. Pursuant to the clause, any sale or refinancing of the hotels would make the entire remainder of the \$247 million loan due immediately. The clause contained an exception, however: between years five and fifteen of the loan, the hotels could be sold or refinanced subject to the restructured loan (meaning the new buyer would take on the loan obligations), without the full amount of the loan coming due on sale, as long as certain conditions were met.⁴

PIM Ashford's treatment under the reorganization depended on whether it voted for the plan. If it voted against the plan, it would not receive any distributions. If it voted for the plan, PIM Ashford would be entitled to a small percentage of surplus cash flow in the future. The plan extinguished the mezzanine loan's collateral (the Mezzanine Debtors' equity interest in the Operating Debtors).

There were ten classes of claims under the plan.⁵ The mortgage loan and the mezzanine loan were each in a class by themselves. After the plan was proposed, Lender acquired the mezzanine loan from PIM Ashford. Lender then voted both

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its positions (its original claim and the claim it obtained from PIM Ashford) against the plan.

The plan was confirmed despite the votes of Lender's two dissenting classes because the plan satisfied the “cram down” requirements of § 1129(b).⁶ Pursuant to the plan, the restructured mortgage loan entitled the Lender to deferred cash payments (1) totaling at least the amount of the allowed claim (\$247 million, or the “total loan amount”), and (2) having a net present value equal to the value of the *1166 collateral (\$92 million). § 11 U.S.C. § 1129(b)(2)(A)(i)(II). Lender also retained a lien on the hotels for the total loan amount. *Id.* § 1129(b)(2)(A)(i)(I).

As part of the consummation of the plan, the Operating Debtors were renamed SWVP La Paloma, LLC, and SWVP Hilton Head Property, LLC (collectively “Reorganized Debtors”) and continued to be wholly owned by SWVP through an intermediary entity. The Reorganized Debtors became the borrowers under the restructured mortgage loan.

C. Lender's Two Objections to the Plan

Lender objected to two aspects of the plan. First, Lender contended that the ten-year exception to the due-on-sale clause should be removed because it negated its § 1111(b) election. According to Lender, the option to keep the entire loan amount as a secured claim, codified in § 1111(b), was intended by Congress to protect secured creditors against the undervaluation of their collateral. If the collateral for a loan were undervalued, Lender argued, the due-on-sale clause would protect the lender's interests by, for example, preventing the debtor from immediately selling the collateral subject to the restructured loan and capturing the true value of the collateral.⁷ Here, Lender specifically asserted that the exception to the due-on-sale clause between years five and fifteen would allow Reorganized Debtors to unfairly negate at least part of the benefit of Lender's § 1111(b) election.

Second, Lender complained that the bankruptcy court misapplied one of the plan-confirmation requirements.

Section 1129(a)(10) requires that, “[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan [must have] accepted the plan” for it to be confirmed. § 11 U.S.C. § 1129(a)(10). Lender pointed out that in cases involving multiple debtors, courts

have split on whether § 1129(a)(10)'s requirement applies per plan or per debtor. Compare, e.g., *In re Tribune Co.*, 464 B.R. 126, 180–84 (Bankr.D.Del.2011) (per debtor), with *JPMorgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC* (*In re Charter Commc'ns*), 419 B.R. 221, 264–66 (Bankr.S.D.N.Y.2009) (per plan). Lender argued for the per-debtor interpretation of § 1129(a)(10). Because the Mezzanine Debtors here did not have any impaired class of creditors voting for the plan, *1167 Lender argued that, under this interpretation, the plan violated § 1129(a)(10).

The bankruptcy court overruled Lender's two objections and confirmed the plan.

D. Post-confirmation Proceedings

Four days after the bankruptcy court confirmed the plan, Lender filed a notice of appeal.⁸ On the same day, Lender filed a motion in the bankruptcy court requesting that the consummation of the plan be stayed pending appeal. Lender argued that failure to grant the stay could result in the appeal being rendered moot. Debtors and SWVP each filed objections to the stay request, arguing that Lender had not shown how substantial consummation of the plan would moot Lender's appeal. The bankruptcy court denied Lender's motion for a stay and—having apparently accepted Debtors' and SWVP's arguments—ruled that Lender had not shown the likelihood of irreparable harm required for a stay because the possibility of mootness was “speculative, at best.” Lender then filed an identical stay motion in the district court, and Debtors and SWVP again opposed it. Like the bankruptcy court, the district court declined to issue a stay.

When the district court then considered the appeal—which advanced Lender's two objections to the plan—it held that the appeal was equitably moot. Although the district court acknowledged that Lender had been diligent in seeking a stay, it stated that the plan had been consummated, third parties had relied on the confirmation of the plan, and the relief sought would be inequitable.

Lender filed this timely appeal from that decision.

II.

In re Transwest Resort Properties, Inc., 801 F.3d 1161 (2015)

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[1] [2] [3] Equitable mootness is a prudential doctrine by which a court elects not to reach the merits of a bankruptcy appeal. *Rev Op Grp. v. ML Manager LLC (In re Mortgs.*

Ltd.) (“*Mortgages I*”), 771 F.3d 1211, 1215 n. 2 (9th Cir.2014). “An appeal is equitably moot if the case presents transactions that are so complex or difficult to unwind that debtors, creditors, and third parties are entitled to rely on the final bankruptcy court order.” *Id.* at 1215 (alteration omitted). Unlike Article III mootness, which causes federal courts to lack jurisdiction and so to have an *inability* to provide relief, equitable mootness is a judge-created doctrine that reflects an *unwillingness* to provide relief. *Id.*⁹

We have set out four considerations to help determine whether an appeal is equitably moot:

We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the *1168 plan and thereby creating an uncontrollable situation for the bankruptcy court.

 *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869, 881 (9th Cir.2012). Because each of Lender's objections would require a separate form of relief, the equitable mootness analysis must be applied separately to each objection. See *Rev Op Grp. v. ML Manager LLC (In re Mortgs. Ltd.)* (“*Mortgages II*”), 771 F.3d 623, 628 (9th Cir.2014).

[4] In evaluating a dismissal on equitable mootness grounds, we review factual findings for clear error and legal conclusions de novo. See  *Mortgages I*, 771 F.3d at 1214.

A.

[5] Courts must be cautious in applying equitable mootness when a party has been diligent about seeking a stay. *Mortgages II*, 771 F.3d at 628. “To say that a party's claims, although diligently pursued, are equitably moot because of the passage of time, before the party had a chance to present views on appeal, would alter the doctrine to be one of ‘inequitable mootness.’ ... [I]t would be inequitable to dismiss their appeal on equitable mootness grounds merely because the reorganization has proceeded.”  *In re Thorpe*, 677 F.3d at 881.

Mortgages I and *Mortgages II* together highlight the importance of diligence in the equitable mootness analysis. In *Mortgages I*, the appellant had failed to seek a stay while pursuing an appeal.  771 F.3d at 1214. That the appellant had sat on its rights weighed heavily in favor of holding the appeal equitably moot.  *Id.* at 1217. In *Mortgages II*, by contrast, the appellant had sought a stay pending the appeal. 771 F.3d at 627. We held that the appeal was not equitably moot and, in doing so, specifically emphasized the request for a stay as a factor differentiating it from *Mortgages I*. See *Mortgages II*, 771 F.3d at 629 (“Unlike in [*Mortgages I*], [appellant] diligently pursued its rights by seeking a stay of the Declaratory Judgment Order, even though it was unable to obtain the stay.”).

[6] Here, Lender was diligent about seeking appellate review of its two objections to the plan. Four days after the bankruptcy court confirmed the plan, Lender filed a notice of appeal and asked the bankruptcy court to stay the consummation of the plan. When the bankruptcy court denied that motion, Lender sought a stay from the district court. That Lender was diligent here cuts strongly in favor of appellate review of Lender's claims. See *Mortgages II*, 771 F.3d at 628 (“[W]e are cautious about not giving a party who is diligent ... an opportunity to present its appeal.”).

B.

The next consideration in the test for equitable mootness is “whether substantial consummation of the plan has occurred.”

 *In re Thorpe*, 677 F.3d at 882; see also *Mortgages II*,

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771 F.3d at 628–29. The term “substantial consummation” is defined in the Bankruptcy Code as:

- (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
- (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
- (C) commencement of distribution under the plan.

11 U.S.C. § 1101(2).

As Lender does not dispute, the record indicates that the plan has been substantially consummated. SWVP assumed control over the Debtors. SWVP then reorganized the Debtors by, among other things, extinguishing Mezzanine Debtors' equity interests in Operating Debtors. Finally, *1169 SWVP funded accounts necessary to make disbursements under the plan and assumed contracts in order to run the hotels.

[7] Reorganized Debtors argue that substantial consummation creates a presumption that the appeal is moot. To support this proposition, they cite to a series of out-of-circuit cases. *See* Appellees' Br. 32 (citing, e.g., *Aetna Cas. & Sur. Co. v. LTV Steel Co. (In re Chateaugay Corp.)*, 94 F.3d 772, 776 (2d Cir.1996)). Our circuit's articulation of the equitable mootness test, however, has never included such a presumption. *See Mortgages II*, 771 F.3d at 629 (“Substantial consummation of a bankruptcy plan often brings with it a comprehensive change in circumstances that renders appellate review of the merits of the plan impractical. But this is not always the case.... We must still consider whether, despite substantial consummation, we can fashion effective relief. To do so, we analyze the final two factors from *Thorpe*.”) (citations omitted); *see also In re Thorpe*, 677 F.3d at 882 n. 7. Although substantial consummation is a factor weighing in favor of finding the appeal moot, the law in this circuit requires that we still look at the third and fourth prongs of the equitable mootness test.

C.

[8] The third consideration in the test for equitable mootness is whether the relief sought would bear unduly on innocent third parties. *In re Thorpe*, 677 F.3d at 882; *Mortgages II*,

771 F.3d at 629. To evaluate this, we must ask “whether it is possible to [alter the plan] in a way that does not affect third party interests to such an extent that the change is inequitable.” *In re Thorpe*, 677 F.3d at 882. Third parties' reliance on the consummation of the plan is not enough to find this prong satisfied. Rather, for this factor to weigh in favor of holding a party's appeal to be equitably moot, the specific relief sought must bear unduly on innocent third parties. *See id.*

We analyze each of Lender's objections in turn.

1. The Exception to the Due-on-Sale Clause

[9] Lender argued that the plan's exception to the due-on-sale clause negates its § 1111(b) election. If Lender prevailed on the merits of this argument, Lender's proposed relief would be the elimination of the exception to the due-on-sale clause. Without the exception, the due-on-sale clause would prevent Reorganized Debtors from selling or refinancing the hotels without paying Lender the remainder of the total loan amount.

The relief requested by Lender affects only the division between Lender and Reorganized Debtors of any appreciation in value of the hotels (or from any inaccurately low valuation of the hotels during the bankruptcy proceeding). No party other than Lender and Reorganized Debtors (and their owner SWVP) would be affected by this division.

Reorganized Debtors argue that SWVP, as the owner of Reorganized Debtors, is the type of innocent third party that the equitable mootness doctrine is meant to protect. In light of SWVP's participation at every stage of these proceedings, we hold that SWVP is not an innocent third party. SWVP became involved in the reorganization as a new investor and as the proposed owner of the reorganized entity before the confirmation of the plan. Although Debtors put forward the initial version of the plan, SWVP participated in the hearings held by the bankruptcy court regarding confirmation of the plan, and the bankruptcy court acknowledged that it considered SWVP's pleadings in reaching its decision to confirm the plan. In fact, *1170 SWVP negotiated with Lender over the final form of the confirmation order (in other words, the final version of the plan), including the portions that gave rise to Lender's objections.¹⁰

Following confirmation of the plan, SWVP participated in further proceedings in the bankruptcy and district courts. SWVP filed a notice of appearance as “Appellee” in the

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earlier stage of this appeal in the district court. When Lender sought a stay pending appeal, SWVP then filed objections in both the bankruptcy and district courts, arguing, among other things, that Lender's objections to the plan were meritless.

[10] In *Thorpe*, we noted that in evaluating whether any remedy would unduly affect innocent third parties, “[a]n important consideration is whether all the parties affected by the appeal are before the court.” *In re Thorpe*, 677 F.3d at 882. Reorganized Debtors are a party to this appeal, and SWVP called itself an appellee—and participated as such—in the first stage of this appeal in the district court. Counsel for SWVP has not appeared in the proceedings before this court, but regardless of whether that means SWVP is not “before the court” in the sense anticipated by *Thorpe*, the involvement SWVP had at every other step in the process means it is not an innocent third party. Indeed, when a sophisticated investor such as SWVP helps craft a reorganization plan that “press[es] the limits” of the bankruptcy laws, appellate consequences are a foreseeable result. *Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 244 (5th Cir.2009).¹¹

2. Section 1129(a)(10)'s Accepting–Class Requirement

[11] Lender suggests that there would be two possible remedies if it prevailed on appeal on its argument that  § 1129(a)(10)'s requirement should be applied to each Debtor. First, Lender argues that it could be compensated for the plan's having extinguished the collateral of its mezzanine loan. Second, Lender argues that the liens on the ownership interest in the now-Reorganized Debtors could be reinstated.

Reorganized Debtors have not shown how either of these proposed forms of relief would affect innocent third parties. Instead, Reorganized Debtors' arguments focus on the effect that allowing the appeal to go forward would have on SWVP. But the two forms of relief sought—distribution *1171 of money from Reorganized Debtors to Lender or reinstatement of Lender's liens—would alter only the relationship between Reorganized Debtors and Lender. See, e.g., *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 34 (9th Cir. BAP 2008) (finding that reinstatement of a lien would not affect third parties). Even if SWVP would be affected indirectly through the impact on Reorganized Debtors, SWVP's involvement in the reorganization process means that it is not the type of innocent third party that

the third prong of the equitable mootness test is designed to protect.

D.

[12] The fourth, and most important, consideration in the equitable mootness test is whether the bankruptcy court could fashion equitable relief without completely undoing the plan.

See *Mortgages II*, 771 F.3d at 629; *In re Thorpe*, 677 F.3d at 883. Even if the relief would be only partial, “[w]here equitable relief, though incomplete, is available, the appeal is not moot.” *In re Thorpe*, 677 F.3d at 883.

1. The Exception to the Due-on-Sale Clause

[13] Lender seeks elimination of the exception to the due-on-sale clause. Lender's argument in support is that allowing a sale of the hotels subject to the restructured loan frustrates the intended purpose of the § 1111(b) election. We need not and should not consider the merits of that argument given that our present task is only to determine whether equitable mootness prevents the district court from considering the argument at all. It is sufficient for now to understand that, if Lender succeeded on the merits of this argument, eliminating the exception to the due-on-sale clause would give Lender complete relief.

Even if Lender were successful on the merits, however, the potential options for relief would not necessarily be limited to eliminating the full exception. Because even incomplete relief can be enough to counsel against mooting the appeal, see *Mortgages II*, 771 F.3d at 629, we have to ask whether there are any forms of even partial relief that could be provided without unravelling the plan. We can think of two examples of potential partial relief. First, the bankruptcy court could reduce the length of the window during which the due-on-sale clause does not apply. Second, the court could decide that, if a sale occurred during the window, Lender would be entitled to some percentage of the difference between the remainder of the total loan amount and the loan's present value.

Reorganized Debtors insist that any relief would be inequitable. Their position implies that were the court to narrow the window of the exception by one day—or, in the case of a sale during the period of the exception, to award Lender one percent of the difference between the remainder of the total loan amount and the loan's present value—that would

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undermine the entire plan. We see no reason why this would be true, and Reorganized Debtors have offered none.¹²

Additionally, Reorganized Debtors' present contention that altering the exception to the due-on-sale clause would unravel the *1172 economics of the plan is in tension with the positions SWVP (filing briefs as a self-termed "interested party," before the reorganization took place) and the original Debtors advocated in the bankruptcy and district courts. SWVP and Debtors both actively opposed the stay sought by Lender in the bankruptcy and district courts, arguing that there would be no likelihood of irreparable harm absent a stay. In doing so, SWVP specifically stated that Lender had not demonstrated how "substantial consummation of the Confirmed Plan would, in fact, moot its appeal." Debtors argued that there would be no "immediate harm" from the plan's exception to the due-on-sale clause because the exception would not arise until "approximately January 2017," and that "[i]t [wa]s entirely speculative whether such a sale would ever occur." These prior positions by their predecessors-in-interest severely undermine Reorganized Debtors' argument before this court that the exception to the due-on-sale clause was a fundamental component of the transaction and that it cannot now be eliminated or altered without unraveling the plan.

2. Section 1129(a)(10)'s Accepting-Class Requirement

 Section 1129(a)(10) requires that, in order to confirm a plan, at least one impaired class of claims must vote in favor of the plan. Lender's second objection was that  § 1129(a)(10)'s requirement that there be an impaired class voting for the plan should apply to each individual debtor, not to the plan as a whole. Because Lender, in its position as the sole creditor of the Mezzanine Debtors, voted against the plan, Lender argued that this requirement was not satisfied here.

If Lender succeeded on the merits of this argument, it would have shown that, under the Bankruptcy Code, it had the right to veto the plan at the confirmation stage.¹³ Even if we assume that vetoing the entire plan is no longer an available form of relief, though, we must again ask whether there is any other remedy that could be crafted to address Lender's claim.

[14] Logically, the value of Lender's ability to veto was worth somewhere between nothing and \$39 million—the total value of Lender's claims against the Mezzanine Debtors. Under 11 U.S.C. § 1126(f), a class of claims that is not

impaired (meaning the plan does not alter its rights) is deemed to automatically accept the plan. Accordingly, if Lender's mezzanine claim had been paid in full, the mezzanine claim would have been deemed to have voted for the plan. Making that payment now (or, at least, that payment *1173 plus interest) would thus seem to eliminate the  § 1129(a)(10)

objection. A lesser payment may not eliminate the  § 1129(a)(10) objection altogether, but would at least offer a partial remedy. And we see no reason why, if the court were to devise a remedy that required Reorganized Debtors to pay Lender one dollar, for example, the plan would be undone.

See  *In re Thorpe*, 677 F.3d at 883 (holding that equitable remedies "vest great discretion in a court devising a remedy").

* * *

We conclude that Lender's appeal is not equitably moot. Although the plan has been substantially consummated, Lender was diligent about seeking a stay, and it would be possible to devise an equitable remedy for each objection that would not bear unduly on innocent third parties.

III.

For the foregoing reasons, we **REVERSE** the district court's dismissal for equitable mootness and **REMAND** for further proceedings.

M. SMITH, Circuit Judge, dissenting:

I respectfully dissent.

The majority wrongly concludes that the interests of Southwest Value Partners (SWVP), a third-party investor with no pre-petition interest in this bankruptcy, should not inform our assessment of whether it would be prudent or equitable to disturb this reorganization plan at this late stage. It is only by ignoring these interests that the majority is able to conclude that any equitable remedies would be available in this case. In reality, the remedies the Lender proposes are grossly inequitable to SWVP and would surely jeopardize the reorganization. More broadly, the majority's decision discourages potential investors from relying on the finality of bankruptcy court confirmation orders, or from investing in struggling properties until all bankruptcy litigation is concluded, which, as in this case, can take many years. This

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impedes the Bankruptcy Code's goal of "maximizing debtors' estates and facilitating successful reorganization," to the detriment of both debtors and creditors.  *In re Continental Airlines*, 91 F.3d 553, 565 (3d Cir.1996).

The majority and I agree that this plan has been substantially consummated, and that this factor weighs in favor of finding this appeal equitably moot. We disagree, however, regarding just how much weight the factor should carry. While I agree that "the fact that a plan is substantially consummated ... does not, by itself, render an appeal moot," *In re Mortgages Ltd.*, 771 F.3d 623, 629 (9th Cir.2014) (internal quotation marks omitted), substantial consummation should be our "foremost consideration" in assessing equitable mootness, see  *In re Continental Airlines*, 91 F.3d at 560. Indeed, as the majority acknowledges, many of our sister circuits have held that substantial consummation creates a *presumption* of equitable mootness. See  *Aetna Cas. & Sur. Co. v. LTV Steel Co. (In re Chateaugay Corp.)*, 94 F.3d 772, 776 (2d Cir.1996); *Rochman v. Ne. Utils. Serv. Grp.* ( *In re Pub. Serv. Co. of N.H.*), 963 F.2d 469, 473 n. 13 (1st Cir.1992);  *In re AOV Indus., Inc.*, 792 F.2d 1140, 1149 (D.C.Cir.1986). While we have not recognized such a presumption, nothing in our precedents suggests that we should not accord significant weight to substantial consummation in determining whether an equitable and effective remedy is available. Cf. *In re Mortgages*, 771 F.3d at 629 (recognizing that "[s]ubstantial consummation of a bankruptcy plan often brings with it a comprehensive change in circumstances that renders appellate review of the merits of the plan impractical," but that courts must still consider whether it is possible to "fashion effective relief").

*1174 I strongly disagree with the majority's conclusion that the equitable mootness doctrine is not meant to protect the interests of a third-party investor in SWVP's position. The majority concludes that we should not consider how the proposed remedies will affect SWVP's interests because SWVP participated in the bankruptcy proceedings, and, to some extent, in this appeal. But we have never held that we may ignore a third-party investor's interests merely because the third party participated in the proceedings. The majority relies in part on the Fifth Circuit's decision  in *Bank of New York Trust Co. v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir.2009). However, that case involved a reorganization plan that had been crafted by a creditor and a competitor of the debtor.

 *Id.* at 238. It was therefore at least arguably fair to discount the creditor and competitor's interests in deciding whether the appeal was equitably moot, since they were responsible for the deficiencies in the plan. *Id.* There is no indication that SWVP had any connection to this case until the Debtors approached it to fund a reorganization plan the debtors had already crafted. In fact, a different third-party investor initially agreed to fund the plan. It was only after the first investor unexpectedly declined to pursue the transaction that SWVP agreed to make an investment on terms that were substantially similar to those the Debtors had previously negotiated with the other third-party investor. Once SWVP agreed to fund the plan, it was only natural that it would be involved in the bankruptcy proceedings, since its investment was the very reason the proposed reorganization was feasible.

See  *In re GWI PCS I Inc.*, 230 F.3d 788, 801–02 (5th Cir.2000) (rejecting argument that "insiders" "lack[ed] good faith reliance on the reorganization plan," and noting that "it would be natural for many, if not a majority, of the transactions set forth in a reorganization plan to involve the participants of the chapter 11 proceedings").

The majority suggests that SWVP was not entitled to rely on the finality of the confirmation order because it could reasonably foresee that the order would be appealed. This argument unduly focuses on the reasonableness of SWVP's reliance, rather than on the compelling reasons why investors should be affirmatively *encouraged* to rely on the finality of confirmation orders. As the Third Circuit has observed,

[o]ur inquiry should not be about the "reasonableness" of the Investors' reliance or the probability of either party succeeding on appeal. Rather, we should ask whether we want to encourage or discourage reliance by investors and others on the finality of bankruptcy confirmation orders. The strong public policy in favor of maximizing debtors' estates and facilitating successful reorganization, reflected in the Code itself, clearly weighs in favor of encouraging such reliance. Indeed, the importance of allowing approved reorganizations to go forward in reliance on bankruptcy court confirmation orders may be the

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central animating force behind the equitable mootness doctrine.

 *In re Continental Airlines*, 91 F.3d at 565. This case illustrates perfectly why encouraging reliance on bankruptcy confirmation orders is critical to facilitating complex reorganizations. Once a third party like SWVP invests to improve the debtors' capital, to the benefit of creditors and debtors alike, it is much more difficult for it to walk away if the terms of its bargain are altered on appeal. The rule the majority endorses ignores the realities of the marketplace, and creates strong incentives for investors to delay funding improvements until after the appeal is completed, which *1175 may take years. It has already taken approximately three years since SWVP funded the plan in this case. Had SWVP waited to fund improvements, the Debtors' hotels would still be depreciating in value, and perhaps might even have been abandoned for want of funding. This would have negatively impacted the Lender by decreasing the value of its collateral and impeding, or terminating, the ability of the Debtors to generate cash flow and service their debt. Worse, the majority approach discourages third parties from agreeing to make these kinds of post-confirmation investments in the first instance. This is likely to detrimentally impact both creditors and debtors by decreasing the value of debtors' estates *ex ante* and making it more difficult to facilitate workable reorganizations. As the Seventh Circuit has eloquently observed:

Every incremental risk of revision on appeal puts a cloud over the plan of reorganization, and derivatively over the assets of the reorganized firm. People pay less for assets that may be snatched back or otherwise affected by subsequent events. Self-protection through the adjustment of prices may affect the viability of the reorganization, and in any event may distort the allocation of assets away from the persons who can make the most valuable uses of them and toward persons who are less sensitive to the costs of *ex post* changes of plans. By protecting the interests of persons who acquire assets in reliance on a plan of

reorganization, a court increases the price the estate can realize *ex ante*, and thus produces benefits for creditors in the aggregate.

 *In re UNR Indus., Inc.*, 20 F.3d 766, 770 (7th Cir.1994), *cert. denied*, 513 U.S. 999, 115 S.Ct. 509, 130 L.Ed.2d 416 (1994). Once this plan was confirmed, and once the Lender's request for a stay was denied, the very success of the reorganization depended on SWVP promptly funding improvements in reliance on the confirmation order. Reliance should be encouraged here, not discouraged.

There is another reason we absolutely must consider the impact the proposed remedies will have on SWVP. To determine whether this appeal is equitably moot, we must assess whether the remedies will “completely knock[] the props out from under the plan and thereby creat[e] an uncontrollable situation for the bankruptcy court.”  *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869, 881 (9th Cir.2012). Because the success of the entire reorganization plan hinges on SWVP's continued investment, answering this question requires us to predict whether SWVP will still consider this transaction attractive if the requested remedies are imposed.

There is ample reason to believe that incorporating the proposed remedies into the reorganization plan could cause SWVP to stop funding improvements and divest. The Lender suggests that “the bankruptcy court could compensate Lender for the value of its extinguished collateral by amending the Plan to provide a distribution to Lender equal to the approximately \$30 million that SWVP paid for the new ownership interests in the reorganized Debtors.” For all practical purposes this would amount to a distribution of money from SWVP to the Lender, since SWVP owns the Reorganized Debtors and was the source of their capital. There is no indication in the record that SWVP is obligated to invest in the Reorganized Debtors and continue to fund improvements if the plan is unwound. Therefore, if the confirmation order is vacated, the only thing keeping SWVP at the table will be its substantial sunk costs. The bankruptcy court could try to force the Reorganized Debtors to pay the Lender and hope that SWVP's sunk costs deter it from divesting. *1176 But it is unlikely that SWVP will look favorably upon a plan that requires its wholly owned

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subsidiaries to pay an extra \$30 million, the amount of SWVP's investment under the original plan, to the Lender.

Nor is it likely that SWVP will view the other two proposed remedies any more favorably. The Lender suggests that “the bankruptcy court could replace Lender's collateral by providing Lender with a lien on the ownership interests in the reorganized Debtors.” The Lender does not explain why SWVP would wish to continue to invest in renovating the properties of the Reorganized Debtors if its ownership interest was suddenly subject to a lien. The other remedy the Lender proposes, full due-on-sale protections, would also fundamentally alter the economics of the transaction. SWVP's right to sell the hotels after five years was undoubtedly an essential feature of SWVP's bargain.

Even if the proposed remedies could be imposed on SWVP without jeopardizing its commitment to funding the improvements, it would not be equitable to do so. As the majority recognizes, we must address each of the Lender's claims separately. The Lender's first claim is that the ten-year exception to the due-on-sale clause should be removed because it negated the Lender's § 1111(b) election. However, it does not appear that the original loan even contained a due-on-sale provision. Instead, the original loan permitted transfers of the properties on substantially similar terms as the ten-year exception to the due-on-sale clause contained in the reorganization plan. The Lender is therefore seeking greater protections than it had under the original loan. It would not be equitable to upset the plan at this juncture to provide protections that the Lender has no reasonable basis to expect.

The Lender's second claim is that the Mezzanine Debtors did not have any impaired class of creditors voting for the plan. The Lender acquired the mezzanine loan after the plan was proposed, knowing that the plan, if confirmed, would extinguish the mezzanine loan's collateral. That collateral was worthless, because it consisted of the Mezzanine Debtors' equity interest in the deeply insolvent Operating Debtors. Therefore, as the majority acknowledges, the mezzanine loan

only had value because, according to the Lender's view of the law, it allowed the Lender to veto the plan.

The majority concludes that this issue is not equitably moot because the bankruptcy court can compensate the Lender for the loss of its veto right by, for instance, “requir[ing] [the] Reorganized Debtors to pay [the] Lender one dollar.” The availability of this relief does not justify upsetting the plan at this stage. It will generally be possible to award a nominal sum without wholly upsetting the economics of the plan. However, if this nominal remedy qualified as the “effective and equitable relief” required by our equitable mootness cases, see  *In re Thorpe*, 677 F.3d at 881, a remedy would always be available and no case would ever be equitably moot. The proper inquiry here is not only whether some nominal sum could be awarded, but whether it is prudent and fair at this juncture to vacate the confirmation order and jeopardize this reorganization.

I conclude that it is neither prudent nor fair. The majority would have us upset this successful reorganization for the sole purpose of vindicating the Lender's purported right to thwart a viable plan of reorganization, a right it strategically acquired on the eve of confirmation. This strongly conflicts with the Bankruptcy Code's purpose of promoting successful reorganization.  *In re Continental Airlines*, 91 F.3d at 565. The public interest in promoting reliance on the finality of bankruptcy *1177 court confirmation orders, as well as basic fairness to SWVP, now greatly outweigh the Lender's interest in receiving compensation for its strategically acquired veto right.

I respectfully dissent.

All Citations

801 F.3d 1161, 74 Collier Bankr.Cas.2d 658, 15 Cal. Daily Op. Serv. 10,342, 2015 Daily Journal D.A.R. 10,624

Footnotes

- 1 The amount of the claim consisted of the principal amount of the mortgage loan (\$209 million) plus interest, fees, and premiums. The bankruptcy court then disallowed the premiums and reduced the amount to approximately \$247 million.
- 2 The amount of the claims consisted of the principal amount of the mezzanine loan (\$21.5 million) plus interest, late fees, and \$10 million the Mezzanine Debtors were required to pay back because they failed to make certain promised improvements.

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- 3 If Lender had not made the § 1111(b) election, then its claim would have been bifurcated into (1) a secured claim equal to the value of the collateral (\$92 million) and (2) an unsecured claim for the remainder. See 11 U.S.C. § 506(a)(1).
- 4 The original loan agreement between Operating Debtors and Lender also contained restrictions on the ability to sell the properties.
- 5 In bankruptcy reorganizations, claims against the debtor are grouped into classes according to their rights vis-à-vis the debtor. See 11 U.S.C. § 1122; 7 Collier on Bankruptcy ¶ 1122.01 (16th ed. 2012) (“Section 1122 ... provides a plan proponent with an important tool in aid of confirmation of a plan—namely, the ability to classify substantially similar claims in the same class for purposes of voting and treatment.”). A class accepts the plan when at least two-thirds in amount and more than one-half in number of the claims in the class vote in favor. 11 U.S.C. § 1126(c). Generally, for a plan to be confirmed, every class must either vote in favor of the plan or receive full payment. See id. § 1129(a)(8); but see id. § 1129(b) (setting forth an exception to this rule, for confirmation of nonconsensual cram down plans).
- 6 The Bankruptcy Code allows a plan proponent to confirm—or “cram down”—a plan over the dissent of a class as long as certain requirements for nonconsensual confirmation are met. See 11 U.S.C. § 1129(b); RadLAX Gateway Hotel, LLC v. Amalgamated Bank, — U.S. —, 132 S.Ct. 2065, 2069, 182 L.Ed.2d 967 (2012) (“Section 1129(b) creates an exception to that general rule, permitting confirmation of nonconsensual plans—commonly known as ‘cramdown’ plans—if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”).
- 7 Lender cites to the following treatise passage to support its argument that the sale of the hotels subject to the restructured loan would undermine its § 1111(b) election:

Assume a debtor with a first mortgage debt of \$10,000,000. At the time of the bankruptcy petition the court determines that the value of the mortgage real estate is \$7,500,000.... Assume ... that our creditor makes the [§ 1111(b)] election and so is left after confirmation with a \$10,000,000 mortgage. Just as he predicted, real estate values reverse themselves and the debtor makes an agreement to sell the property for \$12,000,000 to a third party. When the creditor appears at the closing to receive its \$10,000,000, the debtor says: “Not so fast. I have sold the property subject to the mortgage. You will continue to get your payments because my purchaser has assumed the mortgage and I remain liable on it, but the only cash available is the \$2,000,000 above the \$10,000,000 and that goes to me.” To make section 1111(b)(2) even remotely fair, this sort of activity should be prohibited. Surely the policy behind section 1111(b)(2) demands that the court infer a “due on sale” clause in any such mortgage whether one exists or not.

David G. Epstein et al., Bankruptcy § 10–27, at 776, 778 (1993). In this case, sale of the hotels subject to a due-on-sale clause would entitle Lender to immediate payment of the remainder of the total loan amount. If the sale occurred during the exception to the due-on-sale clause, however, Lender would continue to receive only a stream of payments with a net present value lower than the total loan amount.
- 8 Appeals from bankruptcy courts in this circuit may be heard in the first instance by either a district court or the Ninth Circuit's bankruptcy appellate panel (“BAP”). See 28 U.S.C. § 158(a)-(b). Lender's appeal was initially referred to the BAP, but Debtors and SWVP exercised their right to object to proceeding before the BAP, so the appeal was heard by the district court. See id. § 158(c)(1). A party seeking review of a decision from the district court or the BAP may appeal to this court, id. § 158(d), as Lender did here.
- 9 The doctrine of equitable mootness is not without its critics. See, e.g., In re Cont'l Airlines, 91 F.3d 553, 567–73 (3d Cir.1996) (in banc) (Alito, J., dissenting) (questioning the legal basis for equitable mootness).
- 10 The dissent ignores the role that SWVP had in negotiating the final confirmation order. SWVP and Lender negotiated numerous aspects of the plan documents. Ultimately, they were not able to agree on two issues—the subjects of the two objections to the plan that Lender then challenged on appeal. SWVP chose to go forward with the confirmation process despite its awareness of Lender's objections.
- 11 The dissent warns that, by saying that SWVP is not an innocent third party, we risk reducing the amount investors will be willing to pay for reorganized entities. Yet, if we allow SWVP to stick to a plan that may violate the Bankruptcy Code and prevent Lender from arguing its objections on appeal, we risk decreasing potential lenders' incentives to make loans in the first place. The Fifth Circuit in Pacific Lumber aptly warned that “[a]pplying equitable mootness too broadly to disfavor appeals challenging the treatment of secured debt carries a price. It may promote the confirmation of reorganization plans, but it also destabilizes the credit market for financially troubled companies.” 584 F.3d at 244 n. 19.

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Moreover, investors involved in the reorganization process have substantial control over the risk that a plan will be revised due to an appeal. Here, for example, SWVP could have continued negotiating a resolution of Lender's objections before the parties agreed to the final confirmation order, or SWVP could have declined to participate in the plan given that Lender's objections remained outstanding. *See supra* note 10.

- 12 The dissent delves into the merits of Lender's objection, arguing that Lender is asking for more than it had pre-bankruptcy, that providing the precise form of relief Lender has requested would be inequitable, and that the requested relief might even cause SWVP to divest from the hotels. Perhaps these are arguments that could persuade the bankruptcy court on remand from an appellate victory by Lender on the merits. But our task at this juncture is merely to determine whether, if Lender succeeded on the merits, an equitable remedy could be fashioned.

We also disagree with the dissent's suggestion that a nominal remedy will always be available, preventing any case from being equitably moot. When true third parties have acted in reliance on a plan, there may be instances in which any

plan amendment would unfairly undermine that reliance. *See, e.g.,*  *In re Pac. Lumber*, 584 F.3d at 251 (“[W]e must hold [the lender's] impairment and classification contentions equitably moot. Because the plan has been substantially consummated, the smaller unsecured creditors—irrespective of their status vis à vis the reorganized companies—have received payment for their claims. Third-party expectations cannot reasonably be undone, and no remedy for [the lender's] contentions is practicable other than unwinding the plan.”).

- 13 To the extent that Reorganized Debtors argue that Lender was acting in bad faith by acquiring the mezzanine loan to improve its leverage in negotiations about the mortgage loan, that argument was already litigated before the bankruptcy court. Debtors filed a motion arguing that Lender had acquired the mezzanine loan in bad faith and that the court should therefore designate Lender pursuant to 11 U.S.C. § 1126(e). (In this context, designate means disqualify from voting.) The bankruptcy court denied Debtors' motion. Reorganized Debtors could have filed a cross appeal in the district court to contest that ruling but did not.

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This case was not selected for publication in West's Federal Reporter. See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also U.S.Ct. of Appeals 4th Cir. Rule 32.1. United States Court of Appeals, Fourth Circuit.

IN RE: PROVINCE GRANDE OLDE
LIBERTY, LLC, a/k/a Silver Deer
Olde Liberty AA Lots, LLC, Debtor.
Pem Entities, LLC, Appellant,
v.
Province Grande Olde Liberty, LLC, Defendant,
and
Eric M. Levin; Howard
Shareff, Creditors—Appellees.

No. 15–1669

Argued: May 10, 2016

Decided: August 12, 2016

Synopsis

Background: Creditors brought adversary proceeding to equitably subordinate or recharacterize certain debt. The United States Bankruptcy Court for the Eastern District of North Carolina, [Randy D. Doub, J.](#), 2014 WL 6901052, granted creditors' motion for summary judgment on recharacterization claim, and appeal was taken. The District Court, [James C. Dever III](#), Chief Judge, affirmed. Appeal was taken.

[Holding:] The Court of Appeals held that bankruptcy court's decision to recharacterize the \$300,000 contributed by limited liability company's (LLC's) members to pay off earlier loan as equity contribution to debtor was sufficiently supported by evidence.

Affirmed.

Procedural Posture(s): Motion for Summary Judgment.

West Headnotes (1)

[1] Bankruptcy **Weight and sufficiency**

Bankruptcy court's decision to recharacterize the \$300,000 contributed by limited liability company's (LLC's) members to pay off earlier loan as equity contribution to debtor was sufficiently supported by evidence, including evidence of identity of interest that existed between debtor and LLC, of debtor's inability to obtain financing from any other source, and of parties' failure to observe such formalities as payment schedules, actual interest payments or even a ledger.

***972** Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh. James C. Dever III, Chief District Judge. (5:14-cv-00889-D; 8:13-01563; 8:13-00122)

Affirmed by unpublished per curiam opinion.

Attorneys and Law Firms

Argued: [John Arlington Northen](#), Northen Blue, LLP, Chapel Hill, North Carolina, for Appellant. [James C. White](#), Law Office of James C. White, P.C., Chapel Hill, North Carolina, for Appellees. On Brief: [Vicki L. Parrott](#), [John Paul H. Cournoyer](#), Northen Blue, LLP, Chapel Hill, North Carolina, for Appellant. [Michelle M. Walker](#), Law Office of James C. White, P.C., Chapel Hill, North Carolina, for Appellees.

Before [GREGORY](#), Chief Judge, [TRAXLER](#), Circuit Judge, and [Joseph F. ANDERSON, Jr.](#), Senior United States District Judge for the District of South Carolina, sitting by designation.

Opinion

Unpublished opinions are not binding precedent in this circuit.

PER CURIAM:

PEM Entities, LLC (“PEM”) appeals the district court’s order affirming the bankruptcy court’s grant of summary judgment in favor of Eric M. Levin and Howard Shareff (“Appellees”). Specifically, PEM contests the bankruptcy court’s recharacterization of certain debt into equity. For the following reasons, we affirm the decision of the district court.

I.

This case arises out of several North Carolina real estate investments involving Howard Jacobsen (“Howard”). Lakebound Fixed Return Fund, LLC (“Lakebound”) is a company formed to invest in real estate and provide a fixed, high-yield return to its investors. Lakebound is managed by Howard. Appellees invested \$500,000.00 each into Lakebound. Province Grande Olde Liberty, LLC (“Debtor”) is an entity formed by Howard for the purpose of acquiring the Olde Liberty Golf and Country Club (“Golf Club”), a golf and residential real estate development in Franklin County, North Carolina. Debtor’s membership included Howard, his parents—Stanley and Rhonda Jacobsen—and Robert B. Conaty.

***973** To finance the acquisition of the Golf Club, Debtor obtained \$188,000.00 from Lakebound and borrowed \$6,465,000.00 from Paragon Commercial Bank (“Paragon”). The transfer of \$188,000.00 from Lakebound to Debtor is the subject of ongoing litigation in North Carolina state court and provides a basis for Appellees’ claims in the underlying bankruptcy proceeding. Specifically, Appellees contend that this transfer was a misappropriation of Lakebound’s funds. The \$6,465,000.00 loan from Paragon was an arms-length transaction evidenced by a promissory note and secured by a deed of trust on the Golf Club property.

In 2010, Debtor defaulted on the Paragon loan. The following year, Paragon initiated foreclosure proceedings on the real estate security. In an effort to resolve the loans to Debtor and other entities, Howard, Debtor, and several other related entities entered into a settlement agreement with Paragon. Under that agreement, Paragon agreed to sell its \$6,465,000.00 loan to a new company, PEM, for the discounted price of \$1,242,000.00. PEM is a Delaware company, owned by Stanley Jacobsen—Howard’s father, Robert B. Conaty, and an entity owned by trusts established by Stanley Jacobsen for the benefit of his grandchildren (“the Trust”).

Importantly, PEM’s members did not negotiate the settlement agreement. Rather, Debtor’s principals, including Howard Jacobsen, negotiated the agreement that purported to be “in settlement of the Loan.” Paragon understood that Debtor’s principals had the authority to bind PEM. Further, the settlement agreement bound Paragon to sell the loan to PEM for a fixed price and even included an outline of the financing of the loan’s purchase. PEM, however, was not a signor of the settlement agreement.

To fund the loan purchase provision of the settlement agreement, PEM used both equity contributions from its members as well as outside debt. Stanley Jacobsen contributed \$130,000.00, Conaty contributed \$100,000.00, and the Trust contributed \$70,000.00. Together, these three contributions totaled \$300,000.00.

PEM relied on financing to assemble the remainder of purchase price. Two individuals, Joseph Deglomini and Joseph Simone (collectively “D&S”), loaned PEM \$650,000.00. Additionally, Paragon agreed to loan PEM the final \$292,000.00, interest free, needed to complete the settlement. Both loans were secured by Golf Club real estate owned not by PEM, but by Debtor. Finally, PEM agreed to subordinate its position in the security to the loans from both D&S and Paragon.

After the completion of the settlement agreement, Debtor sold some of its property for \$462,146.15. From those funds, Debtor paid \$240,120.00 directly to Paragon and D&S in partial payment of the loans those entities made to PEM. Debtor transferred \$202,087.71 to PEM. Shortly thereafter, PEM “re-advanced” \$50,000.00 to Debtor for miscellaneous operating expenses. At no time did PEM or Debtor maintain any ledger or account of the Paragon loan. Several other cash transfers went between Debtor and PEM and Howard sometimes called “loans” and other times “readvances.”

Debtor filed its bankruptcy petition on March 11, 2013. In that filing, it listed PEM’s claim at \$7,000,000, including the principal from the Paragon loan and accrued interest. Additionally, it listed Appellees as creditors with unknown and disputed claims. Appellees filed claims in the Debtor’s bankruptcy proceeding in the amount of \$500,000.00 each. They made claims for equitable subordination and recharacterization and also statutory claims ***974** for avoidance and recovery of allegedly fraudulent transfers. The parties moved for summary judgment on all claims.

The bankruptcy court granted summary judgment in favor of Appellees on their equitable claim of recharacterization. Specifically, the bankruptcy court concluded that the PEM's loan purchase was, in effect, a settlement and satisfaction of the Paragon loan. The court recharacterized the \$300,000.00 portion of the \$1,242,000.00 paid by PEM pursuant to the settlement agreement from a debt owed it by Debtor into an equity investment in Debtor. Thus, the court rendered PEM's \$7,000,000.00 claim void.

PEM appealed the bankruptcy court's order to the United States District Court for the Eastern District of North Carolina. In its *de novo* review, the district court found the bankruptcy court correctly applied the law and affirmed its judgment. PEM timely filed its Notice of Appeal to this Court.

II.

A.

Recharacterization is well within the broad powers afforded a bankruptcy court.  [In re: Official Committee of Unsecured Creditors for Dornier Aviation \(North America\), Inc.](#), 453 F.3d 225 (2006). The Bankruptcy Code establishes a scheme in which contributions to capital receive a lower priority than loans because their nature is that of a fund contributed to meet the obligations of a business and which should be repaid only after all other obligations have been satisfied.  [Id.](#) at 231. Thus, adjudication under the Bankruptcy Code often requires a determination of whether a particular obligation is debt or equity.  [Id.](#) When that question is in dispute, the bankruptcy court must make this determination in order to effectuate the priority scheme.  [Id.](#)

In determining whether or not to recharacterize a claim, a bankruptcy court should apply the eleven factors adopted by this Court in  [Dornier](#):

- (1) the names given to the instruments, if any, evidencing the indebtedness;
- (2) the presence or absence of a fixed maturity date and schedule of payments;
- (3) the presence or absence of a fixed rate of interest

and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

 [Id.](#) at 233 (quoting  [Bayer Corp. v. Masco Tech, Inc. \(In re AutoStyle Plastics, Inc.\)](#), 269 F.3d 726, 747-48 (6th Cir. 2001)). None of these eleven factors are themselves dispositive.  [Id.](#) at 234. Rather, their significance varies depending upon the circumstance.  [Id.](#)

B.

In this case, the bankruptcy court weighed each of the  [Dornier](#) factors in analyzing the settlement agreement. The court found that all of them weighed in favor of recharacterization. The court emphasized several facts in drawing its conclusion: (1) the naming of the settlement agreement and the fact that it was entered into "in settlement of the loan"; (2) the fact that Debtor's principals negotiated the settlement agreement and note purchase on behalf of PEM; (3) the failure of both *975 Debtor and PEM to observe any formalities such as payment schedules, actual interest payments or even a ledger; (4) Debtor's total reliance on money from PEM to meet expenses and its inability to obtain any other financing; (5) the identity of interests between Debtor and PEM; and (6) that approximately \$900,000.00 of the \$1,242,000.00 was funded by the pledge of security owned by Debtor. These facts adequately support the bankruptcy court's decision.

PEM contends that the bankruptcy court misapplied the  [Dornier](#) factors by applying them to the wrong transaction. PEM argues that the bankruptcy court should have limited

its analysis to the inception of the Paragon debt rather than to the later settlement agreement. Thus, according to PEM, we should apply the [!\[\]\(c507f772dba2b921f86777f01218e570_img.jpg\) *Dornier*](#) factors to the situation at the time Paragon made the loan to Debtor. We find this argument unpersuasive.

The bankruptcy court's broad recharacterization power is "integral to the consistent application of the Bankruptcy Code." [!\[\]\(4729e517bc6a7cd81c8025b9646574fb_img.jpg\) *Dornier*, 453 F.3d at 233](#). "A bankruptcy court's equitable powers have long included the ability to look beyond form to substance." [!\[\]\(90a2fb2f2c617b26262139ae4159c0a0_img.jpg\) *Id.* at 233](#). The recharacterization decision itself rests on the "substance of the transaction" involved. [!\[\]\(40394d85fb59f1a516df36b5a2680ad2_img.jpg\) *Id.* at 232](#) (emphasis in original).

Here, the settlement agreement is the "substance of the transaction" because it was the basis of the note purchase and gave rise to the PEM's claims. The settlement agreement was negotiated and executed by Paragon and Debtor's principals. While PEM notes that it was neither a party to nor a signor of the settlement agreement, Paragon believed Debtor's principals had the authority to bind PEM. Further, the settlement agreement specifically obligated Paragon to sell the loan to PEM. Indeed, the settlement agreement specifically outlined the sources of PEM's funding. It even obligated Paragon to loan PEM \$292,000.00. Clearly, PEM knew of, participated in, and consented to those terms. While PEM itself may not have been obligated by the settlement agreement, the settlement agreement certainly obligated Paragon towards PEM.

Thus, the bankruptcy court properly "looked beyond form" to determine that the "substance of the transaction" was in fact the settlement agreement in which Debtor used PEM as an extension of itself to complete what was, in effect, a satisfaction of the Paragon loan. Moreover, the bankruptcy court's application of the [!\[\]\(a03a7eb2f4046e1d3c76772003e549ea_img.jpg\) *Dornier*](#) factors adequately supported its recharacterization decision.

C.

PEM challenges several of the bankruptcy court's factual findings. Findings of fact by a bankruptcy court in proceedings within its full jurisdiction are reviewable only for clear error. [!\[\]\(e474458956c9a37fbf9586ddb60a7fa1_img.jpg\) *In re Johnson*, 960 F.2d 396, 399 \(4th Cir. 1992\)](#). Under this standard, we will not reverse a bankruptcy court's factual finding that is supported by the evidence unless

that finding is clearly wrong. [!\[\]\(3e2231b1ad3ca8da8658228c00dd08e0_img.jpg\) *In re ESA Envtl. Specialists, Inc.*, 709 F.3d 388, 399 \(4th Cir. 2013\)](#). We will conclude that a finding is clearly erroneous only if, after reviewing the record, we are left with "a firm and definite conviction that a mistake has been committed." [!\[\]\(96a82dd1250f57fd139c5f3b80c9d977_img.jpg\) *Klein v. PepsiCo, Inc.*, 845 F.2d 76, 79 \(4th Cir. 1988\)](#) (citation omitted).

Of the six errors claimed by PEM, none rise to the level of clear error. First, PEM challenges the court's alleged mischaracterization of both the \$300,000.00 contribution by the members of PEM and the relief requested by Appellees. The bankruptcy court recharacterized the \$300,000.00 portion of the \$1,242,000.00 *976 settlement of the \$7,000,000.00 claim or in other words, exactly the relief sought by Appellees. The court made a detailed explanation of all the intricate moving parts of this complex dispute. To the extent the court failed to clearly explain each moving piece, it was not due to any mistaken fact, but rather to the unwieldy jargon associated with this type of litigation.

Next, PEM contends the court was in error by stating that Stanley Jacobsen was the sole member of PEM at the time of the settlement agreement. This fact appears to be incorrect as the evidence, discussed above, is that the members of PEM were Stanley Jacobsen, Robert B. Conaty, and the Trust. However, this minor mistake does not rise to the level of clear error. First, the court made this mistake in its recitation of undisputed facts. Secondly, the court obviously understood that PEM's membership included all three members at all relevant times. In its analysis of the first [!\[\]\(870f5d5e9c0d57485634be3ecf52f3ca_img.jpg\) *Dornier*](#) factor, the court specifically noted that these three members were responsible for the \$300,000.00.

PEM's four other claims of errors merely reargue the proper application of the [!\[\]\(4fe57c3593bf1b21d272ae7ac8dfaf77_img.jpg\) *Dornier*](#) factors. None constitute clear error.

III.

For the foregoing reasons, the judgment of the district court is **AFFIRMED**.

AFFIRMED

In Re: Province Grande Olde Liberty, LLC, 655 Fed.Appx. 971 (2016)

All Citations

655 Fed.Appx. 971

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In re Fitness Holdings Intern., Inc., 714 F.3d 1141 (2013)

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Declined to Follow by [In re Alternate Fuels, Inc.](#), 10th Cir., June 12, 2015

714 F.3d 1141

United States Court of Appeals,
Ninth Circuit.In the Matter of [FITNESS HOLDINGS](#)[INTERNATIONAL, INC.](#), Debtor.

Official Committee of Unsecured

Creditors, of the Estate of [Fitness](#)[Holdings International, Inc.](#), Appellant,

v.

Hancock Park Capital II, L.P., a Delaware Limited
Partnership; Pacific Western Bank; Kenton VanHarten; Michael Fourticq, Sr.; [Hancock Park
Associates, III](#); [Hancock Park Associates](#), Appellees.

No. 11-56677.

Argued and Submitted Feb. 4, 2013.

Filed April 30, 2013.

Synopsis

Background: Committee of unsecured creditors, acting on behalf of debtor in bankruptcy and its estate, brought action to recover the payments made to debtor's shareholder as a result of refinancing transaction with bank, and seeking declaration that such payments were fraudulent transfers. The United States District Court for the Central District of California, [Andrew J. Guilford, J.](#), 2011 WL 7763674, affirmed the bankruptcy court's dismissal of claims. Debtor's trustee appealed.

Holdings: The Court of Appeals, [Ikuta](#), Circuit Judge, held that:

[1] as a matter of first impression, a transfer is not constructively fraudulent if it is made in repayment of a claim, or right to payment, under state law, and

[2] remand was required to allow district court to apply proper standard.

Vacated and remanded.

Procedural Posture(s): On Appeal; Motion to Dismiss for Failure to State a Claim.

West Headnotes (7)

[1] **Federal Courts** Pleading

District court's dismissal of a trustee's complaint for failure to state a claim is reviewed de novo.

[43 Cases that cite this headnote](#)

[2] **Bankruptcy** Creation of estate; time

Filing a petition in bankruptcy creates an estate made up of the debtor's assets.

[3] **Bankruptcy** Fraudulent conveyances in general

To the extent a transfer constitutes repayment of the debtor's antecedent or present debt, the transfer is not constructively fraudulent. 11 U.S.C.A. § 548(a)(1)(B)(i).

[9 Cases that cite this headnote](#)

[4] **Bankruptcy** Claims allowable; what constitutes "claim."

Bankruptcy Effect of state law, in general

A court may not fashion a rule solely of its own creation in determining what constitutes a claim for purposes of bankruptcy; rather, subject to any qualifying or contrary provisions of the Bankruptcy Code, a court must determine whether the asserted interest in the debtor's assets is a right to payment recognized under state law.

[11 Cases that cite this headnote](#)

[5] **Bankruptcy** "Reasonably equivalent value" in general

A transfer is for "reasonably equivalent value," and thus is not constructively fraudulent, if it

is made in repayment of a claim, or right to payment, under state law.  11 U.S.C.A. § 548(a)(1)(B)(i).

[9 Cases that cite this headnote](#)

[6] **Bankruptcy** “Reasonably equivalent value” in general

In an action to avoid a transfer as constructively fraudulent, if any party claims that the transfer constituted the repayment of a debt, and thus was a transfer for “reasonably equivalent value,” the court must determine whether the purported “debt” constituted a right to payment under state law; if it did not, the court may recharacterize the debtor's obligation to the transferee under state law principles.

[27 Cases that cite this headnote](#)

[7] **Bankruptcy** Remand

Remand was required to allow district court to determine, under correct legal standard, whether debtor's promissory notes to shareholder constituted a right to payment under state law, in order to determine whether such payments were fraudulent transfers, where district court had erroneously concluded that it was barred from considering whether the complaint plausibly alleged that the promissory notes could be recharacterized as creating equity interests rather than debt.  11 U.S.C.A. § 548(a)(1)(B)(i).

[4 Cases that cite this headnote](#)

Attorneys and Law Firms

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Lawrence C. Barth and **M. Lance Jasper** (argued), Munger, Tolles & Olson, LLP, Los Angeles, CA, for Appellees Hancock Park Capital II, L.P., Michael Fourtieg, Sr., Hancock Park Associates, III and Hancock Park Associates.

Appeal from the United States District Court for the Central District of California, **Andrew J. Guilford**, District Judge, Presiding. D.C. No. 2:10-cv-00647-AG.

*1143 Before: **CONSUELO M. CALLAHAN**, **SANDRA S. IKUTA**, and **ANDREW D. HURWITZ**, Circuit Judges.

OPINION

IKUTA, Circuit Judge:

This case presents the question whether a debtor's pre-bankruptcy transfer of funds to its sole shareholder, in repayment of a purported loan, may be a constructively fraudulent transfer under  11 U.S.C. § 548(a)(1)(B). In order to answer this question, we must determine whether a bankruptcy court has the power to recharacterize the purported loan as an equity investment. We hold that a court has the authority to determine whether a transaction creates a debt or an equity interest for purposes of  § 548, and that a transaction creates a debt if it creates a “right to payment” under state law. See  11 U.S.C. § 101(5),  (12);  *Butner v. United States*, 440 U.S. 48, 54, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) (noting that “Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law”). Because the district court concluded that it lacked authority to make this determination, we vacate the decision below and remand for further proceedings. ¹

¹ In this opinion, we address only the trustee's claim for avoidance of a constructively fraudulent transfer under  § 548(a)(1)(B) and his request for declaratory relief (claims 2 and 7 of the First Amended Complaint). We resolve the remaining claims in a memorandum disposition filed concurrently with this opinion.

I

Fitness Holdings International, Inc., the debtor in this bankruptcy case, was a home fitness corporation. Before declaring bankruptcy, the company received significant funding from two entities: Hancock Park, its sole shareholder, and Pacific Western Bank. Defendants Kenton Van Harten and Michael Fourticq both served on Fitness Holdings' board of directors. Fourticq was also a manager of Hancock Park.

Between 2003 and 2006, Fitness Holdings executed eleven separate subordinated promissory notes to Hancock Park for a total of \$24,276,065. Each note required Fitness Holdings to pay a specified principal amount to Hancock Park, plus interest of ten percent per year, on or before the note's maturity date.²

² The maturity dates of the eleven notes were set for September 30, 2006, November 5, 2006, and October 1, 2009.

In July 2004, Pacific Western Bank made a \$7 million revolving loan and a \$5 million installment loan to Fitness Holdings, both of which were secured by all of Fitness Holdings' assets. Hancock Park guaranteed these loans. Fitness Holdings and Pacific Western Bank amended the loan agreement multiple times. The amendments eased Fitness Holdings' obligations in various ways, for example, by extending the maturity dates on the revolving loan and waiving past breaches.

Finally, in June 2007, Fitness Holdings and Pacific Western Bank agreed to refinance Fitness Holdings' debt. Under the terms of the agreement, Pacific Western Bank made two loans to Fitness Holdings: a \$17 million term loan, and an \$8 million revolving line of credit. These loans were also secured by all of Fitness Holdings' assets. The loan agreement provided that upon closing, \$8,886,204 would be disbursed to pay off Pacific Western Bank's original secured loan, and \$11,995,500 would be disbursed to Hancock Park to pay off its unsecured promissory notes. The payoff of Pacific Western Bank's prior ***1144** secured loan had the effect of releasing Hancock Park from its guarantee.

These attempts to save Fitness Holdings proved unsuccessful, and the company filed for Chapter 11 bankruptcy on October 20, 2008. A committee of unsecured creditors, acting on behalf of Fitness Holdings and its estate, filed a complaint

against Hancock Park, Pacific Western Bank, Van Harten, and Fourticq to recover the payments made to Hancock Park as a result of the refinancing transaction with Pacific Western Bank. The complaint also requested declaratory relief, asking the court to characterize the financing Hancock Park provided to Fitness Holdings in connection with the promissory notes as equity investments in Fitness Holdings, rather than extensions of credit. As a result, the complaint alleged, the transfer of \$11,995,500 to Hancock Park was constructively fraudulent.

On January 15, 2010, the bankruptcy court dismissed all claims against Hancock Park with prejudice. The case was subsequently converted to a Chapter 7 filing on April 6, 2010, *In re Fitness Holdings Int'l, Inc.*, No. 2:08-bk-27527-BR, Dkt. # 291 (Bankr.C.D.Cal. April 6, 2010). The following month, the bankruptcy court appointed a trustee for Fitness Holdings, who replaced the committee of unsecured creditors in the litigation.

The trustee appealed the bankruptcy court's dismissal of the complaint to the district court, which affirmed the bankruptcy court and dismissed the case for failure to state a claim.  *In re Fitness Holdings Int'l, Inc. (Fitness I)*, No. CV 10-0647 AG, 2011 WL 7763674, *1 (C.D.Cal. Aug. 31, 2011). The district court held that, under longstanding precedent of the Ninth Circuit Bankruptcy Appellate Panel, Hancock Park's advances to Fitness Holdings were loans and, as a matter of law, it was barred from recharacterizing such loans as equity investments.  *Id.* at *5 (citing  *In re Pacific Express*, 69 B.R. 112, 115 (B.A.P. 9th Cir.1986)).³

³ The district court erred in holding it was bound by a decision of the Bankruptcy Appellate Panel. See  *Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 472 (9th Cir.1990) ("As article III courts, the district courts must always be free to decline to follow BAP decisions and to formulate their own rules within their jurisdiction.").

The trustee timely appealed, claiming that the district court should have: (1) recharacterized Hancock Park's payment of \$11,995,500 to Fitness Holdings as a payment in satisfaction of an equity interest rather than a debt, and then (2) avoided Fitness Holdings' \$11,995,500 transfer to Hancock Park as a constructively fraudulent transfer under  § 548(a)(1)(B) of the Bankruptcy Code.

II

[1] We have jurisdiction under 28 U.S.C. §§ 158(d)(1) and 1291. Because the district court dismissed the trustee's complaint for failure to state a claim, we review de novo. *Telesaurus VPC, LLC v. Power*, 623 F.3d 998, 1003 (9th Cir.2010). In order to survive a motion to dismiss, a party must allege “ ‘sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.’ ”

Id. (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009)). “A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” *Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937. In reviewing a dismissal for failure to state a claim, “[a]ll well-pleaded allegations of material fact in the complaint are accepted as true and are *1145 construed in the light most favorable to the non-moving party.” *Faulkner v. ADT Sec. Servs., Inc.*, 706 F.3d 1017, 1019 (9th Cir.2013).

A

We begin by setting forth the legal framework for fraudulent transfers under § 548(a)(1)(B) of the Bankruptcy Code.⁴

⁴ The trustee brought a “recharacterization” claim as a separate cause of action (claim 7 of the First Amended Complaint). We interpret this claim as a request for a determination that Fitness Holdings' transfer to Hancock Park was not made in repayment of a “debt” as that term is defined in the Code. 11 U.S.C. § 101(12).

[2] Filing a petition in bankruptcy creates an estate made up of the debtor's assets. *Schwab v. Reilly*, 560 U.S. 770, 130 S.Ct. 2652, 2657, 177 L.Ed.2d 234 (2010). In a Chapter 7 bankruptcy, a trustee is appointed or elected to administer the estate. 11 U.S.C. §§ 701–04. In order to protect the interests of the estate, a bankruptcy trustee may bring an action to avoid a transfer made before the bankruptcy that is allegedly either intentionally fraudulent, 11 U.S.C. § 548(a)(1)(A), or constructively fraudulent,

§ 548(a)(1)(B); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 535, 114 S.Ct. 1757, 128 L.Ed.2d 556 (1994). A transfer is constructively fraudulent, and thus can be avoided by the trustee, 11 U.S.C. § 550, if the debtor made the transfer on or within two years before the date of filing the bankruptcy petition, the debtor “received less than a reasonably equivalent value in exchange for such transfer or obligation,” § 548(a)(1)(B)(i), and one of four circumstances obtains.⁵

5

11 U.S.C. § 548(a)(1)(B) (defining constructive fraudulent transfers) provides in pertinent part:

(a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

....

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

[3] In construing the statutory requirement that the debtor “received less than a reasonably equivalent value in exchange

In re Fitness Holdings Intern., Inc., 714 F.3d 1141 (2013)

69 Collier Bankr.Cas.2d 1089, 57 Bankr.Ct.Dec. 243, Bankr. L. Rep. P 82,493...

for such transfer or obligation,” § 548(a)(1)(B)(i), we must turn to a series of interlocking statutory definitions. The key phrase in § 548(a)(1)(B)(i), “reasonably equivalent value,” is not defined in the Code. *BFP*, 511 U.S. at 535, 114 S.Ct. 1757. “Value” is defined, however, and includes the “satisfaction or securing of a present or antecedent debt of the debtor.” § 548(d)(2)(A). Under this definition, “[p]ayment of a preexisting debt is value, and if the payment is dollar-for-dollar, full value is given.” 5 Collier on Bankruptcy ¶ 548.03[5] (16th ed. 2012). Therefore, to the extent a transfer constitutes repayment of the debtor’s antecedent or present *1146 debt, the transfer is not constructively fraudulent.

See *Freeland v. Enodis Corp.*, 540 F.3d 721, 735 (7th Cir.2008) (holding that there is “reasonably equivalent value” where “payment of the accrued interest constituted ‘dollar-for-dollar forgiveness of a contractual debt.’”) (quoting *In re Carrozzella & Richardson*, 286 B.R. 480, 491 (D.Conn.2002)).

We next address the definition of the term “debt.” The Bankruptcy Code defines “debt” to mean “liability on a claim.” 11 U.S.C. § 101(12); see also *Johnson v. Home State Bank*, 501 U.S. 78, 84 n. 5, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991) (noting that “‘debt’ ... has a meaning coextensive with that of ‘claim.’”) (citing *Penn. Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 558, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990)). “Claim” is defined, in relevant part, to mean “a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” 11 U.S.C. § 101(5)(A). The Code thus broadly defines “debt” as liability on virtually any type of “right to payment.”

Under these interlocking definitions, to the extent a transfer is made in satisfaction of a “claim” (i.e., a “right to payment”), that transfer is made for “reasonably equivalent value” for purposes of § 548(a)(1)(B)(i). And a determination that a transfer was made for “reasonably equivalent value” precludes a determination that it was constructively fraudulent under § 548(a)(1)(B). See *In re United Energy Corp.*, 944 F.2d 589, 595–96 (9th Cir.1991).

B

This analysis raises the further question of how courts are to determine whether there is a “right to payment” that constitutes a “claim” under the Code. Supreme Court precedent establishes that, unless Congress has spoken, the nature and scope of a right to payment is determined by state law.⁶ The Supreme Court has “long recognized that the basic federal rule in bankruptcy is that state law governs the substance of claims, Congress having generally left the determination of property rights in the assets of a bankrupt’s estate to state law.” *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (internal quotation marks omitted). This principle was given its clearest statement in *Butner*, 440 U.S. 48, 99 S.Ct. 914, which held that because “[p]roperty interests are created and defined by state law,” *id.* at 55, 99 S.Ct. 914, “[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.” *Id.* This means that “when the Bankruptcy Code uses the word ‘claim’—which the Code itself defines as a ‘right to payment,’—it is usually referring to a right to payment recognized under state law.” *Travelers*, 549 U.S. at 451, 127 S.Ct. 1199 (internal citation omitted).

⁶ The term “state law” is often used “expansively ... to refer to all nonbankruptcy law that creates substantive claims.” *Grogan v. Garner*, 498 U.S. 279, 284 n. 9, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). “We thus mean to include in this term claims that have their source in substantive federal law.” *Id.*

Relying on the *Butner* principle, the Supreme Court held in *Travelers* that a court should not use a federal rule to determine whether a pre-petition contract guaranteeing attorneys’ fees created a “right to payment” giving rise to a “claim” under the Code. *Id.* at 446–47, 453–54, 127 S.Ct. 1199. *Travelers* arose from a Ninth Circuit *1147 case in which we had relied on circuit precedent holding that attorneys’ fees are not recoverable in bankruptcy “for

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litigating issues peculiar to federal bankruptcy law.” *Id.* at 451, 127 S.Ct. 1199 (internal quotation omitted). In a unanimous reversal, the Supreme Court criticized us for relying “solely on a rule of [our] own creation.” *Id.* According to the Court, because the creditor’s contractual right to attorneys’ fees could be enforceable under the law of California, the pre-petition contract could give rise to a “claim” in bankruptcy, and so the Ninth Circuit erred in holding that, as a per se rule, a right to attorneys’ fees for litigating bankruptcy issues never gives rise to a claim in bankruptcy. *Id.* at 450–52, 127 S.Ct. 1199; see also *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 21, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000) (holding that where there was “no sign that Congress meant to alter” a state substantive right, the *Butner* rule required a creditor’s claim to be assessed in light of state law, including the allocation of the burden of proof).

[4] Under the *Butner* principle, therefore, a court may not fashion a rule “solely of its own creation” in determining what constitutes a “claim” for purposes of bankruptcy. Rather, “subject to any qualifying or contrary provisions of the Bankruptcy Code,” *Raleigh*, 530 U.S. at 20, 120 S.Ct. 1951, a court must determine whether the asserted interest in the debtor’s assets is a “right to payment” recognized under state law, *id.*

[5] [6] We now construe § 548(a)(1)(B) in light of the *Butner* principle. Because the Code defines debt as “liability on a claim,” § 101(12), and defines “value” as including “satisfaction or securing of a ... debt,” § 548(d)(2)(A), we conclude that a transfer is for “reasonably equivalent value” for purposes of § 548(a)(1)(B)(i) if it is made in repayment of a “claim,” i.e., a “right to payment” under state law. Therefore, in an action to avoid a transfer as constructively fraudulent under § 548(a)(1)(B), if any party claims that the transfer constituted the repayment of a debt (and thus was a transfer for “reasonably equivalent value”), the court must determine whether the purported “debt” constituted a right to payment under state law. If it did not, the court may recharacterize the debtor’s obligation to the transferee under state law principles.

Because we hold that a court may recharacterize an obligation that does not constitute “debt” under state law, we disagree with *In re Pacific Express, Inc.*, which held that the Code did not authorize courts to characterize claims as equity or debt, but limited courts to the statutory remedy of equitable subordination under 11 U.S.C. § 510. 69 B.R. 112, 115 (B.A.P. 9th Cir.1986). This is incorrect, because “recharacterization and equitable subordination address distinct concerns.” *In re SubMicron Sys.*, 432 F.3d 448, 454 (3d Cir.2006). Under the Code, the statutory equitable subordination remedy allows a court, under equitable principles, to subordinate “all or part of an allowed claim to all or part of another allowed claim.” § 510(c)(1). In contrast, a court considering a motion to avoid a transfer as constructively fraudulent under § 548(a)(1)(B) must determine whether the transfer is for the repayment of a “claim” at all. Therefore *Pacific Express* erred in holding that the “characterization of claims as equity or debt” is governed by § 510(c). 69 B.R. at 115.⁷

⁷ In this opinion, we do not address whether the trustee has adequately pleaded a claim for equitable subordination. We resolve this issue in the memorandum disposition filed concurrently with this opinion.

*1148 C

In concluding that the Bankruptcy Code gives courts the authority to recharacterize claims in bankruptcy proceedings, we join our sister circuits, which have reached the same conclusion. See *In re Lothian Oil*, 650 F.3d 539, 542–43 (5th Cir.2011); *SubMicron*, 432 F.3d at 454; *In re Dornier Aviation*, 453 F.3d 225, 231 (4th Cir.2006); *In re Hedged-Investments Associates, Inc.*, 380 F.3d 1292, 1298 (10th Cir.2004); *In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 748 (6th Cir.2001). But despite their broad agreement that the Code authorizes courts to recharacterize claims, the circuits have taken different approaches in identifying the legal framework for this recharacterization. Compare *Lothian Oil*, 650 F.3d at 543 (holding that, under the *Butner* principle, courts are required to define claims by reference to state law, and are thus required to recharacterize purported “debt” as equity where state law would treat the

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asserted interest as an equity interest) with *SubMicron*, 432 F.3d at 454–56 (holding that a court has the equitable authority to recharacterize a transaction and determine if it is more like “debt” or “equity”) and *AutoStyle Plastics*, 269 F.3d at 749–50 (announcing an eleven-factor test, derived from federal tax law, for determining whether a purported “debt” is in fact “equity”).

We agree with the approach adopted by the Fifth Circuit in *Lothian Oil*, 650 F.3d at 543, which is consistent with the *Butner* principle. *Lothian Oil* considered two pre-bankruptcy loan agreements which stated that the debtor would repay the loan in the form of equity interests and royalties, and did not specify interest rates or maturity dates. 650 F.3d at 541. When the debtor asked the court to recharacterize the loans as equity interests, the court construed this as a request to disallow the lender's claim under 11 U.S.C. § 502 on the ground that the purported loans were “unenforceable against the debtor and property of the debtor, under any agreement or applicable law.” *Id.* at 543 (quoting 11 U.S.C. § 502(b)(1)). Recognizing the Supreme Court's determination in *Butner* that “‘applicable law’ is state law,” *id.* at 543, *Lothian Oil* looked to Texas law, which employed a multi-factor test to “distinguish between debt and equity,” *id.* at 544 (quoting *Arch Petrol., Inc. v. Sharp*, 958 S.W.2d 475, 477 n. 3 (Tex.Ct.App.1997)). Under Texas law, the interests created by the lender's agreements with the debtor constituted “common equity interests at best,” and not debt. *Id.* Therefore, the court disallowed the claims and recharacterized them as equity interests. *Id.*

We believe the Fifth Circuit's approach is more consistent with Supreme Court precedent than that of the circuits that have fashioned a federal test for recharacterizing an alleged debt in reliance on their general equitable authority under 11 U.S.C. § 105(a).⁸ See, e.g., *AutoStyle*, 269 F.3d at 749–50; *Hedged-Investments*, 380 F.3d at 1298–99. Such an equitable approach is inconsistent with Supreme Court precedent requiring us to determine whether a party has a “right to payment,” i.e., a “claim,” § 101(5), by reference to state law, see *Butner*, 440 U.S. at 55, 99 S.Ct. 914; *Travelers*, 549 U.S. at 451, 127 S.Ct. 1199.

Given the Supreme Court's *1149 direction, courts may not rely on § 105(a) and federal common law rules “of [their] own creation” to determine whether recharacterization is warranted. *Travelers*, 549 U.S. at 451, 127 S.Ct. 1199; cf. James M. Wilton & Stephen Moeller-Sally, *Debt Recharacterization Under State Law*, 62 Bus. Law. 1257, 1278 (Aug. 2007) (“Federal courts, if they are to follow Supreme Court precedent, cannot create a separate legal standard for the enforceability of insider debt in bankruptcy and should follow the state law of debt recharacterization.”).

Therefore, we agree with *Lothian Oil* that in order to determine whether a particular obligation owed by the debtor is a “claim” for purposes of bankruptcy law, it is first necessary to determine whether that obligation gives the holder of the obligation a “right to payment” under state law.

8 11 U.S.C. § 105(a) provides:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

III

[7] We now consider the application of these principles to this case. The question before the district court was whether the trustee's complaint plausibly alleged that Fitness Holdings' transfer of \$11,995,500 to Hancock Park was a constructively fraudulent transfer under § 548(a)(1)(B). As explained in our decision today, to survive a motion to dismiss, the trustee was required to plausibly allege that the interests created by Hancock Park's agreements with Fitness Holdings constituted equity investments (rather than debt) under applicable state law, and that therefore Hancock Park had no “right to payment” of \$11,995,500 from Fitness Holdings. By making such allegations, the trustee could then claim that Fitness Holdings' transfer was not for reasonably equivalent value. See § 548(d)(2)(A).⁹ Such allegations, combined with plausible allegations of the other elements of a claim for a constructively fraudulent transfer under § 548(a)(1)(B), could potentially “nudge” the trustee's claims

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“across the line from conceivable to plausible,”  *Iqbal*, 556

U.S. at 680, 129 S.Ct. 1937 (quoting  *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)), and show an entitlement to relief sufficient to withstand a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure.

9 The trustee also contends that Fitness Holdings did not receive “reasonably equivalent value” because it paid down unsecured preexisting debt with newly acquired secured financing. We reject this argument, because it is not supported by either the Code or our case law.  Section 548(d)(2) (A) defines “value” to include the “satisfaction or securing of a present or antecedent debt.” Under this definition, a debtor who grants a security interest in its property in exchange for funds has received reasonably equivalent value, see  *In re Northern Merch., Inc.*, 371 F.3d 1056, 1059 (9th Cir.2004), as has a debtor who pays down preexisting debt. We therefore see no basis for holding that a debtor who takes both actions simultaneously (obtaining a secured loan and simultaneously paying down pre-existing debt) has received something less than “reasonably equivalent value.” The trustee’s reliance on  *In re Superior Stamp & Coin Co.*, 223 F.3d 1004, 1008 n. 3 (9th Cir.2000), is misplaced, because that case considered the circumstances that might give rise to a voidable preference under § 547(b), not

whether the debtor obtained reasonably equivalent value under  § 548.

The district court did not view the trustee’s constructively fraudulent transfer claim through this lens. Because the court erroneously concluded that it was barred from considering whether the complaint plausibly alleged that the promissory notes could be recharacterized as creating equity interests rather than debt, it failed to apply the correct standard in considering whether the trustee’s allegation that Fitness Holdings did not receive reasonably equivalent value for its transfer of \$11,995,500 to Hancock Park plausibly *1150 gave rise to a claim for relief under  § 548(a)(1)(B).

Analyzing the trustee’s constructive fraudulent transfer claim under the proper legal framework requires the identification of the pertinent legal principles under applicable state law. Rather than ruling on these issues in the first instance, see  *Salmon Spawning & Recovery Alliance v. Gutierrez*, 545 F.3d 1220, 1230 n. 6 (9th Cir.2008), we vacate the district court’s dismissal of the complaint’s constructive fraudulent transfer claim and remand for further proceedings consistent with this opinion. Each party will bear its own costs on appeal.

VACATED AND REMANDED.

All Citations

714 F.3d 1141, 69 Collier Bankr.Cas.2d 1089, 57 Bankr.Ct.Dec. 243, Bankr. L. Rep. P 82,493, 13 Cal. Daily Op. Serv. 4294, 2013 Daily Journal D.A.R. 5560

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 KeyCite Yellow Flag - Negative Treatment
Superseded by Statute as Stated in [In re Jones](#), Bankr.S.D.Tex., April 18, 2007

124 S.Ct. 1951
Supreme Court of the United States

Lee M. **TILL**, et ux., Petitioners,
v.
SCS CREDIT CORPORATION.

No. 02-1016.
|
Argued Dec. 2, 2003.
|
Decided May 17, 2004.

Synopsis

Background: Secured creditor objected to **interest rate** on payments to creditor on cram down loan under debtors' proposed Chapter 13 payment plan. The United States Bankruptcy Court for the Southern District of Indiana overruled objection, and creditor appealed. The District Court, [Larry J. McKinney](#), Chief Judge, reversed. Debtors appealed, and the United States Court of Appeals for the Seventh Circuit, [Ripple](#), Circuit Judge,  [301 F.3d 583](#), vacated and remanded. Certiorari was granted.

[Holding:] The Supreme Court, Justice [Stevens](#), held that formula approach, requiring adjustment of prime national **interest rate** based on risk of nonpayment, was appropriate method for determining adequate rate of interest on cram down loan.

Reversed and remanded.

Justice [Thomas](#) filed opinion concurring in judgment.

Justice [Scalia](#) filed dissenting opinion, in which Chief Justice [Rehnquist](#), Justice [O'Connor](#), and Justice [Kennedy](#) joined.

Procedural Posture(s): On Appeal.

West Headnotes (4)

[1] Interest Computation of Rate in General

Coerced loan approach was not appropriate method for determining adequate rate of interest on cram down loan pursuant to Chapter 13 payment plan; method required bankruptcy court to consider evidence about market for comparable loans to similar debtors, an inquiry far removed from court's usual task of evaluating debtors' financial circumstances and feasibility of their debt adjustment plan, and it overcompensated creditor. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code,  [11 U.S.C.A. § 1325\(a\)\(5\)\(B\)](#).

[252 Cases that cite this headnote](#)

[2] Interest Computation of Rate in General

Presumptive contract rate approach was not appropriate method for determining adequate rate of interest on cram down loan pursuant to Chapter 13 payment plan; approach improperly focused on creditor's potential use of proceeds of foreclosure sale, it required debtor to obtain information about creditor's costs of overhead, financial circumstances, and lending practices to rebut presumptive contract rate, it could have produced absurd results, entitling inefficient, poorly managed lenders with lower profit margins to obtain higher cram down rates than well managed, better capitalized lenders, and similarly situated creditors could have ended up with vastly different cram down rates. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code,  [11 U.S.C.A. § 1325\(a\)\(5\)\(B\)](#).

[113 Cases that cite this headnote](#)

[3] Interest Computation of Rate in General

Cost of funds approach was not appropriate method for determining adequate rate of interest

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on cram down loan pursuant to Chapter 13 payment plan; approach mistakenly focused on creditworthiness of creditor rather than debtor, it imposed significant evidentiary burden, as debtor seeking to rebut creditor's asserted cost of borrowing had to introduce expert testimony about creditor's financial condition, and creditworthy lender with low cost of borrowing could have obtained lower cram down rate than financially unsound lender. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code, § 11 U.S.C.A. § 1325(a)(5)(B).

137 Cases that cite this headnote

[4] **Interest** — Computation of Rate in General

Formula approach, requiring adjustment of prime national **interest rate** based on risk of nonpayment, was appropriate method for determining adequate rate of interest on cram down loan pursuant to Chapter 13 payment plan; approach entailed straightforward, familiar, and objective inquiry, and minimized need for potentially costly additional evidentiary proceedings, and resulting "prime-plus" rate of interest depended only on state of financial markets, circumstances of bankruptcy estate, and characteristics of loan, not on creditor's circumstances or its prior interactions with debtor. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code, § 11 U.S.C.A. § 1325(a)(5)(B).

374 Cases that cite this headnote

****1952 Syllabus***

Under the so-called "cramdown option" permitted by the Bankruptcy Code, a Chapter 13 debtor's proposed debt adjustment plan must provide each allowed, secured creditor both a lien securing the claim and a promise of future property disbursements whose total value, as of the plan's date, "is not less than the [claim's] allowed

amount," § 11 U.S.C. § 1325(a)(5)(B)(ii). When such plans provide for installment payments, each installment must be calibrated to ensure that the ****1953** creditor receives disbursements whose total present value equals or exceeds that of the allowed claim. Respondent's retail installment contract on petitioners' truck had a secured value of \$4,000 at the time petitioners filed a Chapter 13 petition. Petitioners' proposed debt adjustment plan provided the amount that would be distributed to creditors each month and that petitioners would pay an annual 9.5% **interest rate** on respondent's secured claim. This "prime-plus" or "formula rate" was reached by augmenting the national prime rate of 8% to account for the nonpayment risk posed by borrowers in petitioners' financial position. In confirming the plan, the Bankruptcy Court overruled respondent's objection that it was entitled to its contract **interest rate** of 21%. The District Court reversed, ruling that the 21% "coerced loan rate" was appropriate because cramdown rates must be set at the level the creditor could have obtained had it foreclosed on the loan, sold the collateral, and reinvested the proceeds in equivalent loans. The Seventh Circuit modified that approach, holding that the original contract rate was a "presumptive rate" that could be challenged with evidence that a higher or lower rate should apply, and remanding the case to the Bankruptcy Court to afford the parties an opportunity to rebut the presumptive 21% rate. The dissent proposed adoption of the formula approach rejecting a "cost of funds rate" that would simply ask what it would cost the creditor to obtain the cash equivalent of the collateral from another source.

Held: The judgment is reversed, and the case is remanded.

§ 301 F.3d 583, reversed and remanded.

Justice STEVENS, joined by Justice SOUTER, Justice GINSBURG, and Justice BREYER, concluded that the prime-plus or formula rate best meets the purposes of the Bankruptcy Code. Pp. 1958–1964.

***466 a)** The Code gives little guidance as to which of the four **interest rates** advocated by opinions in this case Congress intended when it adopted the cramdown provision. A debtor's promise of future payments is worth less than an immediate lump-sum payment because the creditor cannot use the money right away, inflation may cause the dollar's value to decline before the debtor pays, and there is a nonpayment risk. In choosing an **interest rate** sufficient to compensate the creditor for such concerns, bankruptcy courts must consider that: (1) Congress likely intended bankruptcy judges and trustees to follow essentially the same approach when choosing an

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appropriate **interest rate** under any of the many Code provisions requiring a court to discount a stream of deferred payments back to their present dollar value; (2) Chapter 13 expressly authorizes a bankruptcy court to modify the rights of a creditor whose claim is secured by an interest in anything other than the debtor's principal residence; and (3) from a creditor's point of view, the cramdown provision mandates an objective rather than a subjective inquiry. Pp. 1958–1960.

(b) These considerations lead to the conclusion that the coerced loan, presumptive contract rate, and cost of funds approaches should be rejected, since they are complicated, impose significant evidentiary costs, and aim to make each individual creditor whole rather than to ensure that a debtor's payments have the required present value. Pp. 1960–1961.

(c) The formula approach has none of these defects. Taking its cue from ordinary lending practices, it looks to the national prime rate, which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate **1954 for the loan's opportunity costs, the inflation risk, and the relatively slight default risk. A bankruptcy court is then required to adjust the prime rate to account for the greater nonpayment risk that bankrupt debtors typically pose. Because that adjustment depends on such factors as the estate's circumstances, the security's nature, and the reorganization plan's duration and feasibility, the court must hold a hearing to permit the debtor and creditors to present evidence about the appropriate risk adjustment. Unlike the other approaches proposed in this case, the formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary hearings. The resulting prime-plus rate also depends only on the state of financial markets, the bankruptcy estate's circumstances, and the loan's characteristics, not on the creditor's circumstances or its prior interactions with the debtor. The risk adjustment's proper scale is not before this Court. The Bankruptcy Court approved 1.5% in this case, and other courts have generally approved 1% to 3%, but respondent claims a risk adjustment in this range is inadequate. The issue *467 need not be resolved here; it is sufficient to note that courts must choose a rate high enough to compensate a creditor for its risk but not so high as to doom the bankruptcy plan. Pp. 1961–1962.

Justice THOMAS concluded that the proposed 9.5% rate will sufficiently compensate respondent for the fact that it is receiving monthly payments rather than a lump sum payment, but that § 11 U.S.C. § 1325(a)(5)(B)(ii) does

not require that the proper **interest rate** reflect the risk of nonpayment. Pp. 1965–1968.

(a) The plain language of § 1325(a)(5)(B)(ii) requires a court to determine, first, the allowed amount of the claim; second, what is the property to be distributed under the plan; and third, the “value, as of the effective date of the plan,” of the property to be distributed. This third requirement, which is at issue here, incorporates the principle of the time value of money. Section 1325(a)(5)(B)(ii) requires valuation of the *property*, not valuation of the *plan*. Thus, a plan need only propose an **interest rate** that will compensate a creditor for the fact that had he received the property immediately rather than at a future date, he could have immediately made use of the property. In most, if not all, cases, where the plan proposes simply a stream of cash payments, the appropriate risk-free rate should suffice. There may be some risk of nonpayment, but § 1325(a)(5)(B)(ii) does not take this risk into account. Respondent's argument that § 1325(a)(5)(B)(ii) was crafted to protect creditors rather than debtors ignores the statute's plain language and overlooks the fact that secured creditors are compensated in part for the nonpayment risk through the valuation of the secured claim. Further, the statute's plain language is by no means debtor protective. Given the presence of multiple creditor-specific protections, it is not irrational to assume that Congress opted not to provide further protection for creditors by requiring a debtor-specific risk adjustment under § 1325(a)(5). Pp. 1965–1967.

(b) Here, the allowed amount of the secured claim is \$4,000, and the property to be distributed under the plan is cash payments. Because the proposed 9.5% **interest rate** is higher than the risk-free rate, it is sufficient to account for the time value of money, which is all the statute requires. Pp. 1967–1968.

STEVENS, J., announced the judgment of the Court and delivered an opinion, in which SOUTER, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed an opinion concurring in the **1955 judgment, *post*, p. 1965. SCALIA, J., filed a dissenting opinion, in which REHNQUIST, C.J., and O'CONNOR and KENNEDY, JJ., joined, *post*, p. 1968.

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petitioners.

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Opinion

Justice STEVENS announced the judgment of the Court and delivered an opinion, in which Justice SOUTER, Justice GINSBURG, and Justice BREYER join.

*468 To qualify for court approval under Chapter 13 of the Bankruptcy Code, an individual debtor’s proposed debt adjustment plan must accommodate each allowed, secured creditor in one of three ways: (1) by obtaining the creditor’s acceptance of the plan; (2) by surrendering the property securing the claim; or (3) by providing the creditor both a lien securing the claim and a promise of future property distributions (such as deferred cash payments) whose total “value, as of the effective date of the plan, ... is not less than the allowed amount of such claim.”¹ The third alternative is *469 commonly known as the “cram down option” because it may be enforced over a claim holder’s objection.² *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 957, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997).

Plans that invoke the cramdown power often provide for installment payments over a period of years rather than a single payment.³ In such circumstances, the amount of each installment must be calibrated **1956 to ensure that, over time, the creditor receives disbursements whose total present value⁴ equals or exceeds that of the allowed claim. The proceedings in this case that led to our grant of certiorari identified four different methods of determining the appropriate method with which to perform that calibration. Indeed, the Bankruptcy Judge, the District Court, the Court of Appeals majority, and the dissenting judge each endorsed a different approach. We detail the underlying facts and describe each of those approaches before setting forth our judgment as to which approach

best meets the purposes of the Bankruptcy Code.

I

On October 2, 1998, petitioners Lee and Amy Till, residents of Kokomo, Indiana, purchased a used truck from Instant Auto Finance for \$6,395 plus \$330.75 in fees and taxes. *470 They made a \$300 downpayment and financed the balance of the purchase price by entering into a retail installment contract that Instant Auto immediately assigned to respondent, SCS Credit Corporation. Petitioners’ initial indebtedness amounted to \$8,285.24—the \$6,425.75 balance of the truck purchase plus a finance charge of 21% per year for 136 weeks, or \$1,859.49. Under the contract, petitioners agreed to make 68 biweekly payments to cover this debt; Instant Auto—and subsequently respondent—retained a purchase money security interest that gave it the right to repossess the truck if petitioners defaulted under the contract.

On October 25, 1999, petitioners, by then in default on their payments to respondent, filed a joint petition for relief under Chapter 13 of the Bankruptcy Code. At the time of the filing, respondent’s outstanding claim amounted to \$4,894.89, but the parties agreed that the truck securing the claim was worth only \$4,000. App. 16–17. In accordance with the Bankruptcy Code, therefore, respondent’s secured claim was limited to \$4,000, and the \$894.89 balance was unsecured.⁵ Petitioners’ filing automatically stayed debt-collection activity by their various creditors, including the Internal Revenue Service (IRS), respondent, three other holders of secured claims, and unidentified unsecured creditors. In addition, the filing created a bankruptcy estate, administered by a trustee, which consisted of petitioners’ property, including the truck.⁶

*471 Petitioners’ proposed debt adjustment plan called for them to submit their future earnings to the supervision and control of the Bankruptcy Court for three years, and to assign \$740 of their wages to the trustee each month.⁷ App. to Pet. for Cert. 76a–81a. The plan charged the trustee with distributing these monthly wage assignments to pay, in order of priority: (1) **1957 administrative costs; (2) the IRS’s priority tax claim; (3) secured creditors’ claims; and finally, (4) unsecured creditors’ claims. *Id.*, at 77a–79a.

The proposed plan also provided that petitioners would pay interest on the secured portion of respondent’s claim

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at a rate of 9.5% per year. Petitioners arrived at this “prime-plus” or “formula rate” by augmenting the national prime rate of approximately 8% (applied by banks when making low-risk loans) to account for the risk of nonpayment posed by borrowers in their financial position. Respondent objected to the proposed rate, contending that the company was “entitled to interest at the rate of 21%, which is the rate ... it would obtain if it could foreclose on the vehicle and reinvest the proceeds in loans of equivalent duration and risk as the loan” originally made to petitioners. App. 19–20.

At the hearing on its objection, respondent presented expert testimony establishing that it uniformly charges 21% interest on so-called “subprime” loans, or loans to borrowers with poor credit ratings, and that other lenders in the subprime market also charge that rate. Petitioners countered with the testimony of an Indiana University–Purdue University Indianapolis economics professor, who acknowledged that he had only limited familiarity with the subprime auto lending market, but described the 9.5% formula rate as “very reasonable” given that Chapter 13 plans are “supposed to be *472 financially feasible.”⁸ *Id.*, at 43–44. Moreover, the professor noted that respondent’s exposure was “fairly limited because [petitioners] are under the supervision of the court.” *Id.*, at 43. The bankruptcy trustee also filed comments supporting the formula rate as, among other things, easily ascertainable, closely tied to the “condition of the financial market,” and independent of the financial circumstances of any particular lender. App. to Pet. for Cert. 41a–42a. Accepting petitioners’ evidence, the Bankruptcy Court overruled respondent’s objection and confirmed the proposed plan.

The District Court reversed. It understood Seventh Circuit precedent to require that bankruptcy courts set cramdown **interest rates** at the level the creditor could have obtained if it had foreclosed on the loan, sold the collateral, and reinvested the proceeds in loans of equivalent duration and risk. Citing respondent’s unrebutted testimony about the market for subprime loans, the court concluded that 21% was the appropriate rate. *Id.*, at 38a.

On appeal, the Seventh Circuit endorsed a slightly modified version of the District Court’s “coerced” or “forced loan” approach. ■ *In re Till*, 301 F.3d 583, 591 (C.A.7 2002). Specifically, the majority agreed with the District Court that, in a cramdown proceeding, the inquiry should focus on the **interest rate** “that the creditor in question would obtain in making a new loan in the same industry to a debtor who is similarly situated, although not in bankruptcy.” ■ *Id.*, at 592. To approximate that new loan rate, the majority looked to the parties’

prebankruptcy contract rate (21%). The court recognized, however, that using the contract rate would not “duplicat[e] precisely ... the present value of the collateral to the creditor” because loans to bankrupt, court-supervised debtors “involve some risks that would not be incurred in a *473 new loan to a debtor not in default” and also produce “some economies.” ■ *Ibid.* To correct for these inaccuracies, the majority held that the original **1958 contract rate should “serve as a presumptive [cramdown] rate,” which either the creditor or the debtor could challenge with evidence that a higher or lower rate should apply. ■ *Ibid.* Accordingly, the court remanded the case to the Bankruptcy Court to afford petitioners and respondent an opportunity to rebut the presumptive 21% rate.⁹

Dissenting, Judge Rovner argued that the majority’s presumptive contract rate approach overcompensates secured creditors because it fails to account for costs a creditor would have to incur in issuing a new loan. Rather than focusing on the market for comparable loans, Judge Rovner advocated the Bankruptcy Court’s formula approach. ■ *Id.*, at 596. Although Judge Rovner noted that the rates produced by either the formula or the cost of funds approach might be “piddling” relative to the coerced loan rate, she suggested courts should “consider the extent to which the creditor has already been compensated for ... the risk that the debtor will be unable to discharge his obligations under the reorganization plan ... in the rate of interest that it charged to the debtor in return for the original loan.” ■ *Ibid.* We granted certiorari and now reverse. 539 U.S. 925, 123 S.Ct. 2572, 156 L.Ed.2d 601 (2003).

II

The Bankruptcy Code provides little guidance as to which of the rates of interest advocated by the four opinions in this case—the formula rate, the coerced loan rate, the presumptive contract rate, or the cost of funds rate—Congress had in mind when it adopted the cramdown provision. That provision, ■ 11 U.S.C. § 1325(a)(5)(B), does not mention the term “discount rate” or the word “interest.” Rather, it simply *474 requires bankruptcy courts to ensure that the property to be distributed to a particular secured creditor over the life of a bankruptcy plan has a total “value, as of the effective date of the plan,” that equals or exceeds the value of the creditor’s allowed secured claim—in this case, \$4,000.

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§ 1325(a)(5)(B)(ii).

That command is easily satisfied when the plan provides for a lump-sum payment to the creditor. Matters are not so simple, however, when the debt is to be discharged by a series of payments over time. A debtor's promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays, and there is always some risk of nonpayment. The challenge for bankruptcy courts reviewing such repayment schemes, therefore, is to choose an **interest rate** sufficient to compensate the creditor for these concerns.

Three important considerations govern that choice. First, the Bankruptcy Code includes numerous provisions that, like the cramdown provision, require a court to "discoun[t] ... [a] stream of deferred payments back to the[ir] present dollar value," *Rake v. Wade*, 508 U.S. 464, 472, n. 8, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993), to ensure that a creditor receives at least the value of its claim.¹⁰ We think it likely that ***1959** Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate **interest rate** under any of these provisions. Moreover, we think Congress would favor an approach that is familiar in the financial ***475** community and that minimizes the need for expensive evidentiary proceedings.

Second, Chapter 13 expressly authorizes a bankruptcy court to modify the rights of any creditor whose claim is secured by an interest in anything other than "real property that is the debtor's principal residence." **11 U.S.C. § 1322(b)(2)**.¹¹ Thus, in cases like this involving secured interests in personal property, the court's authority to modify the number, timing, or amount of the installment payments from those set forth in the debtor's original contract is perfectly clear. Further, the potential need to modify the loan terms to account for intervening changes in circumstances is also clear: On the one hand, the fact of the bankruptcy establishes that the debtor is overextended and thus poses a significant risk of default; on the other hand, the postbankruptcy obligor is no longer the individual debtor but the court-supervised estate, and the risk of default is thus somewhat reduced.¹²

***476** Third, from the point of view of a creditor, the cramdown provision mandates an objective rather than a subjective inquiry.¹³ That is, although **§ 1325(a)(5)(B)** entitles the creditor to property whose present value objectively equals or exceeds the value of the collateral, it does not require that the terms of the cramdown loan

match the terms to which the debtor and creditor agreed prebankruptcy, nor does it require that the cramdown terms make the creditor subjectively indifferent between present foreclosure and future payment. Indeed, the very idea of a "cramdown" loan *precludes* the latter result: By definition, a creditor forced to accept such a loan would prefer instead to foreclose.¹⁴ Thus, a court ***1960** choosing a cramdown **interest rate** need not consider the creditor's individual circumstances, such as its prebankruptcy dealings with the debtor or the alternative loans it ***477** could make if permitted to foreclose.¹⁵ Rather, the court should aim to treat similarly situated creditors similarly,¹⁶ and to ensure that an objective economic analysis would suggest the debtor's interest payments will adequately compensate all such creditors for the time value of their money and the risk of default.

III

¹¹ These considerations lead us to reject the coerced loan, presumptive contract rate, and cost of funds approaches. Each of these approaches is complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value. For example, the coerced loan approach requires bankruptcy courts to consider evidence about the market for comparable loans to similar (though nonbankrupt) debtors—an inquiry far removed from such courts' usual task of evaluating debtors' financial circumstances and the feasibility of their debt adjustment plans. In addition, the approach overcompensates creditors because the market lending rate must be high enough to cover factors, like lenders' transaction costs and overall profits, that are no longer relevant in the context of court—administered and court—supervised cramdown loans.

¹² Like the coerced loan approach, the presumptive contract rate approach improperly focuses on the creditor's potential use of the proceeds of a foreclosure sale. In addition, although the approach permits a debtor to introduce some evidence about each creditor, thereby enabling the court to tailor the **interest rate** more closely to the creditor's financial circumstances and reducing the likelihood that the creditor ***478** will be substantially overcompensated, that right comes at a cost: The debtor must obtain information about the creditor's costs of overhead, financial circumstances, and lending practices to rebut the presumptive contract rate. Also, the approach produces absurd results, entitling "inefficient, poorly

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managed lenders” with lower profit margins to obtain higher cramdown rates than “well managed, better capitalized lenders.” 2 K. Lundin, Chapter 13 Bankruptcy § 112.1, p. 112–8 (3d ed.2000). Finally, because the approach relies heavily on a creditor’s prior dealings with the debtor, similarly situated creditors may end up with vastly different cramdown rates.¹⁷

****1961** ^[3] The cost of funds approach, too, is improperly aimed. Although it rightly disregards the now-irrelevant terms of the parties’ original contract, it mistakenly focuses on the creditworthiness of the *creditor* rather than the debtor. In addition, the approach has many of the other flaws of the coerced loan and presumptive contract rate approaches. For example, like the presumptive contract rate approach, the cost of funds approach imposes a significant evidentiary burden, as a debtor seeking to rebut a creditor’s asserted cost of borrowing must introduce expert testimony about the creditor’s financial condition. Also, under this approach, a creditworthy lender with a low cost of borrowing may obtain a lower cramdown rate than a financially unsound, fly-by-night lender.

IV

^[4] The formula approach has none of these defects. Taking its cue from ordinary lending practices, the approach begins ***479** by looking to the national prime rate, reported daily in the press, which reflects the financial market’s estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the opportunity costs of the loan, the risk of inflation, and the relatively slight risk of default.¹⁸ Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly. The appropriate size of that risk adjustment depends, of course, on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan. The court must therefore hold a hearing at which the debtor and any creditors may present evidence about the appropriate risk adjustment. Some of this evidence will be included in the debtor’s bankruptcy filings, however, so the debtor and creditors may not incur significant additional expense. Moreover, starting from a concededly *low* estimate and adjusting *upward* places the evidentiary burden squarely on the creditors, who are likely to have readier access to any information absent from the debtor’s

filing (such as evidence about the “liquidity of the collateral market,” *post*, at 1973 (SCALIA, J., dissenting)). Finally, many of the factors relevant to the adjustment fall squarely within the bankruptcy court’s area of expertise.

Thus, unlike the coerced loan, presumptive contract rate, and cost of funds approaches, the formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary proceedings. Moreover, the resulting “prime-plus” rate of interest depends only on the state of financial markets, the circumstances of the bankruptcy estate, and the characteristics of the loan, not on the creditor’s circumstances or its prior interactions with the debtor. For these reasons, ****1962** the ***480** prime-plus or formula rate best comports with the purposes of the Bankruptcy Code.¹⁹

We do not decide the proper scale for the risk adjustment, as the issue is not before us. The Bankruptcy Court in this case approved a risk adjustment of 1.5%, App. to Pet. for Cert. 44a–73a, and other courts have generally approved adjustments of 1% to 3%, see **In re Valenti**, 105 F.3d 55, 64 (C.A.2) (collecting cases), abrogated on other grounds by **Associates Commercial Corp. v. Rash**, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997). Respondent’s core argument is that a risk adjustment in this range is entirely inadequate to compensate a creditor for the real risk that the plan will fail. There is some dispute about the true scale of that risk—respondent claims that more than 60% of Chapter 13 plans fail, Brief for Respondent 25, but petitioners argue that the failure rate for *approved* Chapter 13 plans is much lower, Tr. of Oral Arg. 9. We need not resolve that dispute. It is sufficient for our purposes to note that, under **11 U.S.C. § 1325(a)(6)**, a court may not approve a plan unless, after considering all creditors’ objections and receiving the advice of the trustee, the judge is persuaded that “the debtor will be able to make all payments under the plan and to comply with the plan.” *Ibid.* Together with the cramdown provision, this requirement obligates the court to select a rate high enough to compensate the creditor for its risk but not so high as to doom the plan. If the court determines that the likelihood of default is so high as to necessitate a ***481** “eye-popping” **interest rate**, **301 F.3d, at 593** (Rovner, J., dissenting), the plan probably should not be confirmed.

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V

The dissent's endorsement of the presumptive contract rate approach rests on two assumptions: (1) "subprime lending markets are competitive and therefore largely efficient"; and (2) the risk of default in Chapter 13 is normally no less than the risk of default at the time of the original loan. *Post*, at 1969. Although the Bankruptcy Code provides little guidance on the question, we think it highly unlikely that Congress would endorse either premise.

First, the dissent assumes that subprime loans are negotiated between fully informed buyers and sellers in a classic free market. But there is no basis for concluding that Congress relied on this assumption when it enacted Chapter 13. Moreover, several considerations suggest that the subprime market is not, in fact, perfectly competitive. To begin with, used vehicles are regularly sold by means of tie-in transactions, in which the price of the vehicle is the subject of negotiation, while the terms of the financing are dictated by the seller.²⁰ In addition, there is extensive **1963 federal *482²¹ and state²² regulation of subprime lending, which not only itself distorts the market, but also evinces regulators' belief that unregulated subprime lenders would exploit borrowers' ignorance and charge rates above what a competitive market would allow.²³ Indeed, Congress enacted the Truth in Lending Act in part because it believed "consumers would individually benefit not only from the more informed use of credit, but also from heightened competition which would result from more knowledgeable credit shopping." S.Rep. No. 96-368, p. 16 (1979).²⁴

Second, the dissent apparently believes that the debtor's prebankruptcy default—on a loan made in a market in which creditors commonly charge the maximum rate of interest allowed by law, Brief for Respondent 16, and in which neither creditors nor debtors have the protections afforded by Chapter 13—translates into a high probability that the same debtor's confirmed Chapter 13 plan will fail. In our view, however, Congress intended to create a program under which plans that qualify for confirmation have a high probability of success. Perhaps bankruptcy judges currently confirm too *483 many risky plans, but the solution is to confirm fewer such plans, not to set default cramdown rates at absurdly high levels, thereby increasing the risk of default.

Indeed, as Justice THOMAS demonstrates, *post*, at 1966 (opinion concurring in judgment), the text of § 1325(a)(5)(B)(ii) may be read to support the conclusion that Congress did not intend the cramdown rate to include any compensation for the risk of default.²⁵ That reading is

consistent with a view that Congress believed Chapter 13's protections to be so effective **1964 as to make the risk of default negligible. Because our decision in *Rash* assumes that cramdown interest rates are adjusted to "offset," to the extent possible, the risk of default, § 520 U.S., at 962–963, 117 S.Ct. 1879, and because so many judges who have considered the issue (including the authors of the four earlier opinions in this case) have rejected the risk-free approach, we think it too late in the day to endorse that approach now. Of course, if the text of the statute required such an approach, that would be the end of the matter. We think, however, that § 1325(a)(5)(B)(ii)'s reference to "value, as of the effective date of the plan, of property to be distributed under the plan" is better read to incorporate all of the commonly understood components of "present value," including any risk of nonpayment. Justice THOMAS' reading does emphasize, though, that a presumption that bankruptcy plans will succeed is more consistent with Congress' statutory scheme than the dissent's more cynical focus on bankrupt debtors' "financial instability and ... proclivity to seek legal protection," *post*, at 1969.

Furthermore, the dissent's two assumptions do not necessarily favor the presumptive contract rate approach. For one thing, the cramdown provision applies not only to subprime *484 loans but also to prime loans negotiated prior to the change in circumstance (job loss, for example) that rendered the debtor insolvent. Relatedly, the provision also applies in instances in which national or local economic conditions drastically improved or declined after the original loan was issued but before the debtor filed for bankruptcy. In either case, there is every reason to think that a properly risk-adjusted prime rate will provide a better estimate of the creditor's current costs and exposure than a contract rate set in different times.

Even more important, if all relevant information about the debtor's circumstances, the creditor's circumstances, the nature of the collateral, and the market for comparable loans were equally available to both debtor and creditor, then in theory the formula and presumptive contract rate approaches would yield the same final interest rate. Thus, we principally differ with the dissent not over what final rate courts should adopt but over which party (creditor or debtor) should bear the burden of rebutting the presumptive rate (prime or contract, respectively).

Justice SCALIA identifies four "relevant factors bearing on risk premium[.]" (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement." *Post*, at 1973. In our view, any information

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debtors have about any of these factors is likely to be included in their bankruptcy filings, while the remaining information will be far more accessible to creditors (who must collect information about their lending markets to remain competitive) than to individual debtors (whose only experience with those markets might be the single loan at issue in the case). Thus, the formula approach, which begins with a concededly low estimate of the appropriate **interest rate** and requires the creditor to present evidence supporting a higher rate, places the evidentiary burden on the more knowledgeable ***485** party, thereby facilitating more accurate calculation of the appropriate **interest rate**.

If the rather sketchy data uncovered by the dissent support an argument that Chapter 13 of the Bankruptcy Code should mandate application of the presumptive contract rate approach (rather than merely an argument that bankruptcy judges should exercise greater caution before approving debt adjustment plans), those data ****1965** should be forwarded to Congress. We are not persuaded, however, that the data undermine our interpretation of the statutory scheme Congress has enacted.

The judgment of the Court of Appeals is reversed, and the case is remanded with instructions to remand the case to the Bankruptcy Court for further proceedings consistent with this opinion.

It is so ordered.

Justice **THOMAS**, concurring in the judgment.

This case presents the issue of what the proper method is for discounting deferred payments to present value and what compensation the creditor is entitled to in calculating the appropriate discount rate of interest. Both the plurality and the dissent agree that “[a] debtor’s promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays, and there is always some risk of nonpayment.” *Ante*, at 1958; *post*, at 1968. Thus, the plurality and the dissent agree that the proper method for discounting deferred payments to present value should take into account each of these factors, but disagree over the proper starting point for calculating the risk of nonpayment.

I agree that a “promise of future payments is worth less than an immediate payment” of the same amount, in part because of the risk of nonpayment. But this fact is

irrelevant. The statute does not require that the value of the ***486** promise to distribute property under the plan be no less than the allowed amount of the secured creditor’s claim. It requires only that “the value ... of property to be distributed under the plan,” at the time of the effective date of the plan, be no less than the amount of the secured creditor’s claim. **11 U.S.C. § 1325(a)(5)(B)(ii)** (emphasis added). Both the plurality and the dissent ignore the clear text of the statute in an apparent rush to ensure that secured creditors are not undercompensated in bankruptcy proceedings. But the statute that Congress enacted does not require a debtor-specific risk adjustment that would put secured creditors in the same position as if they had made another loan. It is for this reason that I write separately.

I

“It is well established that ‘when the statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.’ ” **Lamie v. United States Trustee**, 540 U.S. 526, 534, 124 S.Ct. 1023, 1030, 157 L.Ed.2d 1024 (2004) (quoting **Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.**, 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000)). **Section 1325(a)(5)(B)** provides that “with respect to each allowed secured claim provided for by the plan,” “the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim [must] not [be] less than the allowed amount of such claim.” Thus, the statute requires a bankruptcy court to make at least three separate determinations. First, a court must determine the allowed amount of the claim. Second, a court must determine what is the “property to be distributed under the plan.” Third, a court must determine the “value, as of the effective date of the plan,” of the property to be distributed.

The dispute in this case centers on the proper method to determine the “value, as of the effective date of the plan, of property to be distributed under the plan.” The requirement that the “value” of the property ****1966** to be distributed be ***487** determined “as of the effective date of the plan” incorporates the principle of the time value of money. To put it simply, \$4,000 today is worth more than \$4,000 to be received 17 months from today because if received today, the \$4,000 can be invested to start earning

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interest immediately.¹ See G. Munn, F. Garcia, & C. Woelfel, *Encyclopedia of Banking & Finance* 1015 (rev. 9th ed.1991). Thus, as we explained in *Rake v. Wade*, 508 U.S. 464, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993), “[w]hen a claim is paid off pursuant to a stream of future payments, a creditor receives the ‘present value’ of its claim only if the total amount of the deferred payments includes the amount of the underlying claim plus an appropriate amount of interest to compensate the creditor for the decreased value of the claim caused by the delayed payments.” *Id.*, at 472, n. 8, 113 S.Ct. 2187.

Respondent argues, and the plurality and the dissent agree, that the proper **interest rate** must also reflect the risk of nonpayment. But the statute contains no such requirement. The statute only requires the valuation of the “property to be distributed,” not the valuation of the plan (*i.e.*, the promise to make the payments itself). Thus, in order for a plan to satisfy § 1325(a)(5)(B)(ii), the plan need only propose an **interest rate** that will compensate a creditor for the fact that if he had received the property immediately rather than at a future date, he could have immediately made use of the property. In most, if not all, cases, where the plan proposes simply a stream of cash payments, the appropriate risk-free rate should suffice.

Respondent here would certainly be acutely aware of any risk of default inherent in a Chapter 13 plan, but it is nonsensical to speak of a debtor’s risk of default being inherent in the value of “property” unless that property is a promise or *488 a debt. Suppose, for instance, that it is currently time A, the property to be distributed is a house, and it will be distributed at time B. Although market conditions might cause the value of the house to fluctuate between time A and time B, the fluctuating value of the house itself has nothing to do with the risk that the debtor will not deliver the house at time B. The value of the house, then, can be and is determined entirely without any reference to any possibility that a promise to transfer the house would not be honored. So too, then, with cash: the value of the cash can be and is determined without any inclusion of any risk that the debtor will fail to transfer the cash at the appropriate time.

The dissent might be correct that the use of the prime rate,² even with a small risk adjustment, “will systematically undercompensate secured creditors for the true risks of default.” *Post*, at 1968.³ This systematic undercompensation might seem problematic as a matter of policy. But, it raises no problem as a matter of statutory interpretation. Thus, although there is always some risk of nonpayment when A promises to repay a debt to B through a stream of payments over time rather than

through an immediate lump-sum payment, **1967 § 1325(a)(5)(B)(ii) does not take this risk into account.

This is not to say that a debtor’s risk of nonpayment can never be a factor in determining the value of the property to be distributed. Although “property” is not defined in the Bankruptcy Code, nothing in § 1325 suggests that “property” is limited to cash. Rather, “‘property’ can be cash, notes, stock, personal property or real property; in short, anything of value.” 7 Collier on Bankruptcy ¶ 1129.03[7][b][i], p. 1129–44 (rev. 15th ed.2003) (discussing Chapter 11’s cramdown provision). And if the “property to be distributed” *489 under a Chapter 13 plan is a note (*i.e.*, a promise to pay), for instance, the value of that note necessarily includes the risk that the debtor will not make good on that promise. Still, accounting for the risk of nonpayment in that case is not equivalent to reading a risk adjustment requirement into the statute, as in the case of a note, the risk of nonpayment is part of the value of the note itself.

Respondent argues that “Congress crafted the requirements of section 1325(a)(5)(B)(ii) for the protection of *creditors*, not debtors,” and thus that the relevant **interest rate** must account for the true risks and costs associated with a Chapter 13 debtor’s promise of future payment. Brief for Respondent 24 (citing *Johnson v. Home State Bank*, 501 U.S. 78, 87–88, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991)). In addition to ignoring the plain language of the statute, which requires no such risk adjustment, respondent overlooks the fact that secured creditors are already compensated in part for the risk of nonpayment through the valuation of the secured claim. In *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), we utilized a secured-creditor-friendly replacement-value standard rather than the lower foreclosure-value standard for valuing secured claims when a debtor has exercised Chapter 13’s cramdown option. We did so because the statute at issue in that case reflected Congress’ recognition that “[i]f a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use.” *Id.*, at 962, 117 S.Ct. 1879.

Further, the plain language of the statute is by no means specifically debtor protective. As the Court pointed out in *Johnson, supra*, at 87–88, 111 S.Ct. 2150, § 1325 contains a number of provisions to protect creditors: A bankruptcy court can only authorize a plan that “has been

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proposed in good faith,” § 1325(a)(3); secured creditors must accept the plan, obtain the property securing the claim, or “retain the[ir] lien[s]” and receive under the plan distributions of property which equal *490 “not less than the allowed amount of such claim,” § 1325(a)(5); and a bankruptcy court must ensure that “the debtor will be able to make all payments under the plan and to comply with the plan,” § 1325(a)(6). Given the presence of multiple creditor-specific protections, it is by no means irrational to assume that Congress opted not to provide further protection for creditors by requiring a debtor-specific risk adjustment under § 1325(a)(5). Although the dissent may feel that this is insufficient compensation for secured creditors, given the apparent rate at which debtors fail to complete their Chapter 13 plans, see *post*, at 1969, and n. 1, this is a matter that should be brought to the attention of Congress rather than resolved by this Court.

II

The allowed amount of the secured claim is \$4,000. App. 57. The statute then requires **1968 a bankruptcy court to identify the “property to be distributed” under the plan. Petitioners’ Amended Chapter 13 Plan (Plan) provided:

“The future earnings of DEBTOR(S) are submitted to the supervision and control of this Court, and DEBTOR(S) shall pay to the TRUSTEE a sum of \$740 ... per month in weekly installments by voluntary wage assignment by separate ORDER of the Court in an estimated amount of \$170.77 and continuing for a total plan term of 36 months unless this Court approves an extension of the term not beyond 60 months from the date of filing the Petition herein.” App. to Pet. for Cert. 77a.

From the payments received, the trustee would then make disbursements to petitioners’ creditors, pro rata among each class of creditors. The Plan listed one priority claim and four secured claims. For respondent’s secured claim, petitioners proposed an **interest rate** of 9.5%. App. 57. Thus, petitioners proposed to distribute to respondent a stream of cash payments equaling respondent’s pro rata share of \$740 per month for a period of up to 36 months. *Id.*, at 12.

*491 Although the Plan does not specifically state that

“the property to be distributed” under the Plan is cash payments, the cash payments are the only “property” specifically listed for distribution under the Plan. Thus, although the plurality and the dissent imply that the “property to be distributed” under the Plan is the mere *promise* to make cash payments, the plain language of the Plan indicates that the “property to be distributed” to respondent is up to 36 monthly cash payments, consisting of a pro rata share of \$740 per month.

The final task, then, is to determine whether petitioners’ proposed 9.5% **interest rate** will sufficiently compensate respondent for the fact that instead of receiving \$4,000 today, it will receive \$4,000 plus 9.5% interest over a period of up to 36 months. Because the 9.5% rate is higher than the risk-free rate, I conclude that it will. I would therefore reverse the judgment of the Court of Appeals.

Justice SCALIA, with whom THE CHIEF JUSTICE, Justice O’CONNOR, and Justice KENNEDY join, dissenting.

My areas of agreement with the plurality are substantial. We agree that, although all confirmed Chapter 13 plans have been deemed feasible by a bankruptcy judge, some nevertheless fail. See *ante*, at 1962. We agree that any deferred payments to a secured creditor must fully compensate it for the risk that such a failure will occur. See *ante*, at 1958. Finally, we agree that adequate compensation may sometimes require an “eye-popping” **interest rate**, and that, if the rate is too high for the plan to succeed, the appropriate course is not to reduce it to a more palatable level, but to refuse to confirm the plan. See *ante*, at 1962.

Our only disagreement is over what procedure will more often produce accurate estimates of the appropriate **interest rate**. The plurality would use the prime lending rate—a rate we *know* is too low—and require the judge in every case to determine an amount by which to increase it. I believe *492 that, in practice, this approach will systematically undercompensate secured creditors for the true risks of default. I would instead adopt the contract rate—*i.e.*, the rate at which the creditor actually loaned funds to the debtor—as a presumption that the bankruptcy judge could revise on motion of either party. Since that rate is generally a good indicator of actual risk, disputes should be infrequent, and it will provide a quick and reasonably accurate standard.

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**1969 I

The contract-rate approach makes two assumptions, both of which are reasonable. First, it assumes that subprime lending markets are competitive and therefore largely efficient. If so, the high **interest rates** lenders charge reflect not extortionate profits or excessive costs, but the actual risks of default that subprime borrowers present. Lenders with excessive rates would be undercut by their competitors, and inefficient ones would be priced out of the market. We have implicitly assumed market competitiveness in other bankruptcy contexts. See [Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership](#), 526 U.S. 434, 456–458, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). Here the assumption is borne out by empirical evidence: One study reports that subprime lenders are nearly twice as likely to be unprofitable as banks, suggesting a fiercely competitive environment. See J. Lane, Associate Director, Division of Supervision, Federal Deposit Insurance Corporation, A Regulator's View of Subprime Lending: Address at the National Automotive Finance Association Non-Prime Auto Lending Conference 6 (June 18–19, 2002) (available in Clerk of Court's case file). By relying on the prime rate, the plurality implicitly assumes that the *prime* lending market is efficient, see *ante*, at 1961; I see no reason not to make a similar assumption about the *subprime* lending market.

The second assumption is that the expected costs of default in Chapter 13 are normally no less than those at the *493 time of lending. This assumption is also reasonable. Chapter 13 plans often fail. I agree with petitioners that the relevant statistic is the percentage of *confirmed* plans that fail, but even resolving that issue in their favor, the risk is still substantial. The failure rate they offer—which we may take to be a conservative estimate, as it is doubtless the lowest one they could find—is 37%. See Girth, [The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals](#), 65 Ind. L.J. 17, 40–42 (1989) (reporting a 63.1% success rate).¹ In every one of the failed plans making up that 37%, a bankruptcy judge had found that “the debtor will be able to make all payments under the plan,” [11 U.S.C. § 1325\(a\)\(6\)](#), and a trustee had supervised the debtor's compliance, § 1302. That so many nonetheless failed proves that bankruptcy judges are not oracles and that trustees cannot draw blood from a stone.

While court and trustee oversight may provide some marginal benefit to the creditor, it seems obviously outweighed by the fact that (1) an already-bankrupt borrower has demonstrated a financial instability and a proclivity to seek legal protection that other subprime borrowers have not, **1970 and *494 (2) the costs of foreclosure are substantially higher in bankruptcy because the automatic stay bars repossession without judicial permission. See § 362. It does not strike me as plausible that creditors would *prefer* to lend to individuals already in bankruptcy than to those for whom bankruptcy is merely a possibility—as if Chapter 13 were widely viewed by secured creditors as some sort of godsend. Cf. Dunagan, [Enforcement of Security Interests in Motor Vehicles in Bankruptcy](#), 52 Consumer Fin. L.Q. Rep. 191, 197 (1998). Certainly the record in this case contradicts that implausible proposition. See App. 48 (testimony of Craig Cook, sales manager of Instant Auto Finance) (“Q. Are you aware of how other lenders similar to Instant Auto Finance view credit applicants who appear to be candidates for Chapter 13 bankruptcy?” “A. Negative[ly] as well”). The better assumption is that bankrupt debtors are riskier than other subprime debtors—or, at the very least, not systematically *less* risky.

The first of the two assumptions means that the contract rate reasonably reflects actual risk at the time of borrowing. The second means that this risk persists when the debtor files for Chapter 13. It follows that the contract rate is a decent estimate, or at least the lower bound, for the appropriate **interest rate** in cramdown.²

The plurality disputes these two assumptions. It argues that subprime lending markets are not competitive because “vehicles are regularly sold by means of tie-in transactions, in which the price of the vehicle is the subject of negotiation, while the terms of the financing are dictated by the seller.” *495 *Ante*, at 1962.³ Tie-ins do not *alone* make financing markets noncompetitive; they only cause prices and **interest rates** to be considered *in tandem* rather than separately. The force of the plurality's argument depends entirely on its claim that “the terms of the financing are dictated by the seller.” *Ibid*. This unsubstantiated assertion is contrary to common experience. Car sellers routinely advertise their **interest rates**, offer promotions like “zero-percent financing,” and engage in other behavior that plainly assumes customers are sensitive to **interest rates** and not just price.⁴

**1971 *496 The plurality also points to state and federal regulation of lending markets. *Ante*, at 1962–1963. It claims that state usury laws evince a belief that subprime lending markets are noncompetitive. While that is one *conceivable* explanation for such laws, there are countless

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others. One statistical and historical study suggests that usury laws are a “primitive means of social insurance” meant to ensure “low **interest rates**” for those who suffer financial adversity. Glaeser & Scheinkman, Neither a Borrower Nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws, 41 J. Law & Econ. 1, 26 (1998). Such a rationale does not reflect a belief that lending markets are inefficient, any more than rent controls reflect a belief that real estate markets are inefficient. Other historical rationales likewise shed no light on the point at issue here. See *id.*, at 27. The mere existence of usury laws is therefore weak support for any position.

The federal Truth in Lending Act, 15 U.S.C. § 1601 **U.S.C. § 1601** *et seq.*, not only fails to support the plurality’s position; it positively refutes it. The plurality claims the Act reflects a belief that full disclosure promotes competition, see *ante*, at 1963, and n. 24; the Act itself says as much, see **15 U.S.C. § 1601(a)**. But that belief obviously *presumes* markets are competitive (or, at least, that they were noncompetitive only because of the absence of the disclosures the Act now requires). If lending markets were not competitive—if the terms of financing were indeed “dictated by the seller,” *ante*, at 1962—disclosure requirements would be pointless, since consumers would have no use for the information.⁵

As to the second assumption (that the expected costs of default in Chapter 13 are normally no less than those at the *497 time of lending), the plurality responds, not that Chapter 13 *as currently administered* is less risky than subprime lending generally, but that it *would* be less risky, if only bankruptcy courts would confirm fewer risky plans. *Ante*, at 1963. Of course, it is often quite difficult to predict which plans will fail. See Norberg, *Consumer Bankruptcy’s New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 *Am. Bankr.Inst. L.Rev.* 415, 462 (1999). But even assuming the high failure rate primarily reflects judicial dereliction rather than unavoidable uncertainty, the plurality’s argument fails for want of any reason to believe the dereliction will abate. While full compensation can be attained either by low-risk plans and low **interest rates**, or by high-risk plans and high **interest rates**, it cannot be attained by high-risk plans and low **interest rates**, which, absent cause to anticipate a change in confirmation practices, is precisely what the formula approach would yield.

The plurality also claims that the contract rate overcompensates creditors because it includes “transaction costs and **1972 overall profits.” *Ante*, at 1960. But the same is true of the rate the plurality

prescribes: The prime lending rate includes banks’ overhead and profits. These are necessary components of *any* commercial lending rate, since creditors will not lend money if they cannot cover their costs and return a level of profit sufficient to prevent their investors from going elsewhere. See **Koopmans v. Farm Credit Services of Mid-America, ACA**, 102 F.3d 874, 876 (C.A.7 1996). The plurality’s criticism might have force if there were reason to believe subprime lenders made exorbitant profits while banks did not—but, again, the data suggest otherwise. See Lane, *Regulator’s View of Subprime Lending*, at 6.⁶

*498 Finally, the plurality objects that similarly situated creditors might not be treated alike. *Ante*, at 1960–1961, and n. 17. But the contract rate is only a presumption. If a judge thinks it necessary to modify the rate to avoid unjustified disparity, he can do so. For example, if two creditors charged different rates solely because they lent to the debtor at different times, the judge could average the rates or use the more recent one. The plurality’s argument might be valid against an approach that *irrebuttably* presumes the contract rate, but that is not what I propose.⁷

II

The defects of the formula approach far outweigh those of the contract-rate approach. The formula approach starts with the prime lending rate—a number that, while objective and easily ascertainable, is indisputably too low. It then adjusts *499 by adding a risk premium that, unlike the prime rate, is neither objective nor easily ascertainable. If the risk premium is typically small relative to the prime rate—as the 1.5% premium added to the 8% prime rate by the court below would lead one to believe—then this subjective element of the computation might be forgiven. But in fact risk premiums, if properly computed, would typically be substantial. For example, if the 21% contract rate is an accurate reflection of risk in this case, the risk **1973 premium would be 13%—nearly two-thirds of the total **interest rate**. When the risk premium is the greater part of the overall rate, the formula approach no longer depends on objective and easily ascertainable numbers. The prime rate becomes the objective tail wagging a dog of unknown size.

As I explain below, the most relevant factors bearing on risk premium are (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the

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collateral market; and (4) the administrative expenses of enforcement. Under the formula approach, a risk premium must be computed in every case, so judges will invariably grapple with these imponderables. Under the contract-rate approach, by contrast, the task of assessing all these risk factors is entrusted to the entity most capable of undertaking it: the market. See [Bank of America, 526 U.S., at 457, 119 S.Ct. 1411](#) (“[T]he best way to determine value is exposure to a market”). All the risk factors are reflected (assuming market efficiency) in the debtor’s contract rate—a number readily found in the loan document. If neither party disputes it, the bankruptcy judge’s task is at an end. There are straightforward ways a debtor *could* dispute it—for example, by showing that the creditor is now substantially oversecured, or that some other lender is willing to extend credit at a lower rate. But unlike the formula approach, which requires difficult estimation in every case, the contract-rate approach requires it only when the parties choose to contest the issue.

***500** The plurality defends the formula approach on the ground that creditors have better access to the relevant information. *Ante*, at 1964–1965. But this is not a case where we must choose between one initial estimate that is too low and another that is too high. Rather, the choice is between one that is far too low and another that is generally reasonably accurate (or, if anything, a bit too low). In these circumstances, consciously choosing the less accurate estimate merely because creditors have better information smacks more of policymaking than of faithful adherence to the statutory command that the secured creditor receive property worth “*not less than* the allowed amount” of its claim, [11 U.S.C. § 1325\(a\)\(5\)\(B\)\(ii\)](#) (emphasis added). Moreover, the plurality’s argument assumes it is plausible—and desirable—that the issue will be litigated in most cases. But the costs of conducting a detailed risk analysis and defending it in court are prohibitively high in relation to the amount at stake in most consumer loan cases. Whatever approach we prescribe, the norm should be—and undoubtedly will be—that the issue is not litigated because it is not worth litigating. Given this reality, it is far more important that the initial estimate be accurate than that the burden of proving inaccuracy fall on the better informed party.

There is no better demonstration of the inadequacies of the formula approach than the proceedings in this case. Petitioners’ economics expert testified that the 1.5% risk premium was “very reasonable” because Chapter 13 plans are “supposed to be financially feasible” and “the borrowers are under the supervision of the court.” App. 43. Nothing in the record shows how these two platitudes

were somehow manipulated to arrive at a figure of 1.5%. It bears repeating that feasibility determinations and trustee oversight do not prevent at least 37% of confirmed Chapter 13 plans from failing. On cross-examination, the expert admitted that he had only limited familiarity with the subprime auto lending market and that he was not familiar with the default rates or the ***501** costs of collection in that market. *Id.*, at 44–45. In light of these devastating concessions, it is ***1974** impossible to view the 1.5% figure as anything other than a smallish number picked out of a hat.

Based on even a rudimentary financial analysis of the facts of this case, the 1.5% figure is obviously wrong—not just off by a couple percent, but probably by roughly an order of magnitude. For a risk premium to be adequate, a hypothetical, rational creditor must be indifferent between accepting (1) the proposed risky stream of payments over time and (2) immediate payment of its present value in a lump sum. Whether he is indifferent—*i.e.*, whether the risk premium added to the prime rate is adequate—can be gauged by comparing benefits and costs: on the one hand, the expected value of the extra interest, and on the other, the expected costs of default.

Respondent was offered a risk premium of 1.5% on top of the prime rate of 8%. If that premium were fully paid as the plan contemplated, it would yield about \$60.⁸ If the debtor defaulted, all or part of that interest would not be paid, so the expected value is only about \$50.⁹ The prime rate itself already includes some compensation for risk; as it turns out, about the same amount, yielding another \$50.¹⁰ ***502** Given the 1.5% risk premium, then, the total expected benefit to respondent was about \$100. Against this we must weigh the expected costs of default. While precise calculations are impossible, rough estimates convey a sense of their scale.

The first cost of default involves depreciation. If the debtor defaults, the creditor can eventually repossess and sell the collateral, but by then it may be substantially less valuable than the remaining balance due—and the debtor may stop paying long before the creditor receives permission to repossess. When petitioners purchased their truck in this case, its value was almost equal to the principal balance on the loan.¹¹ By the time the plan was confirmed, however, the truck was worth only \$4,000, while the balance on the loan was \$4,895. If petitioners were to default on their Chapter 13 payments and if respondent suffered the same relative loss from depreciation, it would amount to about \$550.¹²

****1975** The second cost of default involves liquidation.

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The \$4,000 to which respondent would be entitled if paid in a lump sum reflects the *replacement* value of the vehicle, *i.e.*, the amount it would cost the debtor to purchase a similar used truck. See [Associates Commercial Corp. v. Rash](#), 520 U.S. 953, 965, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997). If the debtor defaults, the creditor cannot sell the truck for that amount; it receives only a lesser ***503** *foreclosure* value because collateral markets are not perfectly liquid and there is thus a spread between what a buyer will pay and what a seller will demand. The foreclosure value of petitioners' truck is not in the record, but, using the relative liquidity figures in [Rash](#) as a rough guide, respondent would suffer a further loss of about \$450.¹³

The third cost of default consists of the administrative expenses of foreclosure. While a Chapter 13 plan is in effect, the automatic stay prevents secured creditors from repossessing their collateral, even if the debtor fails to pay. See [11 U.S.C. § 362](#). The creditor's attorney must move the bankruptcy court to lift the stay. [§ 362\(d\)](#). In the District where this case arose, the filing fee for such motions is now \$150. See United States Bankruptcy Court for the Southern District of Indiana, Schedule of Bankruptcy Fees (Nov. 1, 2003) (available in Clerk of Court's case file). And the standard attorney's fee for such motions, according to one survey, is \$350 in Indiana and as high as \$875 in other States. See J. Cossitt, Chapter 13 Attorney Fee Survey, American Bankruptcy Institute Annual Spring Meeting (Apr. 10–13, 2003) (available in Clerk of Court's case file). Moreover, bankruptcy judges will often excuse first offenses, so foreclosure may require multiple trips to court. The total expected administrative expenses in the event of default could reasonably be estimated at \$600 or more.

I have omitted several other costs of default, but the point is already adequately made. The three figures above total \$1,600. Even accepting petitioners' low estimate of the plan failure rate, a creditor choosing the stream of future payments instead of the immediate lump sum would be selecting an alternative with an expected cost of about \$590 (\$1,600 multiplied by 37%, the chance of failure) and an expected ***504** benefit of about \$100 (as computed above). No rational creditor would make such a choice. The risk premium over prime necessary to make these costs and benefits equal is in the neighborhood of 16%, for a total **interest rate** of 24%.¹⁴

Of course, many of the estimates I have made can be disputed. Perhaps the truck will depreciate more slowly now than at first, perhaps the collateral market is more liquid than the one in [Rash](#), perhaps respondent can

economize on attorney's fees, and perhaps there is some reason (other than judicial optimism) to think the **Tills** were unlikely to default. I have made some liberal assumptions,¹⁵ but also some ***1976** conservative ones.¹⁶ When a risk premium is off by an order of magnitude, one's estimates need not be very precise to show that it cannot possibly be correct.

In sum, the 1.5% premium adopted in this case is far below anything approaching fair compensation. That result is not unusual, see, *e.g.*, [In re Valenti](#), 105 F.3d 55, 64 (C.A.2 1997) (recommending a 1%–3% premium over the *treasury* rate—*i.e.*, approximately a 0% premium over prime); it is the entirely predictable consequence of a methodology that tells bankruptcy judges to set **interest rates** based on highly imponderable factors. Given the inherent uncertainty of the enterprise, what heartless bankruptcy judge can be expected to demand that the unfortunate debtor pay *triple* the prime rate as a condition of keeping his sole means of transportation? It challenges human nature.

*505 III

Justice THOMAS rejects both the formula approach and the contract-rate approach. He reads the statutory phrase “property to be distributed under the plan,” [11 U.S.C. § 1325\(a\)\(5\)\(B\)\(ii\)](#), to mean the proposed payments *if made as the plan contemplates*, so that the plan need only pay the risk-free rate of interest. *Ante*, at 1966 (opinion concurring in judgment). I would instead read this phrase to mean the right to receive payments that the plan vests in the creditor upon confirmation. Because there is no guarantee that the promised payments will in fact be made, the value of this property right must account for the risk of nonpayment.

Viewed in isolation, the phrase is susceptible of either meaning. Both the promise to make payments and the proposed payments themselves are property rights, the former “to be distributed under the plan” immediately upon confirmation, and the latter over the life of the plan. Context, however, supports my reading. The cramdown option which the debtors employed here is only one of three routes to confirmation. The other two—creditor acceptance and collateral surrender, [§§ 1325\(a\)\(5\)\(A\), \(C\)](#)—are both creditor protective, leaving the secured creditor roughly as well off as he would have been had

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the debtor not sought bankruptcy protection. Given this, it is unlikely the third option was meant to be substantially underprotective; that would render it so much more favorable to debtors that few would ever choose one of the alternatives.

The risk-free approach also leads to anomalous results. Justice THOMAS admits that, if a plan distributes a note rather than cash, the value of the “property to be distributed” must reflect the risk of default on the note. *Ante*, at 1966–1967. But there is no practical difference between obligating the debtor to make deferred payments under a plan and obligating the debtor to sign a note that requires those same payments. There is no conceivable reason why Congress *506 would give secured creditors risk compensation in one case but not the other.

Circuit authority uniformly rejects the risk-free approach. While Circuits addressing the issue are divided over *how* to calculate risk, to my knowledge all of them require some compensation for risk, either explicitly or implicitly. See *In re Valenti*, *supra*, at 64 (treasury rate plus 1%–3% risk premium); *GMAC v. Jones*, 999 F.2d 63, 71 (C.A.3 1993) (contract rate); *United Carolina Bank v. Hall*, 993 F.2d 1126, 1131 (C.A.4 1993) (creditor’s rate for similar **1977 loans, but not higher than contract rate); *In re Smithwick*, 121 F.3d 211, 214 (C.A.5 1997) (contract rate); *In re Kidd*, 315 F.3d 671, 678 (C.A.6 2003) (market rate for similar loans); *In re Till*, 301 F.3d 583, 592–593 (C.A.7 2002) (case below) (contract rate); *In re Fisher*, 930 F.2d 1361, 1364 (C.A.8 1991) (market rate for similar loans) (interpreting parallel Chapter 12 provision); *In re Fowler*, 903 F.2d 694, 698 (C.A.9 1990) (prime rate plus risk premium); *In re Hardzog*, 901 F.2d 858, 860 (C.A.10 1990) (market rate for similar loans, but not higher than contract rate) (Chapter 12); *In re Southern States Motor Inns, Inc.*, 709 F.2d 647, 652–653 (C.A.11 1983) (market rate for similar loans) (interpreting similar Chapter 11 provision); see also 8 Collier on Bankruptcy, ¶ 1325.06[3][b], p. 1325–37 (rev. 15th ed. 2004). Justice THOMAS identifies no decision adopting his view.

Nor does our decision in *Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148, support the risk-free approach. There we considered whether a secured creditor’s claim should be valued at what the debtor would pay to replace the collateral or at the lower price the creditor would receive from a foreclosure sale. Justice THOMAS contends that *Rash* selected the former in order to compensate creditors for the risk of plan failure,

and that, having compensated them once in that context, we need not do so again here. *Ante*, at 1967. I disagree with this reading of *Rash*. The Bankruptcy Code provides that “value shall be determined in light of the purpose of the valuation and of the *507 proposed disposition or use of [the] property.” 11 U.S.C. § 506(a). *Rash* held that the foreclosure-value approach failed to give effect to this language, because it assigned the same value whether the debtor surrendered the collateral or was allowed to retain it in exchange for promised payments. 520 U.S., at 962, 117 S.Ct. 1879. “From the creditor’s perspective as well as the debtor’s, surrender and retention are not equivalent acts.” *Ibid*. We did point out that retention entails risks for the creditor that surrender does not. *Id.*, at 962–963, 117 S.Ct. 1879. But we made no effort to correlate that increased risk with the difference between replacement and foreclosure value. And we also pointed out that retention benefits the debtor by allowing him to continue to use the property—a factor we considered “[o]f prime significance.” *Id.*, at 963, 117 S.Ct. 1879. *Rash* stands for the proposition that surrender and retention are fundamentally different sorts of “disposition or use,” calling for different valuations. Nothing in the opinion suggests that we thought the valuation difference reflected the degree of increased risk, or that we adopted the replacement-value standard *in order to compensate* for increased risk. To the contrary, we said that the debtor’s “actual use ... is the proper guide under a prescription hinged to the property’s ‘disposition or use.’ ” *Ibid*.

If Congress wanted to compensate secured creditors for the risk of plan failure, it would not have done so by prescribing a particular method of valuing collateral. A plan may pose little risk even though the difference between foreclosure and replacement values is substantial, or great risk even though the valuation difference is small. For example, if a plan proposes immediate cash payment to the secured creditor, he is entitled to the higher replacement value under *Rash* even though he faces no risk at all. If the plan calls for deferred payments but the collateral consists of listed securities, the valuation difference may be trivial, but the creditor still faces substantial risks. And a creditor oversecured in even the slightest degree at **1978 the time of bankruptcy *508 derives no benefit at all from *Rash*, but still faces some risk of collateral depreciation.¹⁷

There are very good reasons for Congress to prescribe full risk compensation for creditors. Every action in the free market has a reaction somewhere. If subprime lenders are

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systematically undercompensated in bankruptcy, they will charge higher rates or, if they already charge the legal maximum under state law, lend to fewer of the riskiest borrowers. As a result, some marginal but deserving borrowers will be denied vehicle loans in the first place. Congress evidently concluded that widespread access to credit is worth preserving, even if it means being ungenerous to sympathetic debtors.

Of those eight, four are of the view that beginning with the contract rate would most accurately reflect the actual risk, and four are of the view that beginning with the prime lending rate would do so. The ninth Justice takes no position on the latter point, since he disagrees with the eight on the former point; he would reverse because the rate proposed here, being above the risk-free rate, gave respondent no cause for complaint. Because I read the statute to require full risk compensation, and because I would adopt a valuation method that has a realistic prospect of enforcing that directive, I respectfully dissent.

* * *

Today's judgment is unlikely to burnish the Court's reputation for reasoned decisionmaking. Eight Justices are in agreement that the rate of interest set forth in the debtor's approved plan must include a premium for risk.

All Citations

541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2, Bankr. L. Rep. P 80,099, 04 Cal. Daily Op. Serv. 4224, 2004 Daily Journal D.A.R. 5841, 17 Fla. L. Weekly Fed. S 282

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See [United States v. Detroit Timber & Lumber Co.](#), 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

¹ [11 U.S.C. § 1325\(a\)\(5\)](#). The text of the statute reads as follows:

“[§ 1325](#). Confirmation of plan

“(a) Except as provided in subsection (b), the court shall confirm a plan if—

.....

“(5) with respect to each allowed secured claim provided for by the plan—

“(A) the holder of such claim has accepted the plan;

“(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

“(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

“(C) the debtor surrenders the property securing such claim to such holder....”

² As we noted in [Associates Commercial Corp. v. Rash](#), 520 U.S. 953, 962, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), a debtor may also avail himself of the second option (surrender of the collateral) despite the creditor's objection.

³ See [Rake v. Wade](#), 508 U.S. 464, 472, n. 8, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993) (noting that property distributions under [§ 1325\(a\)\(5\)\(B\)\(ii\)](#) may take the form of “a stream of future payments”).

⁴ In the remainder of the opinion, we use the term “present value” to refer to the value as of the effective date of the bankruptcy plan.

⁵ [Title 11 U.S.C. § 506\(a\)](#) provides:

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“An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in such property, ... and is an unsecured claim to the extent that the value of such creditor’s interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor’s interest.”

⁶ See §§ 541(a), 1306(a).

⁷ Petitioners submitted an initial plan that would have required them to assign \$1,089 of their wages to the trustee every month. App. 9. Their amended plan, however, reduced this monthly payment to \$740. App. to Pet. for Cert. 77a.

⁸ The requirement of financial feasibility derives from [11 U.S.C. § 1325\(a\)\(6\)](#), which provides that the bankruptcy court shall “confirm a plan if ... the debtor will be able to make all payments under the plan and to comply with the plan.” See *infra*, at 1962.

⁹ As 21% is the maximum **interest rate** creditors may charge for consumer loans under Indiana’s usury statute, [Ind.Code § 24–4.5–3–201 \(1993\)](#), the remand presumably could not have benefited respondent.

¹⁰ See [11 U.S.C. § 1129\(a\)\(7\)\(A\)\(ii\)](#) (requiring payment of property whose “value, as of the effective date of the plan” equals or exceeds the value of the creditor’s claim); [§§ 1129\(a\)\(7\)\(B\)](#), [1129\(a\)\(9\)\(B\)\(i\)](#), [1129\(a\)\(9\)\(C\)](#), [1129\(b\)\(2\)\(A\)\(i\)\(II\)](#), [1129\(b\)\(2\)\(B\)\(i\)](#), [1129\(b\)\(2\)\(C\)\(i\)](#), [1173\(a\)\(2\)](#), [1225\(a\)\(4\)](#), [1225\(a\)\(5\)\(B\)\(ii\)](#), [1228\(b\)\(2\)](#), [1325\(a\)\(4\)](#), [1228\(b\)\(2\)](#) (same).

¹¹ [Section 1322\(b\)\(2\)](#) provides:

“[T]he plan may ... modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence, ... or leave unaffected the rights of holders of any class of claims.”

¹² Several factors contribute to this reduction in risk. First, as noted below, *infra*, at 1962, a court may only approve a cramdown loan (and the debt adjustment plan of which the loan is a part) if it believes the debtor will be able to make all of the required payments. [§ 1325\(a\)\(6\)](#). Thus, such loans will only be approved for debtors that the court deems creditworthy. Second, Chapter 13 plans must “provide for the submission” to the trustee “of all or such portion of [the debtor’s] future ... income ... as is necessary for the execution of

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the plan," § 1322(a)(1), so the possibility of nonpayment is greatly reduced. Third, the Bankruptcy Code's extensive disclosure requirements reduce the risk that the debtor has significant undisclosed obligations. Fourth, as a practical matter, the public nature of the bankruptcy proceeding is likely to reduce the debtor's opportunities to take on additional debt. Cf. 11 U.S.C. § 525 (prohibiting certain Government grant and loan programs from discriminating against applicants who are or have been bankrupt).

¹³ We reached a similar conclusion in *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), when we held that a creditor's secured interest should be valued from the debtor's, rather than the creditor's, perspective. *Id.*, at 963, 117 S.Ct. 1879 ("[The debtor's] actual use, rather than a foreclosure sale that will not take place, is the proper guide ...").

¹⁴ This fact helps to explain why there is no readily apparent Chapter 13 "cram down market rate of interest": Because every cramdown loan is imposed by a court over the objection of the secured creditor, there is no free market of willing cramdown lenders. Interestingly, the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. See, e.g., Balmoral Financial Corporation, <http://www.balmoral.com/bdip.htm> (all Internet materials as visited Mar. 4, 2004, and available in Clerk of Court's case file) (advertising debtor in possession lending); Debtor in Possession Financing: 1st National Assistance Finance Association DIP Division, <http://www.loanmallusa.com/dip.htm> (offering "to tailor a financing program ... to your business' needs and ... to work closely with your bankruptcy counsel"). Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce. In the Chapter 13 context, by contrast, the absence of any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure.

¹⁵ See *supra*, at 1957 (noting that the District Court's coerced loan approach aims to set the cramdown **interest rate** at the level the creditor could obtain from new loans of comparable duration and risk).

¹⁶ Cf. 11 U.S.C. § 1322(a)(3) ("The plan shall ... provide the same treatment for each claim within a particular class").

¹⁷ For example, suppose a debtor purchases two identical used cars, buying the first at a low purchase price from a lender who charges high interest, and buying the second at a much higher purchase price from a lender who charges zero-percent or nominal interest. Prebankruptcy, these two loans might well produce identical income streams for the two lenders. Postbankruptcy, however, the presumptive contract rate approach would entitle the first lender to a considerably higher cramdown **interest rate**, even though the two secured debts are objectively indistinguishable.

¹⁸ We note that, if the court could somehow be certain a debtor would complete his plan, the prime rate would be adequate to compensate any secured creditors forced to accept cramdown loans.

¹⁹ The fact that Congress considered but rejected legislation that would endorse the Seventh Circuit's presumptive contract rate approach, H.R. 1085, 98th Cong., 1st Sess., § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess., § 19(2)(A) (1983); H.R. 4786, 97th Cong., 1st Sess., § 19(2)(A) (1981), lends some support to our conclusion. It is perhaps also relevant that our conclusion is endorsed by the Executive Branch of the Government and by the National Association of Chapter Thirteen Trustees. Brief for United States as *Amicus Curiae*; Brief for National Association of Chapter Thirteen Trustees as *Amicus Curiae*. If we have misinterpreted Congress' intended meaning of "value, as of the date of the plan," we are confident it will enact appropriate remedial legislation.

²⁰ The dissent notes that "[t]he ins do not *alone* make financing markets noncompetitive; they only cause prices and **interest rates** to be considered *in tandem* rather than separately." *Post*, at 1970. This statement, while true, is nonresponsive. If a market prices the cost of goods and the cost of financing

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together, then even if that market is perfectly competitive, all we can know is that the *combined* price of the goods and the financing is competitive and efficient. We have no way of determining whether the allocation of that price between goods and financing would be the same if the two components were separately negotiated. But the only issue before us is the cramdown **interest rate** (the cost of financing); the value of respondent's truck (the cost of the goods) is fixed. See [Rash](#), 520 U.S., at 960, 117 S.Ct. 1879 (setting the value of collateral in Chapter 13 proceedings at the "price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller"). The competitiveness of the market for cost-cum-financing is thus irrelevant to our analysis.

²¹ For example, the Truth in Lending Act regulates credit transactions and credit advertising. [15 U.S.C. §§ 1604–1649, 1661–1665b](#).

²² Usury laws provide the most obvious examples of state regulation of the subprime market. See, e.g., [Colo.Rev.Stat. § 5–2–201 \(2003\)](#); [Fla. Stat. Ann. § 537.011 \(Supp.2004\)](#); [Ind.Code § 24–4.5–3–201 \(1993\)](#); [Md. Com. Law Code Ann. § 12–404\(d\) \(2000\)](#).

²³ Lending practices in Mississippi, "where there currently is no legal usury rate," support this conclusion: In that State, subprime lenders charge rates "as high as 30 to 40%"—well above the rates that apparently suffice to support the industry in States like Indiana. Norberg, [Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13](#), 7 *Am. Bankr.Inst. L.Rev.* 415, 438–439 (1999).

²⁴ See also H.R.Rep. No. 1040, 90th Cong., 1st Sess., 17 (1967) ("The basic premise of the application of disclosure standards to credit advertising rests in the belief that a substantial portion of consumer purchases are induced by such advertising and that if full disclosure is not made in such advertising, the consumer will be deprived of the opportunity to effectively comparison shop for credit").

²⁵ The United States, too, notes that "[t]he text of [Section 1325](#) is consistent with the view that the appropriate discount rate should reflect only the time value of money and not any risk premium." Brief for United States as *Amicus Curiae* 11, n. 4. The remainder of the United States' brief, however, advocates the formula approach. See, e.g., *id.*, at 19–28.

¹ For example, if the relevant **interest rate** is 10%, receiving \$4,000 one year from now is the equivalent to receiving \$3,636.36 today. In other words, an investor would be indifferent to receiving \$3,636.36 today and receiving \$4,000 one year from now because each will equal \$4,000 one year from now.

² The prime rate is "[t]he **interest rate** most closely approximating the riskless or pure rate for money." G. Munn, F. Garcia, & C. Woelfel, *Encyclopedia of Banking & Finance* 830 (rev. 9th ed.1991).

³ Of course, in an efficient market, this risk has been (or will be) built into the **interest rate** of the original loan.

¹ The true rate of plan failure is almost certainly much higher. The Girth study that yielded the 37% figure was based on data for a single division (Buffalo, New York) from over 20 years ago (1980–1982). See [65 Ind. L. J.](#), at 41. A later study concluded that "the Buffalo division ha[d] achieved extraordinary results, far from typical for the country as a whole." Whitford, [The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy](#), 68 *Am. Bankr.L.J.* 397, 411, n. 50 (1994). Although most of respondent's figures are based on studies that do not clearly exclude unconfirmed plans, one study includes enough detail to make the necessary correction: It finds 32% of filings successful, 18% dismissed without confirmation of a plan, and 49% dismissed after confirmation, for a postconfirmation failure rate of 60% (*i.e.*, 49% ÷ (32% + 49%)). See Norberg, [Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13](#), 7 *Am. Bankr.Inst. L.Rev.* 415, 440–441 (1999). This 60% failure rate is far higher than the 37% reported by Girth.

- 2 The contract rate is only a presumption, however, and either party remains free to prove that a higher or lower rate is appropriate in a particular case. For example, if market **interest rates** generally have risen or fallen since the contract was executed, the contract rate could be adjusted by the same amount in cases where the difference was substantial enough that a party chose to make an issue of it.
- 3 To the extent the plurality argues that subprime lending markets are not “*perfectly* competitive,” *ante*, at 1962 (emphasis added), I agree. But there is no reason to doubt they are *reasonably* competitive, so that pricing in those markets is *reasonably* efficient.
- 4 I confess that this is “nonresponsive” to the argument made in the plurality’s footnote (that the contract **interest rate** may not accurately reflect risk when set jointly with a car’s sale price), see *ante*, at 1962, n. 20; it is in response to the quite different argument made in the plurality’s text (that joint pricing shows that the subprime lending market is not competitive), see *ante*, at 1962. As to the *former* issue, the plurality’s footnote makes a fair point. When the seller provides financing itself, there is a possibility that the contract **interest rate** might not reflect actual risk because a higher contract **interest rate** can be traded off for a lower sale price and vice versa. Nonetheless, this fact is not likely to bias the contract-rate approach in favor of creditors to any significant degree. If a creditor offers a promotional **interest rate**—such as “zero-percent financing”—in return for a higher sale price, the creditor bears the burden of showing that the true **interest rate** is higher than the contract rate. The opposite tactic—inflating the **interest rate** and decreasing the sale price—is constrained at some level by the buyer’s option to finance through a third party, thus taking advantage of the lower price while avoiding the higher **interest rate**. (If a seller were to condition a price discount on providing the financing itself, the debtor should be entitled to rely on that condition to rebut the presumption that the contract rate reflects actual risk.) Finally, the debtor remains free to rebut the contract rate with any other probative evidence. While joint pricing may introduce some inaccuracy, the contract rate is still a far better initial estimate than the prime rate.
- 5 The plurality also argues that regulatory context is relevant because it “distorts the market.” *Ante*, at 1963. Federal disclosure requirements do not distort the market in any meaningful sense. And while state usury laws do, that distortion works only to the benefit of debtors under the contract-rate approach, since it keeps contract rates artificially low.
- 6 Some transaction costs are avoided by the creditor in bankruptcy—for example, loan-origination costs such as advertising. But these are likely only a minor component of the **interest rate**. According to the record in this case, for example, the average **interest rate** on new-car loans was roughly 8.5%—only about 0.5% higher than the prime rate and 2.5% higher than the risk-free treasury rate. App. 43 (testimony of Professor Steve Russell). And the 2% difference between prime and treasury rates represented “mostly ... risk [and] to some extent transaction costs.” *Id.*, at 42. These figures suggest that loan-origination costs included in the new-car loan and prime rates but not in the treasury rate are likely only a fraction of a percent. There is no reason to think they are substantially higher in the subprime auto lending market. Any transaction costs the creditor avoids in bankruptcy are thus far less than the additional ones he incurs.
- 7 The plurality’s other, miscellaneous criticisms do not survive scrutiny either. That the cramdown provision applies to prime as well as subprime loans, *ante*, at 1964, proves nothing. Nor is there any substance to the argument that the formula approach will perform better where “national or local economic conditions drastically improved or declined after the original loan was issued.” *Ibid.* To the extent such economic changes are reflected by changes in the prime rate, the contract rate can be adjusted by the same amount. See n. 2, *supra*. And to the extent they are not, they present the same problem under either approach: When a party disputes the presumption, the court must gauge the significance of the economic change and adjust accordingly. The difference, again, is that the contract-rate approach starts with a number that (but for the economic change) is reasonably accurate, while the formula approach starts with a number that (with or without the economic change) is not even close.
- 8 Given its priority, and in light of the amended plan’s reduced debtor contributions, the \$4,000 secured claim

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would be fully repaid by about the end of the second year of the plan. The average balance over that period would be about \$2,000, *i.e.*, half the initial balance. The total interest premium would therefore be $1.5\% \times 2 \times \$2,000 = \$60$. In this and all following calculations, I do not adjust for time value, as timing effects have no substantial effect on the conclusion.

- 9 Assuming a 37% rate of default that results on average in only half the interest's being paid, the expected value is $\$60 \times (1 - 37\% \div 2)$, or about \$50.
- 10 According to the record in this case, the prime rate at the time of filing was 2% higher than the risk-free treasury rate, and the difference represented "mostly ... risk [and] to some extent transaction costs." App. 42 (testimony of Professor Steve Russell); see also Federal Reserve Board, Selected **Interest Rates**, <http://www.federalreserve.gov/releases/h15/data.htm> (as visited Apr. 19, 2004) (available in Clerk of Court's case file) (historical data showing prime rate typically exceeding 3-month constant-maturity treasury rate by 2%–3.5%). If "mostly" means about three-quarters of 2%, then the risk compensation included in the prime rate is 1.5%. Because this figure happens to be the same as the risk premium over prime, the expected value is similarly \$50. See nn. 8–9, *supra*.
- 11 The truck was initially worth \$6,395; the principal balance on the loan was about \$6,426.
- 12 On the original loan, depreciation ($\$6,395 - \$4,000$, or \$2,395) exceeded loan repayment ($\$6,426 - \$4,895$, or \$1,531) by \$864, *i.e.*, 14% of the original truck value of \$6,395. Applying the same percentage to the new \$4,000 truck value yields approximately \$550.
- 13 The truck in *Rash* had a replacement value of \$41,000 and a foreclosure value of \$31,875, *i.e.*, 22% less. *520 U.S.*, at 957, 117 S.Ct. 1879. If the market in this case had similar liquidity and the truck were repossessed after losing half its remaining value, the loss would be 22% of \$2,000, or about \$450.
- 14 A 1.5% risk premium plus a 1.5% risk component in the prime rate yielded an expected benefit of about \$100, see *supra*, at 1973–1974, so, to yield \$590, the total risk compensation would have to be 5.9 times as high, *i.e.*, almost 18%, or a 16.5% risk premium over prime.
- 15 For example, by ignoring the possibility that the creditor might recover some of its undersecurity as an unsecured claimant, that the plan might fail only after full repayment of secured claims, or that an oversecured creditor might recover some of its expenses under *11 U.S.C. § 506(b)*.
- 16 For example, by assuming a failure rate of 37%, cf. n. 1, *supra*, and by ignoring all costs of default other than the three mentioned.
- 17 It is true that, if the debtor defaults, one of the costs the creditor suffers is the cost of liquidating the collateral. See *supra*, at 1975. But it is illogical to "compensate" for this risk by requiring all plans to pay the full cost of liquidation (replacement value minus foreclosure value), rather than an amount that reflects the possibility that liquidation will actually be necessary and that full payments will not be made.

 KeyCite Yellow Flag - Negative Treatment
Declined to Extend by [In re Matthews](#), Bankr.S.D.Ga., September 30, 2020

610 B.R. 308
United States Bankruptcy Court, N.D. California.

IN RE: PG&E CORPORATION,
and
Pacific Gas and Electric Company, Debtors.
Affects both Debtors

* All papers shall be filed in the Lead Case, No.
19-30088 (DM).

Bankruptcy Case No. 19-30088-DM Jointly
Administered

Date: December 11, 2019, Time: 10:00 AM, Place:
Courtroom 17, 450 Golden Gate Ave., 16th Floor,
San Francisco, CA

Signed December 30, 2019

Synopsis

Background: Parties sought to determine applicable postpetition interest to be paid to four classes of allowed unsecured and unimpaired claims under any Chapter 11 reorganization plan for solvent corporate debtors.

[Holding:] The Bankruptcy Court, [Dennis Montali, J.](#), held that unsecured creditors were entitled to postpetition interest at the federal judgment rate, not at contractual or state statutory rates.

Ordered accordingly.

Procedural Posture(s): Other.

West Headnotes (8)

[1] **Bankruptcy** Construction and Operation

Statutory construction of the Bankruptcy Code is a holistic endeavor requiring consideration of the entire statutory scheme.

[2] **Bankruptcy** Application of state or federal law in general

Underlying non-bankruptcy law must give way to contrary provisions of the Bankruptcy Code.

[3] **Courts** Decisions of Higher Court or Court of Last Resort

Courts are bound by the decisions of higher courts under the principle of stare decisis.

[4] **Courts** Conclusiveness of decisions of Court of Appeals within its circuit

Under principle of stare decisis, decision of circuit court of appeals is binding on all lower courts in circuit, including district courts and bankruptcy courts, absent contrary United States Supreme Court decision.

[5] **Courts** Conclusiveness of decisions of Court of Appeals within its circuit

Decision of circuit court of appeals is binding on all lower courts in circuit, even if there is split of opinion between controlling circuit and another circuit court of appeals, and lower court believes that controlling circuit court is in error.

[6] **Bankruptcy** Post-petition interest

Use of terms “legal rate,” in requiring solvent debtors to pay postpetition interest “at the legal rate” to their unsecured creditors, indicates Congress intended the single source used to calculate appropriate rate of interest to be statutory because of the common use of the term when the Bankruptcy Code was enacted. 11 U.S.C.A. § 726(a)(5).

2 Cases that cite this headnote

[7] **Bankruptcy** Post-petition interest

In Chapter 11 cases involving solvent debtors, unsecured creditors are entitled to postpetition interest at the federal judgment rate, not at contractual or state statutory rates. 11 U.S.C.A. § 726(a)(5); 28 U.S.C.A. § 1961(a).

2 Cases that cite this headnote

[8] **Bankruptcy** “Deemed” acceptance; unimpaired classes

Unimpaired creditors, when treated as dictated by the Bankruptcy Code, are not impaired by a Chapter 11 plan; they are conclusively presumed to have accepted the plan. 11 U.S.C.A. § 1124, 1126(f).

1 Cases that cite this headnote

Attorneys and Law Firms

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**MEMORANDUM DECISION REGARDING
POSTPETITION INTEREST**

DENNIS MONTALI, U.S. Bankruptcy Judge

I. INTRODUCTION

On December 11, 2019, the court heard oral argument on the discrete legal issue of the applicable postpetition interest to be paid to four classes of allowed unsecured and unimpaired claims, under any chapter 11 reorganization plan for solvent debtors PG&E Corporation and Pacific Gas and Electric Company (“Debtors”). The Debtors, joined by certain Shareholders, argue that creditors in all four classes should receive interest calculated pursuant to 28 U.S.C. § 1961(a) (the “Federal Interest Rate”) in effect as of the petition date (January 29, 2019) these chapter 11 cases. That rate for these jointly administered cases is 2.59 percent. Debtors contend that use of the Federal Interest Rate is consistent with *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002) (“*Cardelucci*”), which holds that unsecured creditors in a solvent case *310 should receive postpetition interest calculated at the Federal Interest Rate.

Several parties, including the Official Committee of Unsecured Creditors, the Ad Hoc Committee of Senior Unsecured Noteholders, the Ad Hoc Committee of Holders of Trade Claims and others (collectively “Unsecured Creditors”) oppose the motion. They urge application of various rates, generally determined by applicable contracts between the Debtors and the respective claimants, judgment rates or some other rate.

For the following reasons, the court concludes that the

Debtors are correct, that  *Cardelucci* controls and that the Federal Interest Rate applies to any Plan.

II. APPLICABLE LAW

^[1]Statutory construction of the Bankruptcy Code¹ is “a holistic endeavor” requiring consideration of the entire statutory scheme.  *United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988), cited by  *In re BCE West, L.P.*, 319 F.3d 1166, 1171 (9th Cir. 2003).

In  *Timbers*, the Supreme Court utilized this holistic approach to analyze five seemingly unconnected provisions of Title 11 in determining that oversecured creditors are entitled to receive postpetition interest. Applying a similar holistic approach, this court has looked to the structure of the Bankruptcy Code and the purposes behind its many parts to conclude while unsecured creditors are entitled to postpetition interest in a solvent estate, the Bankruptcy Code requires application of the Federal Interest Rate to those claims and that such an application does not impair these claims. Even if  *Cardelucci* were not binding, the court would reach the same conclusion.

Chapter 5, subchapter I (“Creditors and Claims”) of the Bankruptcy Code sets forth the guiding principles for filing and allowance of claims or interests, administrative expenses, determination of secured status and other provisions not important to the current analysis. In contrast, the court must apply the critical provisions of chapter 11, subchapter II (“The Plan”). Section 1123(a) states what a plan “shall” do or include. Section 1123(b) states what a plan “may” do or include. As a definitional matter, section 1124 explains that a class of claims or interest is impaired unless the plan leaves certain legal, equitable and contractual rights unaltered (§ 1124(1)), or cures, restates, or compensates the rights of class or interest members (§ 1124(2)(A)-(E)).

The structure of the Bankruptcy Code and the applicability of these definitional and empowering sections, therefore, dictate rights that are fixed as of the petition date and what rules apply after that. Nothing suggests that, absent specific rules, provisions dealing with prepetition entitlements carry over postpetition. For example, section 502(b)(2) clearly provides that a claim for “unmatured interest”² may not be allowed. An exception to the rule is found in section 506(b) that

permits accrued interest to be allowed as long as the security is “greater than the amount of such claim.”

The Unsecured Creditors’ argument that somehow the definitions and remedies found in section 1124 override the plain impact of section 502(b)(2) is simply not ***311** persuasive and would require the court to ignore not only the plain words of the statute but also the holistic notion of treating them as part of a combined comprehensive instrument of definitions, applicability and implementation. Section 1124(1) describes what claims are unimpaired and section 1124(2) describes what is necessary for a plan to “unimpaired” impaired claims. In contrast, chapter 5 (“Creditors and Claims”) dictates how claims and interests are dealt with in the substantive chapters: 7, 11, 12 and 13. The subparts of section 502(b) list nine specific rules for affecting allowed claims.

^[2]An example not directly related to this case proves the point. Section 502(b)(4) disallows the claim of an insider or an attorney to the extent it exceeds the reasonable value of the services. Unsecured Creditors could not persuade the court or even make a convincing argument that somehow an insider or an attorney whose asserted claim exceeds a reasonable value could take refuge in section 1124(1)’s definitional provision and escape the clear intention of Congress to limit unreasonable claims for services in the same manner it has limited postpetition unsecured claims for unmatured interest. For the same reason, underlying non-bankruptcy law must give way to contrary provisions of the Bankruptcy Code.  *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 444, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (quoting  *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 20, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000)).

With that background, the court turns to the applicability of  *Cardelucci* and its clear message.

III. THIS COURT’S RESPONSIBILITY UNDER *STARE DECISIS*

^[3] ^[4] ^[5]This court is bound by the Ninth Circuit’s  *Cardelucci* decision unless it can be distinguished or overruled:

Courts are bound by the decisions of higher courts under the principle of *stare decisis*. The doctrine derives from the maxim of the common law, “*Stare decisis et non quieta movere*,” which literally means, “Let stand what is decided, and do not disturb what is

settled.” See 1B Jeremy C. Moore et al., Moore’s Federal Practice ¶ 0.402[1] (2d ed. 1992). Moore’s treatise describes the rule as follows:

The rule, as developed in the English law, is that a decision on an issue of law embodied in a final judgment is binding on the court that decided it and such other courts as owe obedience to its decisions, in all future cases. *Id.*

Under this principle a decision of a circuit court of appeal is binding on all lower courts in the circuit, including district courts and bankruptcy courts (absent a contrary United States Supreme Court decision). *Zuniga v. United Can Co.*, 812 F.2d 443, 450 (9th Cir. 1987).

This is true even if there is a split of opinion between the controlling circuit and another circuit court of appeals, and the lower court believes that the controlling circuit court is in error. *Zuniga*, 812 F.2d at 450; *Hasbrouck v. Texaco, Inc.*, 663 F.2d 930, 933 (9th Cir. 1981)[.]

In re Globe Illumination Co., 149 B.R. 614, 617 (Bankr. C.D. Cal. 1993) (multiple internal citations omitted).

Cardelucci is a published panel opinion by the Court of Appeals for the Ninth Circuit. It is binding on this court. *State Farm Fire & Cas. Ins. Co. v. GP West, Inc.*, 190 F. Supp.3d 1003, 1018 (D. Haw. 2016) (citation and internal quotation marks omitted). See *Lair v. Bullock*, 798 F.3d 736, 747 (9th Cir. 2015) (“[W]e are bound by a prior three-judge panel’s published *312 opinions, ...”) (citing *Miller v. Gammie*, 335 F.3d 889, 892–93 (9th Cir. 2003) (en banc)).

IV. THE HOLDING OF *CARDELUCCI*

In *Cardelucci*, the Ninth Circuit framed the issue before it as follows:

This appeal presents the narrow but important issue of whether such post-petition interest is to be calculated using the (federal judgment rate) or is determined by

the parties’ contract or state law.

Cardelucci, 285 F.3d at 1231.

The Ninth Circuit held that in chapter 11 cases involving solvent debtors, unsecured creditors are entitled to postpetition interest at the federal judgment rate, not at not at contractual or state statutory rates. *Id.* at 1234. In so holding, the Ninth Circuit observed that application of the lower federal judgment rate did not violate an unsecured creditor’s substantive due process rights (*id.* at 1236) and that utilization of federal judgment rate for all claims was rationally related to legitimate interests in efficiency, fairness, predictability, and uniformity within bankruptcy system. *Id.*

While the court pinpointed a “narrow but important issue,” it did not narrow the application of its holding, which must be applied broadly given the structure of the Bankruptcy Code and the clear and plain meaning of its applicable provisions, as noted above.

In *Cardelucci*, the debtor and his opponents, holders of a state court judgment, set aside various differences and thereby permitted confirmation to proceed subject to a reservation of rights concerning the applicable postpetition interest rate.³ The Ninth Circuit concluded that the reference by Congress to “the legal rate” in section 726(a)(5) was intentional, in that Congress had rejected proposed language of “interest on claims allowed.” *Cardelucci*, 285 F.3d at 1234. The court also emphasized that a single, easily determined rate for all postpetition interest ensures equitable treatment of creditors.⁴ Although *Cardelucci* was a chapter 11 case, the reference to section 726(a)(5) was critical. Without that reference, the court would be compelled by section 502(b)(2) to allow claims “except to the extent that ... (2) such claim is for unmatured interest.”⁵ There is no specific provision in chapter 11 that allows any interest on unsecured claims.⁶ Without that reference, Unsecured Creditors would be left with no allowed postpetition interest.

^[6]The rule in the seventeen years since *Cardelucci* is clear: unsecured creditors of a solvent debtor will be paid the Federal Interest Rate whether their prepetition *313 contracts call for higher or lower rates, or applicable state law judgment rates are higher, or there are no other applicable rates to consider. Nor is that rule limited to impaired claims. *Cardelucci* is unequivocal and

articulates several reasons for broad application of its holding despite the recognition of the narrow issue presented:

1. The use of the term “legal rate” indicates the Congress intended the single source to be statutory because of the common use of the term when the Bankruptcy Code was enacted.
2. Using the federal rate promotes uniformity within federal law.
3. The analogous post-judgment interest entitlement compensates for being deprived of compensation for the loss of time between ascertainment of damages and payment.
4. Application of a single, easily determined rate ensures equitable treatment of creditors.
5. With a uniform rate, no single creditor will be eligible for a disproportionate share of the remaining assets.

 *Cardelucci*, 285 F.3d at 1235-1236.

The Unsecured Creditors refer to the opinion’s “parting note” to support their cause. The actual conclusion rejects a substantive due process argument that has not been developed here for good reasons. To this court, the “parting note” that dooms their cause is in the penultimate paragraph, and bears repeating:

The Court recognizes that these two interests, fairness among creditors and administrative efficiency, may be of limited relevance in certain bankruptcy proceedings. Where there are only a few unsecured creditors seeking post-petition interest and there are sufficient assets to pay all claims for all interest (sic), there will be no concerns regarding equity among creditors or practicality. In those instances, a debtor may receive a windfall from the application of a lower federal interest rate to an award of post-petition interest. Nonetheless ‘interest at the legal rate’ is a statutory term with a definitive meaning that cannot shift depending on the interests invoked

by the specific factual circumstances before the court. See

 *In re Thompson*, 16 F.3d 576, 581 (4th Cir. 1994).

 *Cardelucci*, 285 F.3d at 1236.

Unsecured Creditors’ reliance on older cases invoking the “absolute priority” rule in defense of postpetition interest at the contract rate are unavailing.  *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982 (1941), was decided under the former Bankruptcy Act and is of questionable viability now that the Bankruptcy Code includes sections 726(a)(5) and 502(b)(2). Similarly,  *Debentureholders Protective Committee of Continental Inv. Corp. v. Continental Inv. Corp.*, 679 F.2d 264 (1st Cir. 1982), was decided under Chapter X of the former Bankruptcy Act and thus offers no guidance here.

The Ninth Circuit’s decision in  *L&J Anaheim Associates v. Kawasaki Leasing International, Inc.* (*In re L&J Anaheim Associates*), 995 F.2d 940 (9th Cir. 1993) does not change the outcome.  *L&J Anaheim* was decided only a few months after  *Cardelucci* and did not cite it, as it addressed an altogether different issue.

In  *L&J Anaheim*, a secured creditor filed a chapter 11 plan that was opposed by the debtor. In order to achieve the statutory requirement for at least one impaired class, the creditor, Kawasaki, proposed changing its own state law remedies following debtor’s breach. It eliminated its right to exercise various remedies under *314 the California Uniform Commercial Code, replacing those entitlements under its proposed plan with a requirement that its collateral and a related lawsuit be sold at public auction under procedures mandated by the Bankruptcy Code.

In determining that Kawasaki’s rights were altered, and thus its claim was impaired, the court stated:

At first blush the idea that an improvement in ones’ position as a creditor might constitute ‘impairment’ seems nonsensical.”

 *L & J Anaheim*, 995 F.2d at 942.

The court examined the term of art adopted by Congress to replace language in the prior Bankruptcy Act and concluded that section 1124 created certainty in determining whether or not a creditor was impaired. Once again, section 1124 is definitional, describing improvement in the context of the plan presented as impairment. The court had no occasion to address whether, for an impaired class, postpetition interest was even relevant.

Of importance here is that the plan's own language altered Kawasaki's rights; in the present case, the Bankruptcy Code, and not the Plan, is what causes Unsecured Creditors to have their postpetition interest limited to the Federal Judgment Rate. The Plan is not the culprit.

A few months after  *Cardelucci*, the Ninth Circuit decided  *Platinum Capital, Inc. v. Sylmar Plaza, L.P.* (*In re Sylmar Plaza, L.P.*, 314 F.3d 1070 (9th Cir. 2002)). There, the court addressed whether or not a plan proponent had proposed the plan in good faith under section 1129(a)(3) when its sole purpose was to enable the debtors to cure and reinstate an obligation. At that time,  *Great W. Bank & Trust v. Entz-White Lumber and Supply, Inc.* (*In re Entz-White Lumber and Supply, Inc.*), 850 F.2d 1338 (9th Cir. 1988), was good law. Under  *Entz-White*, plan proponents were permitted to cure defaults under former section 1124(3), leaving the objecting creditor not impaired under section 1124. Perhaps predicting the crucial distinction between what a plan does and what the Bankruptcy Code does, the  *Sylmar Plaza* court rejected the argument that a plan lacks good faith when it permits owners of a solvent debtor to avoid paying postpetition interest at the default interest rate. The fact that a creditor's contractual rights are adversely affected does not by itself warrant a bad faith finding. Quoting the bankruptcy court in  *In re PPI Enters. (US), Inc.*, 228 B.R. 339 (Bankr. D. Del. 1998), the court stated:

In enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely altered creditors' contractual and non bankruptcy rights

The fact that a debtor proposes a plan which it avails itself of an applicable Code provision does not constitute evidence of bad faith.

 *Sylmar Plaza*, 314 F.3d at 1075 (citations omitted).

Cases cited by the  *Sylmar Plaza* creditor to support a per se rule were distinguishable in that neither adopted or approved such a rule and, moreover, "... because none involved an objection to a plan by an unimpaired creditor."  *Id.*

At oral argument counsel for one of the Unsecured Creditors argued that  *Cardelucci* has been superseded by  *In re New Investments, Inc.*, 840 F.3d 1137 (9th Cir. 2016). That argument is unavailing. The  *New Investments* decision concludes that the 1994 amendments to section 1124 abrogated the holding of  *Entz-White* that default interest rates could be eliminated by curing defaults under a plan. The decision *315 does not even mention postpetition interest or  *Cardelucci* and does not deal with unimpaired claims under section 1124(1) and thus is of no bearing on the issue presented or the outcome here.

V. IMPAIRED OR UNIMPAIRED CLAIMS ARE TREATED ALIKE

Unsecured Creditors attempt in vain to escape  *Cardelucci's* impact by arguing that, unlike the impaired claim there, their claims will be unimpaired under a plan. The court rejects Unsecured Creditors' argument.

First,  *Cardelucci*, in answering the narrow question, drew no distinction as to whether the rule it announced was confined only to impaired claims. The clear and unequivocal analysis based on section 726(b)(5) is obvious: it applies to all unsecured and undersecured claims in a surplus estate.

Second, no plan compels the payment of the Federal Interest Rate. Rather, the Bankruptcy Code does. A similar analysis was applied very recently by the Fifth Circuit in  *In re Ultra Petroleum Corporation*, 943 F.3d 758 (5th Cir. 2019). There, the court contrasted the treatment of creditors' claims outside of bankruptcy and whether the plan itself was a source of limitation on their legal, equitable and contractual rights, or rather the Bankruptcy Code. The court looked to the language of section 1124(1), defining not impaired when the plan "... leaves unaltered [the claimant's] legal, equitable and

contractual rights.” The court ruled that a claim is impaired only if the plan itself does the altering, not what the Bankruptcy Code does.

¶ *Ultra Petroleum* agreed with the only other court of appeals decision to draw the distinction between what a plan might do and what the Bankruptcy Code does do.

¶ *In Solow v. PPI Enterprises (U.S.) Inc. (In re PPI Enterprises (U.S.) Inc.)*, 324 F.3d 197 (3d Cir. 2003) the court upheld confirmation of a plan notwithstanding a limitation on an objecting landlord’s statutorily capped damages under section 502(b)(6). It held that where section 502(b)(6) alters a creditor’s non-bankruptcy claim, there is no alteration of the claimant’s “legal, equitable and contractual rights” for purposes of impairment under section 1124(1). ¶ *Id.* at 203.

The ¶ *PPI Enterprises* court agreed with the bankruptcy court’s analysis in ¶ *In re American Solar King Corp.*, 90 B.R. 808 (Bankr. W.D. Tex. 1988) where the bankruptcy court made the following very thoughtful observation:

A closer inspection of the language employed in [s]ection 1124(1) reveals ‘impairment by statute to be an oxymoron.’ Impairment results from what the plan does, not what the statute does. A plan which ‘leaves unaltered’ the legal rights of a claimant is one which by definition, does not impair the creditor. A plan which leaves a claimant subject to other applicable provisions of Bankruptcy Code does no more to alter a claimant’s legal rights than does a plan which leaves a claimant vulnerable to a given state’s usury laws or to federal environmental laws. The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of person’s, just as surely as it limits contractual rights. Any alteration of legal rights is a consequence not of the plan but of the bankruptcy filing itself.

¶ *American Solar*, 90 B.R. at 819-20.

The ¶ *Ultra Petroleum* court noted that decisions from bankruptcy courts across the country have reached the same conclusion, agreeing that impairment results from what a plan does, not from what a *316 statute does. Its conclusion reinforces the point:

We agree with ¶ *PPI*, every reported decision identified by either party, and Collier’s treatise.

Where a plan refuses to pay funds disallowed by the Code, the Code – not the Plan – is doing the impairing.

¶ *Ultra Petroleum*, 943 F.3d at 765.

^[7]Like the creditors in ¶ *Ultra Petroleum*, the Unsecured Creditors’ complaint is with Congress and the Bankruptcy Code, not the drafters of a Plan. The Bankruptcy Code, not the Plan, limits them to the Federal Interest Rate.⁷ The cases cited by Unsecured Creditors do not apply here, as the rights in those cases were impaired by the plan and not by operation of law. See ¶ *Acequia, Inc. v. Clinton (In re Acequia)*, 787 F.2d 1352, 1363 (9th Cir. 1986) (shareholder voting rights altered by plan); ¶ *In re Rexford Properties, LLC*, 558 B.R. 352, 368 (Bankr. C.D. Cal 2016) (creditor’s rights regarding ongoing business altered by plan).

There is no point in discussing section 1124(2), as that subsection is not relevant to the treatment of the four not impaired classes. Were Debtors to have proposed a treatment of the Unsecured Creditors’ claims that cured, reinstated, or reversed any acceleration, then the analysis might be helpful. But because section 1124(1) is the operative section here, that ends the discussion.

^[8]Because the Plan leaves the Unsecured Creditors’ claims not impaired, there is also no need to dwell on whether or not “fair and equitable” principles apply. They do not. Unimpaired Creditors, when treated as dictated by the Bankruptcy Code, are not impaired by the Plan. They are conclusively presumed to have accepted the Plan. Section 1126(f). Section 1129(b) is not available to them.⁸

VI. CONCLUSION

As a trial court in the Ninth Circuit, this court is bound to follow ¶ *Cardelucci* unless, as a matter of principled reasoning, it can be distinguished. No such grounds exist. The 1994 amendments to section 1124 predated ¶ *Cardelucci*. Thus, whether or not ¶ *Cardelucci* addressed the issue is not the point. Its rule is the law of this circuit until altered either by an *en banc* panel, the United States Supreme Court, legislation or some other controlling change in the law.

Even were [Cardelucci](#) not controlling, this court would follow the lead of [PPI](#) and [Ultra Petroleum](#) (and the lower court decisions cited by [Ultra Petroleum](#)), and reject the contention of Objecting Creditors that imposition of the Federal Interest Rate impairs them. It is the Bankruptcy Code itself, not any plan provision, that imposes that rate.⁹

The court is not concurrently entering an order consistent with this Memorandum Decision as was the case with its recent *317 decision in the Inverse Condemnation action (Dkt. No. 4895). Because of the close relationship between the postpetition interest question and the issues

presented in the forthcoming Make-Whole dispute, orders disposing of them both at the same time seems appropriate and efficient. Whether either or both questions should be certified for direct appeal or to treated as final for purposes of [Fed. R. Bankr. P. 7054](#), can be visited later.

All Citations

610 B.R. 308

Footnotes

- ¹ Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, [11 U.S.C. §§ 101-1532](#).
- ² No one has suggested that “unmatured interest” means anything other than “postpetition interest.”
- ³ While the opinion is silent on the specifics of that debtor’s plan, the opponents’ claim was impaired for reasons not relevant to this analysis. In the present case the Unsecured Creditors’ claims are unimpaired. The Unsecured Creditors put the cart before the horse when they contend that the application of the “fair and equitable” test of section 1129(b) determines that their claims are impaired under section 1124.
- ⁴ In this case, given the vast array of creditors’ claims, the equal application of such uniform policy is all the more compelling.
- ⁵ The exception found in section 506(b) for secured claims has no bearing here.
- ⁶ The court rejects the argument by the Ad Hoc Committee of Holders of Trade Claims that section 103(b) precludes consideration of section 726(a)(5). [Cardelucci](#) merely compared the chapter 7 outcome (apply the Federal Interest Rate) as part of the “best interest” test of Section 1129(a)(9) to compare whether creditors do better in chapter 7 or chapter 11.
- ⁷ For the same reason, creditors who hold contractual claims calling for interest lower than 2.59% will fare better under the Plan.
- ⁸ For this reason, the court rejects as incorrect the bankruptcy court’s reliance [In re Energy Future Holdings](#), 540 B.R. 109 (Bankr. D. Del. 2015) on “equitable principles” to permit unsecured creditors in a solvent case to recover a contract rate or such other rate as it deemed appropriate.
- ⁹ [Ultra Petroleum](#) remanded the case to the bankruptcy court to decide the appropriate Make-Whole amounts, the appropriate postpetition interest rate, and the applicability of the solvent-debtor exception. If the three judges on the Fifth Circuit panel had been members of the Ninth Circuit, there is no doubt they would have been bound by [Cardelucci](#), thus limiting the remand to the Make-Whole issue.

2021 BANKRUPTCY BATTLEGROUND WEST

In re PG&E Corporation, 610 B.R. 308 (2019)

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In re Ultra Petroleum Corporation, 943 F.3d 758 (2019)

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Distinguished by [Ad Hoc Committee of Holders of Trade Claims v. PG&E Corporation](#), N.D.Cal., April 14, 2020

943 F.3d 758

United States Court of Appeals, Fifth Circuit.

IN RE: ULTRA PETROLEUM CORPORATION;
Keystone Gas Gathering, L.L.C.; Ultra Resources,
Incorporated; [Ultra Wyoming, Incorporated](#); Ultra
Wyoming LGS, Incorporated; UP Energy
Corporation; [UPL Pinedale, L.L.C.](#); UPL Three
Rivers Holdings, L.L.C., Debtors,
Ultra Petroleum Corporation; Keystone Gas
Gathering, L.L.C.; Ultra Resources, Incorporated;
[Ultra Wyoming, Incorporated](#); Ultra Wyoming
LGS, Incorporated; UP Energy Corporation; [UPL
Pinedale, L.L.C.](#); UPL Three Rivers Holdings,
L.L.C., Appellants,

v.

Ad Hoc Committee of Unsecured Creditors of
Ultra Resources, Incorporated; OPCO
Noteholders, Appellees.

No. 17-20793

|

FILED November 26, 2019

Synopsis

Background: In surplus case, Chapter 11 debtors objected to noteholders' claim for make-whole premium and postpetition interest at contractual default rate. The United States Bankruptcy Court for the Southern District of Texas, [Marvin P. Isgur, J.](#),  [575 B.R. 361](#), denied objection, and subsequently certified a direct appeal to the Court of Appeals, [2017 WL 4863015](#).

[Holding:] The Court of Appeals, [Andrew S. Oldham](#), Circuit Judge, held that as a matter of first impression, a creditor is not "impaired" by a reorganization plan simply because it incorporates the Bankruptcy Code's disallowance provisions.

Reversed in part, vacated in part, and remanded.

Opinion,  [913 F.3d 533](#), superseded.

Procedural Posture(s): On Appeal; Objection to Proof of

Claim; Petition for Rehearing.

West Headnotes (12)

[1] Bankruptcy Eligibility to vote; impairment

"Unimpaired" creditors cannot object to Chapter 11 plans. [11 U.S.C.A. § 1126\(f\)](#).

[2] Bankruptcy Conclusions of law; de novo review

On appeal from a bankruptcy court decision, the Court of Appeals reviews legal questions anew.

[1 Cases that cite this headnote](#)

[3] Bankruptcy Impairment of Claims or Interests

A creditor is not "impaired" by a reorganization plan simply because it incorporates the Bankruptcy Code's disallowance provisions; when a plan refuses to pay funds disallowed by the Code, the Code, not the plan, is doing the impairing.  [11 U.S.C.A. §§ 502, 1124\(1\)](#).

[1 Cases that cite this headnote](#)

[4] Bankruptcy Acceptance

Because discharge effected by confirmation of a Chapter 11 plan affects a creditor's rights, the Bankruptcy Code generally requires a debtor to vie for the creditor's vote first.  [11 U.S.C.A. §§ 1129\(a\)\(8\), 1141\(d\)\(1\)](#).

1 Cases that cite this headnote

[5] **Bankruptcy** — Eligibility to vote; impairment

Although a creditor generally may vote to accept or reject a Chapter 11 plan, the creditor's right to vote disappears when the plan doesn't actually affect his rights; that is, if the creditor is not impaired under the plan, he is conclusively presumed to have accepted it. 11 U.S.C.A. §§ 1126(a), 1126(f).

1 Cases that cite this headnote

[6] **Bankruptcy** — Impairment of Claims or Interests

A creditor is "impaired" within the meaning of the Bankruptcy Code only if the plan itself alters the creditor's legal, equitable, or contractual rights; the creditor's claim outside of bankruptcy is not the relevant barometer for impairment. 11 U.S.C.A. § 1124(1).

3 Cases that cite this headnote

[7] **Bankruptcy** — Uniformity requirement
Courts — Particular questions or subject matter

Court of Appeals is always chary to create a circuit split, especially in the context of bankruptcy, where uniformity is sufficiently important that the Constitution authorizes Congress to establish uniform laws on the subject of bankruptcies throughout the United States. U.S. Const. art. 1, § 8, cl. 4.

2 Cases that cite this headnote

[8] **Bankruptcy** — Impairment of Claims or

Interests

Under the Bankruptcy Code, courts judge Chapter 11 creditor's impairment after considering everything that defines the scope of the right or entitlement, such as a contract's language or state law. 11 U.S.C.A. § 1124.

[9] **Bankruptcy** — Construction and Operation

Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons.

1 Cases that cite this headnote

[10] **Bankruptcy** — Remand

Questions of whether the Bankruptcy Code disallowed creditors' claims for the make-whole amount and creditors' request for post-petition interest at the contractual default rates specified in note agreement and revolving credit facility would be determined by bankruptcy court, rather than Court of Appeals, in surplus Chapter 11 case, as bankruptcy court never reached either question but was best equipped to understand the individual dynamics pertinent to post-petition interest question. 11 U.S.C.A. § 502(b)(2).

[11] **Bankruptcy** — Equitable powers and principles
Bankruptcy — Debtor's Contracts and Leases

Absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights.

1 Cases that cite this headnote

[12] Bankruptcy Carrying out provisions of Code

Equitable powers that remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.

*759 Appeal from the United States Bankruptcy Court for the Southern District of Texas, [Marvin P. Isgur](#), U.S. Bankruptcy Judge

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Before [DAVIS](#), [ENGELHARDT](#), and [OLDHAM](#), Circuit Judges.

Opinion

[ANDREW S. OLDHAM](#), Circuit Judge:

*760 Treating the Appellees' and Intervenor's Joint Petition for Rehearing En Banc as a Petition for Panel Rehearing, it is GRANTED. The prior opinion, [In re Ultra Petroleum Corporation](#), 913 F.3d 533 (5th Cir. 2019), is withdrawn, and the following opinion is substituted:

These bankruptcy proceedings arise from exceedingly anomalous facts. The debtors entered bankruptcy insolvent and now are solvent. That alone makes them rare. But second, the debtors accomplished their unlikely feat by virtue of a lottery-like rise in commodity prices. The combination of these anomalies makes these debtors as rare as the proverbial rich man who manages to enter the Kingdom of Heaven.

The key legal question before us is whether the rich man's creditors are "impaired" by a plan that paid them everything allowed by the Bankruptcy Code. The bankruptcy court said yes. In that court's view, a plan impairs a creditor if it refuses to pay an amount the Bankruptcy Code independently disallows. In reaching that conclusion, the bankruptcy court split from the only court of appeals to address the question, and the leading treatise discussing the question. We reverse and follow the monolithic mountain of authority holding the Code—not the reorganization plan—defines and limits the claim in these circumstances.

Because the bankruptcy court saw things differently, it did not consider whether the Code disallows certain creditors' contractual claims for a Make-Whole Amount or post-petition interest. Instead, it ordered the debtors to pay both amounts in full. We vacate and remand those determinations for reconsideration.

I.

Ultra Petroleum Corporation ("Petroleum") is an oil and gas exploration and production company. To be more precise, it's a holding company. Petroleum's subsidiaries—UP Energy Corporation ("Energy") and Ultra Resources, Inc. ("Resources")—do the exploring and producing. Resources took on debt to finance its operations. Between 2008 and 2010, Resources issued unsecured notes worth \$1.46 billion to various noteholders. And in 2011, it borrowed another \$999 million under a Revolving Credit Facility. Petroleum and

In re Ultra Petroleum Corporation, 943 F.3d 758 (2019)

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Energy guaranteed both debt obligations.

In 2014, crude oil cost well over \$100 per barrel. But then Petroleum's fate took a sharp turn for the worse. Only a year and a half later, a barrel cost less than \$30. The world was flooded with oil; Petroleum and its subsidiaries were flooded with debt. On April 29, 2016, the companies *761 voluntarily petitioned for reorganization under Chapter 11. See 11 U.S.C. § 301(a). No one argues the companies filed those petitions in bad faith. See *id.* § 1112(b).

^[1]During bankruptcy proceedings, however, oil prices rose. Crude oil approached \$80 per barrel, and the Petroleum companies became solvent again. So, the debtors proposed a rare creature in bankruptcy—a reorganization plan that (they said) would compensate the creditors in full. As to creditors with claims under the Note Agreement and Revolving Credit Facility (together, the “Class 4 Creditors”), the debtors would pay three sums: the outstanding principal on those obligations, pre-petition interest at a rate of 0.1%, and post-petition interest at the federal judgment rate. *In re Ultra Petroleum Corp.*, No. 4:16-bk-32202, ECF No. 1308-1 at 25–26 (Bankr. S.D. Tex. 2017). Accordingly, the debtors elected to treat the Class 4 Creditors as “unimpaired.” Therefore, they could not object to the plan. 11 U.S.C. § 1126(f).

The Class 4 Creditors objected just the same. They insisted their claims *were* impaired because the plan did not require the debtors to pay a contractual Make-Whole Amount and additional post-petition interest at contractual default rates.

Under the Note Agreement, prepayment of the notes triggers the Make-Whole Amount. That amount is designed “to provide compensation for the deprivation of” a noteholder’s “right to maintain its investment in the Notes free from repayment.” A formula defines the Make-Whole Amount as the amount by which “the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal” exceeds the notes’ “Called Principal.” Remaining scheduled payments include “all payments of [the] Called Principal and interest ... that would be due” after prepayment (if the notes had never been prepaid). And the discounted value of those payments is keyed to a “Reinvestment Yield” of 0.5% over the total anticipated return on comparable U.S. Treasury obligations.

Under the Note Agreement, petitioning for bankruptcy automatically renders the outstanding principal, any accrued interest, and the Make-Whole Amount

“immediately due and payable.” Failure to pay immediately triggers interest at a default rate of either 2% above the normal rate set for the note at issue or 2% above J.P. Morgan’s publicly announced prime rate, whichever is greater.

The Revolving Credit Facility does not contain a make-whole provision. But it does contain a similar acceleration clause that made the outstanding principal and any accrued interest “automatically ... due and payable” as soon as Resources petitioned for bankruptcy. And it likewise provides for interest at a contractual default rate—2% above “the rate otherwise applicable to [the] Loan”—if Resources delayed paying the accelerated amount.

Under these two agreements, the creditors argued the debtors owed them an additional \$387 million—\$201 million as the Make-Whole Amount and \$186 million¹ in post-petition interest. Both sides chose to kick the can down the road. Rather than force resolution of the impairment issue at the plan-confirmation stage, the parties stipulated the bankruptcy court could resolve the dispute by deeming the creditors unimpaired and confirming the proposed *762 plan. Meanwhile, the debtors would set aside \$400 million to compensate the Class 4 Creditors if necessary “to render [the creditors] Unimpaired.” The bankruptcy court agreed and confirmed the plan.

After confirmation, the parties (and the bankruptcy court) turned back to the question of impairment. The debtors acknowledged the plan did not pay the Make-Whole Amount or provide post-petition interest at the contractual default rates. But they insisted the Class 4 Creditors were not “impaired” because federal (and state) law barred them from recovering the Make-Whole Amount and entitled them to receive post-petition interest only at the federal judgment rate.

The Bankruptcy Code provides that a class of claims is not impaired if “the [reorganization] plan ... leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder.” 11 U.S.C. § 1124(1). Elsewhere the Code states that a court should disallow a claim “to the extent that [it seeks] unmatured interest.” *Id.* § 502(b)(2). The debtors argued the Make-Whole Amount qualified as unmatured interest. But even if it didn’t, they said, it was an unenforceable liquidated damages provision under New York law. In either case, something *other than* the reorganization plan itself—the Bankruptcy Code or New York contract law—prevented the Class 4 Creditors from recovering the disputed amounts.

The debtors' argument as to post-petition interest was much the same: The Bankruptcy Code entitles creditors, at most, to post-petition interest at the "legal rate," not the rates set by contract. ¹¹ 11 U.S.C. § 726(a)(5). And the legal rate, they said, is the federal judgment rate under 28 U.S.C. § 1961. Once again, the Code—not the plan—limited the Class 4 Creditors' claims.

The bankruptcy court rejected the premise that it must bake in the Code's provisions before asking whether a claim is impaired. Instead it concluded unimpairment "requires that [creditors] receive all that they are entitled to under state law." ¹² *In re Ultra Petroleum Corp.*, 575 B.R. 361, 372 (Bankr. S.D. Tex. 2017). In other words, if a plan does not provide the creditor with all it would receive under state law, the creditor is impaired even if the Code disallows something state law would otherwise provide outside of bankruptcy. So, the bankruptcy court asked only whether New York law permits the Class 4 Creditors to recover the Make-Whole Amount (concluding it does), and whether the Code limits the contractual post-petition interest rates (concluding it does not). ¹³ *Id.* at 368–75. It never decided whether the Code disallows the Make-Whole Amount as "unmatured interest" under § 502(b)(2) or what ¹⁴ § 726(a)(5)'s "legal rate" of interest means. It ordered the debtors to pay the Make-Whole Amount and post-petition interest at the contractual rates to make the Class 4 Creditors truly unimpaired.

¹²The debtors sought a direct appeal to this Court (rather than the district court) because the case raises important and unsettled questions of law. See ¹⁵ 28 U.S.C. § 158(d)(2)(A). The bankruptcy court agreed, and so did we. *In re Ultra Petroleum Corp.*, No. 16-32202, 2017 WL 4863015, at *1 (Bankr. S.D. Tex. Oct. 26, 2017). On appeal, we review those legal questions anew. *In re Positive Health Mgmt.*, 769 F.3d 899, 903 (5th Cir. 2014).

II.

¹³We consider first whether a creditor is "impaired" by a reorganization plan simply because it incorporates the Code's disallowance provisions. We think not.

*763 A.

¹⁴ ¹⁵Chapter 11 lays out a framework for proposing and confirming a reorganization plan. Confirmation of the plan "discharges the debtor from any debt that arose before the date of such confirmation." ¹⁶ 11 U.S.C. § 1141(d)(1). Because discharge affects a creditor's rights, the Code generally requires a debtor to vie for the creditor's vote first. *Id.* § 1129(a)(8). And when it does, the creditor may vote to accept or reject the plan. *Id.* § 1126(a). But the creditor's right to vote disappears when the plan doesn't actually affect his rights. If the creditor is "not impaired under [the] plan," he is "conclusively presumed to have accepted" it. *Id.* § 1126(f). The question, then, is whether the Class 4 Creditors were "impaired" by the plan.

¹⁶Let's start with the statutory text. Section 1124(1) says "a class of claims or interests" is not impaired if "the plan ... leaves unaltered the [claimant's] legal, equitable, and contractual rights." The Class 4 Creditors spill ample ink arguing their rights have been altered. But that's both undisputed and insufficient. The plain text of § 1124(1) requires that "the plan" do the altering. We therefore hold a creditor is impaired under § 1124(1) only if "the plan" itself alters a claimant's "legal, equitable, [or] contractual rights."

The only court of appeals to address the question took the same approach. In ¹⁷ *In re PPI Enterprises (U.S.), Inc.*, a landlord (creditor) argued the reorganization plan of his former tenant (debtor) impaired his claim because it did not pay him the full \$4.7 million of rent he was owed over the life of the lease. ¹⁸ 324 F.3d 197, 201–02 (3d Cir. 2003). The Third Circuit disagreed. Because the Bankruptcy Code caps lease-termination damages under § 502(b)(6), the plan merely reflected the Code's disallowance. ¹⁹ *Id.* at 204. At the end of the day, "a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights." ²⁰ *Ibid.* It simply did not matter the landlord "might have received considerably more if he had recovered on his leasehold claims before [the debtor] filed for bankruptcy." ²¹ *Id.* at 205. The debtor's plan gave the landlord everything the law entitled him to once bankruptcy began, so he was unimpaired.

Decisions from bankruptcy courts across the country all run in the same direction. See, e.g., *In re Tree of Life Church*, 522 B.R. 849, 861–62 (Bankr. D.S.C. 2015); *In re RAMZ Real Estate Co.*, 510 B.R. 712, 717 (Bankr. S.D.N.Y. 2014); *In re K Lunde, LLC*, 513 B.R. 587,

In re Ultra Petroleum Corporation, 943 F.3d 758 (2019)

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595–96 (Bankr. D. Colo. 2014); *In re Mirant Corp.*, No. 03-46590, 2005 WL 6440372, at *3 (Bankr. N.D. Tex. May 24, 2005); *In re Coram Healthcare Corp.*, 315 B.R. 321, 351 (Bankr. D. Del. 2004); *In re Monclova Care Ctr., Inc.*, 254 B.R. 167, 177 (Bankr. N.D. Ohio 2000), *rev'd on other grounds*, 266 B.R. 792 (N.D. Ohio 2001); *In re Am. Solar King Corp.*, 90 B.R. 808, 819–22 (Bankr. W.D. Tex. 1988). All agree that “[i]mpairment results from what the *plan* does, not what the [bankruptcy] statute does.” *Solar King*, 90 B.R. at 819.

^[7]The creditors cannot point to a single decision that suggests otherwise. That’s presumably why Collier’s treatise states the point in unequivocal terms: “Alteration of Rights by the Code Is Not Impairment under Section 1124(1).” 7 COLLIER ON BANKRUPTCY ¶ 1124.03[6] (16th ed. 2018). “We are always chary to create a circuit split.” *United States v. Graves*, 908 F.3d 137, 142 (5th Cir. 2018) (quotation omitted). That’s especially true “in the context of bankruptcy, where uniformity is sufficiently important that our Constitution *764 authorizes Congress to establish ‘uniform laws on the subject of bankruptcies throughout the United States.’ ” *In re Marciano*, 708 F.3d 1123, 1135 (9th Cir. 2013) (Ikuta, J., dissenting) (quoting U.S. CONST. art. I, § 8, cl. 4). We refuse to create one today.

B.

The Class 4 Creditors’ counterarguments do not move the needle. First, they focus on § 1124(1)’s use of the word “claim.” They note the Code elsewhere speaks of “allowed claims.” See, e.g., 11 U.S.C. §§ 506(a)(1), 506(a)(2), 510(c)(1), 1126(c). Then they suggest the absence of “allowed” in § 1124(1) means “claim” there refers to the claim *before* the Code’s disallowance provisions come in and trim its edges.

^[8] ^[9]But the broader statutory context cuts the other way. Section 1124 is not just (or even primarily) about the allowance of claims. It is about rights—the “legal, equitable, and contractual rights to which [the] claim ... entitles the holder.” *Id.* § 1124(1). That means we judge impairment after considering everything that defines the scope of the right or entitlement—such as a contract’s language or state law. See *In re Energy Future Holdings Corp.*, 540 B.R. 109, 121 (Bankr. D. Del. 2015);

11 U.S.C. § 502(b)(1). Even the bankruptcy court recognized this to some extent because it asked whether New York law permitted the Noteholders to recover the Make-Whole Amount. See *Ultra Petroleum*, 575 B.R. at 368–72. “The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons.” *Solar King*, 90 B.R. at 819–20.

Finding no help in § 1124(1)’s statutory text, the Class 4 Creditors turn to the legislative history of a different provision. In 1994, Congress repealed § 1124(3), which provided that a creditor’s claim was not impaired if the plan paid “the *allowed amount* of such claim.” 11 U.S.C. § 1124(3) (1988) (emphasis added). This proves, they say, that disallowance should now play no role in the impairment analysis.

Even for those who think legislative history can be relevant to statutory interpretation, this particular history is not. It does not say that every disallowance causes impairment. Rather, Congress repealed § 1124(3) in response to a specific bankruptcy court decision. See *In re New Valley Corp.*, 168 B.R. 73 (Bankr. D.N.J. 1994). That decision held unsecured creditors who received their allowed claims from a solvent debtor, but who did not receive post-petition interest, were unimpaired. *Id.* at 77–80. In debating the proposed repeal of § 1124(3), the House Judiciary Committee singled out *New Valley* by name as the justification for the repeal. See H.R. Rep. No. 103-835, at 47–48 (1994) (citing *New Valley* and explaining the intent to repeal § 1124(3) “to preclude th[e] unfair result” of “den[ying] the right to receive postpetition interest”). It is noteworthy the committee report does not cite other bankruptcy cases—such as *Solar King*—that addressed Code impairment under § 1124(1). That is why the Third Circuit rejected appellees’ legislative-history argument in *PPI* and held the repeal of § 1124(3) “does not reflect a sweeping intent by Congress to give impaired status to creditors more freely outside the postpetition interest context.” 324 F.3d at 207 (noting the committee report cited *New Valley* but not *Solar King*).

Next, the Class 4 Creditors attempt to distinguish *PPI*. True, that case involved disallowance under § 502(b)(6), not § 502(b)(2). But that’s a distinction without a difference. See *In re W.R. Grace & Co.*, 475 B.R. 34, 161–62 (Bankr. D. Del. 2012); *Energy Future*, 540 B.R. at 122. Section 502 states that “the

court ... shall allow *765 [a] claim in [the requested] amount, *except to the extent that* any one of nine conditions apply. If any of the enumerated conditions applies, the court shall not allow the relevant portion of the claim. *PPI* reasoned that where one of those conditions applies, the Code—not the plan—impairs the creditors' claims. See 324 F.3d at 204. That reasoning applies with equal force to § 502(b)(2).

The Class 4 Creditors (like the bankruptcy court) also point to the mechanics of Chapter 11 discharge to suggest the plan itself, not the Code, is doing the impairing. They note the Code's disallowance provisions are carried into effect only if the plan is confirmed, and "confirmation of the plan ... discharges the debtor from any debt that arose before" confirmation. 11 U.S.C. § 1141(d). In one sense, plan confirmation limits creditors' claims for money by discharging underlying debts. But in another sense, the Code limits the creditors' claims for money and imposes substantive and procedural requirements for plan confirmation. The Class 4 Creditors' argument thus begs the critical question: What is doing the work here? We agree with *PPI*, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code—not the plan—is doing the impairing.

III.

That leaves the questions of whether the Code disallows the creditors' claims for the Make-Whole Amount and the creditors' request for post-petition interest at the contractual default rates specified in the Note Agreement and the Revolving Credit Facility. The creditors say their contracts entitle them to both amounts, and that their contracts should be honored under bankruptcy law's longstanding "solvent-debtor" exception. The debtors argue no such exception exists in modern bankruptcy law. And the debtors further argue both claims are governed by the Bankruptcy Code, not the pre-Code law or the parties' contracts.

^[10]The bankruptcy court never reached either question. The issue of make-whole premiums, like the Make-Whole Amount, has become "[a] common dispute" in modern bankruptcy. DOUGLAS G. BAIRD, *ELEMENTS OF BANKRUPTCY* 84 (6th ed. 2014). Sometimes it is "comparatively easy to tell" whether such premiums are effectively unmaturing interest, and therefore disallowed

under § 502(b)(2). *Id.* at 84–85. Other times, "it is much harder." *Id.* at 85. Accordingly, "much depends on the dynamics of the individual case." *Ibid.* The bankruptcy court is often best equipped to understand these individual dynamics—at least in the first instance. *Cf. U.S. Bank Nat'l Ass'n ex rel. CWC Capital Asset Mgmt. LLC v. Village at Lakeridge, LLC*, — U.S. —, 138 S. Ct. 960, 968 n.6, 200 L.Ed.2d 218 (2018) (noting a bankruptcy court is often best equipped to consider "multifarious, fleeting, special, narrow facts that utterly resist generalization"). So too is the bankruptcy court best able to consider the postpetition interest question. See *ibid.*

^[11] ^[12]Our review of the record reveals no reason why the solvent-debtor exception could not apply. As other circuits have recognized, "absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights." *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006); see also *766 *In re Chicago, Milwaukee, St. Paul and Pac. R.R. Co.*, 791 F.2d 524, 528 (7th Cir. 1986). That might be the case here.² But "mindful that we are a court of review, not of first view," we will not make the choice ourselves or weigh the equities on our own. *Cutter v. Wilkinson*, 544 U.S. 709, 718 n.7, 125 S.Ct. 2113, 161 L.Ed.2d 1020 (2005).

Accordingly, the bankruptcy court should consider the Make-Whole Amount, the appropriate post-petition interest rate, and the applicability of the solvent-debtor exception on remand.

* * *

As we have explained, Code impairment is not the same thing as plan impairment. Because the bankruptcy court found otherwise, it did not address whether the Code disallows the Make-Whole Amount or post-petition interest, and if not, how much the debtors must pay the Class 4 Creditors. The bankruptcy court, therefore, must consider these issues on remand. For that reason and others explained above, we REVERSE in part, VACATE in part, and REMAND for further proceedings consistent with this opinion.

All Citations

943 F.3d 758, Bankr. L. Rep. P 83,466

Footnotes

- ¹ This amount includes \$106 million in interest on the outstanding principal under the notes, \$14 million in interest on the Make-Whole Amount, and \$66 million in interest on the outstanding principal under the Revolving Credit Facility, all accruing after the debtors filed their petitions.
- ² Of course, we follow the Supreme Court's command that any "equitable powers [that] remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." [Law v. Siegel](#), 571 U.S. 415, 421, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014) (quotation omitted). While we express no view on the matter, it is possible a bankruptcy court's equitable power to enforce the solvent-debtor exception is moored in 11 U.S.C. § 1124's command that a "plan leave[] unaltered ... equitable ... rights." See, e.g., [In re Energy Holdings](#), 540 B.R. 109, 123–24 (Bankr. D. Del. 2015).

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United States Bankruptcy Court, S.D. California.
IN RE: [CUKER INTERACTIVE, LLC](#), Debtor.
Blk. No. 18-7363-LA11
|
Signed 12/3/2020

Synopsis

Background: Creditors objected to confirmation of Chapter 11 plan proposed by solvent debtor.

Holdings: The Bankruptcy Court, [Louise DeCarl Adler, J.](#), held that:

[1] plan had to provide postpetition interest on unsecured claims only at federal judgment rate, and

[2] because unsecured creditors' right to receive postpetition interest from solvent Chapter 11 debtor only at federal judgment rate was by operation of bankruptcy statute and not the result of provisions of plan, creditors were "unimpaired" and thus not entitled to vote on plan.

Ordered accordingly.

Procedural Posture(s): Objection to Confirmation of Plan.

West Headnotes (6)

[1] **Bankruptcy** — Eligibility to vote; impairment

"Impairment" of a creditor's claim, such as will entitle creditor to vote on proposed Chapter 11 plan, occurs only where the plan itself alters the creditors' rights. 11 U.S.C.A. §§ 1124(1), 1126(f).

[2] **Bankruptcy** — Impairment of Claims or

Interests

When the alteration of a creditor's legal rights is a consequence of the Bankruptcy Code itself, and not of Chapter 11 plan, creditor is not "impaired," as that term is used in Chapter 11. 11 U.S.C.A. § 1124(1).

[3] **Bankruptcy** — Post-petition interest

When a Chapter 11 debtor is solvent, debtor must generally pay postpetition interest to its general unsecured creditors.

[4] **Bankruptcy** — Post-petition interest

Term "legal rate," as used in bankruptcy statute requiring solvent debtors to pay postpetition interest to their unsecured creditors "at the legal rate," is the federal judgment rate. 11 U.S.C.A. § 726(a)(5).

[5] **Bankruptcy** — Eligibility to vote; impairment

For unsecured creditors to be "unimpaired" under a Chapter 11 plan proposed by a solvent debtor, and thus not entitled to vote on proposed plan, they must receive postpetition interest at federal judgment rate. 11 U.S.C.A. §§ 1124(1), 1126(f).

[6] **Bankruptcy** — Eligibility to vote; impairment

Because unsecured creditors' right to receive

postpetition interest from solvent Chapter 11 debtor only at federal judgment rate, and not at the contract right negotiated by parties, was by operation of bankruptcy statute and not the result of provisions of debtor's proposed plan, creditors were "unimpaired" and thus not entitled to vote on plan. [¶] 11 U.S.C.A. §§ 726(a)(5), 1124(1), 1126(f).

rate" of postpetition interest for this time period.

II.

FACTUAL BACKGROUND

Debtor's estate is solvent. Debtor's Plan proposes leaving all creditors "unimpaired" under 11 U.S.C. § 1124(1)¹ by paying: (i) fully secured creditors 100% of their allowed claims with contractual interest; and (ii) general unsecured creditors 100% of their allowed claims with postpetition interest at the "legal rate" (defined by the Plan as the Federal Judgment Rate), or the rate determined by the Court for their claims to be unimpaired. Because all creditors are "unimpaired," they are conclusively deemed to have accepted the Plan per § 1126(f).

Creditors, Pillsbury Winthrop Shaw Pittman LLP ("Pillsbury") and Wolfe Legal Group, PC ("Wolfe") (collectively "Creditors"), objected to Plan confirmation contending that to remain "unimpaired" for purposes of § 1124(1), the Plan must pay postpetition interest on their unsecured claims at their contractual rate, not the Federal Judgment Rate.² After thorough analysis of the case law and the parties' arguments, and for the reasons more thoroughly set forth below, the Court holds that the "legal rate" of interest to be applied postpetition to Creditors' unsecured claims is the Federal Judgment Rate.

Attorneys and Law Firms

Robert R. Barnes, The Broken-Bench Law Firm, Michael D. Breslauer, Solomon Ward Seidenwurm & Smith, LLP, San Diego, CA, for Debtor.

MEMORANDUM DECISION

LOUISE DE CARL ADLER, JUDGE

*68 I.

INTRODUCTION

On November 18, 2020, the Court held a hearing on Cuker Interactive, LLC's ("Debtor") contested Fourth Amended Plan of Reorganization dated September 15, 2020 ("Plan"). The Court adopted its Tentative Ruling [ECF 442] confirming the Plan and finding that the Federal Judgment Rate (at 2.69%) is the "legal rate" at which postpetition interest must be applied to unsecured claims in a solvent estate from the date of filing to the Plan's effective date. As stated in the Tentative Ruling, the Court writes this Memorandum Decision to augment that ruling on the discrete issue of the appropriate "legal

III.

LEGAL ANALYSIS

^[1] ^[2]Section 1124(1) provides that a claim or interest is "impaired" under a chapter 11 plan, thereby entitling the impaired class to vote, unless "the plan" leaves unaltered the legal, equitable, and contractual rights to which the claim or interest entitles the holder of such claim or

interest. 11 U.S.C. § 1124(1). It is important to note that impairment, for the purposes of § 1124(1), only occurs where the plan itself alters the creditors' rights. *In re PG&E Corp.*, 610 B.R. 308, 315 (Bankr. N.D. Cal. 2019); see also *In re Ultra Petroleum Corp.*, 943 F.3d 758 (5th Cir. 2019) (recognizing that a claim is impaired only if the plan does the altering of creditors' *69 rights, not the Code). Where the alteration of the creditor's legal rights is a consequence of the Bankruptcy Code itself, and not of the plan, the creditors are not "impaired" for purposes of § 1124(1). *In re PG&E Corp.*, 610 B.R. at 315; *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197, 204 (3rd Cir. 2003). Creditors that are "unimpaired" are conclusively deemed to have accepted the plan and not permitted to vote on the plan. 11 U.S.C. § 1126(f).

Here, the Creditors contend they are "impaired," primarily, because the Plan does not require Debtor to pay postpetition interest on their unsecured claims at their contractual rates or at the State Law Judgment Rate (10%). Their characterization of the Plan is incorrect. In fact, the Plan requires Debtor to pay creditors postpetition interest on their unsecured claims at the Federal Judgment Rate (2.69%); or at whatever rate determined by the Court for their claims to be "unimpaired." [See Plan, Art. IV.A.2, Art. II. A.2(b), Art. IV.A.2(c), and Art. IV.A.2(h)] As such, the discrete issue here is what is the rate of postpetition interest that must be applied for Creditors' unsecured claims to be unimpaired?

¹³It is settled law that where a chapter 11 debtor is solvent, the debtor generally must pay postpetition interest to its general unsecured creditors. *In re Cardelucci*, 285 F.3d 1231, 1234 (9th Cir. 2002); see also *Matter of Beverly Hills Bancorp.*, 752 F.2d 1334, 1339 (9th Cir. 1984) (recognizing that postpetition interest should be paid on allowed unsecured claims in a solvent-debtor case). However, the Federal Circuit Courts of Appeal are split as to whether the Federal Judgment Rate or the parties' contract rate applies in the foregoing situation.

This Court is not writing on a clean slate. It must consider *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002) because it also involved the rate of postpetition interest to be paid to general unsecured creditors in a solvent-debtor's chapter 11 case. The Ninth Circuit began by recognizing that where a debtor is solvent, unsecured creditors are entitled to be paid postpetition "interest at the legal rate." *Id.* at 1234 (citing § 726(a)(5), which is incorporated into chapter 11 by § 1129(a)(7)). It examined whether the phrase "interest at the legal rate" in

§ 726(a)(5) is the Federal Judgment Rate or a rate to be determined by the parties' contract or state law. *Id.* at 1234. The Ninth Circuit determined that the principles of statutory interpretation strongly support the conclusion that Congress intended the phrase "interest at the legal rate" to mean the Federal Judgment Rate. *Id.* at 1234-35. Additionally, it reasoned that applying the Federal Judgment Rate promotes uniformity within federal law; that applying a single, easily determined interest rate to all claims for postpetition interest ensures equitable treatment and fairness between creditors; and that using the Federal Judgment Rate is the most judicially efficient and practical manner of allocating the estate's remaining assets. *Id.* at 1235-36.

Creditors argue that *Cardelucci* is inapplicable here. They point out that the Ninth Circuit solely addressed § 726(a)(5), which applies to "impaired" claims in a chapter 11 case only by virtue of the best interests test in § 1129(a)(7); whereas this case involves "unimpairment" under § 1124(1). They are correct that Ninth Circuit's decision in *Cardelucci* never cited to § 1124, and it never addressed the rate of interest for unimpairment to be conclusively deemed to have accepted the plan. Nevertheless, the Court is not persuaded that *Cardelucci* is inapplicable. The Ninth Circuit phrased its holding broadly to apply to all unsecured claims, and it relied heavily on the decision of the Ninth Circuit *70 Bankruptcy Appellate Panel ("BAP") in *In re Beguelin*, 220 B.R. 94 (BAP 9th Cir. 1998). See *Cardelucci*, 285 F.3d at 1234 (relying on, and even quoting, the rationale in *Beguelin* in adopting the Federal Judgment Rate).

Specifically, the BAP in *Beguelin* held that a solvent-debtor must pay postpetition interest to all unsecured creditors at the Federal Judgment Rate. *Beguelin*, 220 B.R. at 101. The BAP reasoned that applying the uniform Federal Judgment Rate promotes universal resolution in bankruptcy courts across the country; and it is the practical, efficient and inexpensive means to calculate the amount of interest to be paid to each creditor. *Id.* at 100-101. Likewise, in *Cardelucci* the Ninth Circuit broadly stated that it favored applying the Federal Judgment Rate "to all claims for postpetition interest" because it ensures uniformity, equitable treatment among creditors and efficiency. *Cardelucci*, 285 F.3d at 1235-36. It concluded that it must apply this rate even where there are "sufficient assets to fully pay all claims for all interest," and even in

instances where “a debtor may receive a windfall” from the lower Federal Judgment Rate. *Id.* at 1236.

The question of *Cardelucci* application to “impairment” under § 1124 was directly addressed in *In re PG & E, Corp.*, 610 B.R. 308 (Bankr. N.D. Cal. 2019), a case that is factually on point. The bankruptcy court in *PG & E* read *Cardelucci* expansively and ultimately adopted its holding as applying to all unsecured creditors in a solvent-debtor case. *In re PG & E*, 610 B.R. at 310. The bankruptcy court considered that the *Cardelucci* decision had addressed a narrower issue, and it did not discuss impairment under § 1124. *Id.* at 312-13. It concluded that the *Cardelucci* holding must be broadly applied to “all unsecured claims” for two reasons: (1) the Ninth Circuit did not narrow the application of its holding to “impaired” claims, and so it applied broadly given the structure of the Code, and the clear and plain meaning of its applicable provisions; and (2) a single, easily determined rate for all postpetition interest ensures equitable treatment of creditors. *Id.* at 312-13, 315. Consequently, the *PG & E* court held it was bound by the sweeping holding of *Cardelucci* in a situation that is factually on point with this case.

In discussing the issue of “impairment” under § 1124 and a creditor’s right to vote on the plan, the *PG & E* court distinguished between the provisions of the Bankruptcy Code and the plan. It explained that limiting an unsecured claim to postpetition interest at the Federal Judgment Rate is a function of the Bankruptcy Code, not the plan. *Id.* at 315-16. Therefore, when a plan treats unsecured creditors as provided by the Bankruptcy Code (by paying them postpetition interest at the Federal Judgment Rate in a solvent-debtor case), the plan does not “impair” creditors in the manner contemplated by § 1124. *Id.* (citing *In re Ultra Petroleum Corp.*, 943 F.3d 758 (5th Cir. 2019), and *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197 (3rd Cir. 2003)).

Creditors urge that *In re PG & E* was wrongly decided. They urge this Court to adopt the “solvent-debtor exception” recognized by several other Circuit Courts of Appeal. This exception enforces the state law rights of unsecured creditors in a solvent-debtor case, including their right to receive postpetition interest at their contractual rate. See *In re Ultra Petroleum Corp.*, 943 F.3d 758 (5th Cir. 2019) (remanding the impairment issue to the bankruptcy court to determine the rate of

postpetition interest to be paid to unsecured creditors, and acknowledging that the “solvent-debtor exception” could apply); see also *71 *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006); *Debentureholders Protective Comm., of Cont’l Inv. Corp. v. Conti. Inv. Corp.*, 679 F.2d 264, 269 (1st Cir. 1982) (both recognizing that the solvent-debtor exception requires a court to enforce the parties’ state law contractual rights, even for unsecured creditors).

On remand, the *Ultra Petroleum* bankruptcy court addressed the same question as the *PG & E* court: What interest rate should be applied postpetition to “unimpaired” claims in a solvent-debtor case? While the bankruptcy court in *Ultra Petroleum* acknowledged that the *Cardelucci* court was legally correct to apply the Federal Judgment Rate in cases where creditors are “impaired,” it read the Ninth Circuit’s decision narrowly and departed from it. *In re Ultra Petroleum Corp.*, No. 16-32202 *et. al.*, 2020 WL 6276712, *21-22 (Bankr. S.D. Tex. Oct. 26, 2020). The court explained that it was deciding the different issue of the rate of postpetition interest where unsecured creditors are “unimpaired.” *Ultra Petroleum*, 2020 WL 6276712 at *21. After analyzing the continuing viability of the “solvent-debtor exception,” it held that where the claims of unsecured creditors are “unimpaired” they must receive postpetition interest at their contractual rate, or otherwise be given the opportunity to vote on the plan. *Id.* at *21-22. The bankruptcy court explained that the underlying purpose of the “solvent-debtor exception” is that a debtor must repay its debts in full when it has the means to do so. *Id.* at *22. Thus, when a debtor is solvent, “a bankruptcy court’s role is merely to enforce the contractual rights of the parties.” *Id.* at *21 (quoting *In re Dow Corning*, 456 F.3d at 679).

[4] [5] [6] While this Court understands the rationale for applying the “solvent-debtor exception,” it is not writing on a clean slate. The Court agrees that it is bound by the Ninth Circuit’s holding in *In re Cardelucci*, which imported the “legal rate” language of § 726(a)(5) into chapter 11 cases for all unsecured creditors and clearly held that the “legal rate” is the Federal Judgment Rate. *In re PG & E*, 610 B.R. at 312-13. Therefore, assuming the Creditors are unsecured, they must receive postpetition interest at the Federal Judgment Rate to be unimpaired by the Plan. The Debtor is correct that this alteration of the Creditors’ rights is a function of the Bankruptcy Code, not the Plan.

The Court sees no reason to diverge from the well-reasoned decision in [PG & E](#). While the “solvent-debtor exception” would work in cases with only a few creditors, the Court agrees that application of this exception poses a significant threat to the bankruptcy court’s administrative efficiency in larger cases. See [In re Cardelucci](#), 285 F.3d at 1236 (recognizing that even on occasions when a debtor may receive a windfall, the uniform approach of applying the Federal Judgment Rate to calculate postpetition interest to unsecured creditors is a more efficient and fair and equitable outcome than applying each creditors’ contractual rate or the applicable state law judgment rate, which varies state-by-state). If the “solvent-debtor exception” were applied to a debtor with hundreds or thousands of creditors, the estate might be compelled to carry on indefinitely, at a huge administrative expense, determining the individual contractual rights of each individual unsecured creditor; and perhaps, resulting in different treatment to creditors of the same class. The Court agrees with the Ninth Circuit in [Cardelucci](#) that there is no reason Congress would have intended to create such a costly administrative inefficiency in the bankruptcy courts.

Finally, the Court does not agree with the view that the bankruptcy court’s role in a solvent-debtor case is merely that of [§ 72](#) an “enforcer” of creditors’ contractual rights. See [Dow Corning](#), 456 F.3d at 679 (expressing its view that in a solvent-debtor case, the bankruptcy court should enforce whatever prepetition contractual rights a given creditor has against the debtor). This view taken literally would arguably mean a court would have to abandon the Code itself. For instance, [§ 502\(b\)\(6\)](#) caps a landlord’s claim in bankruptcy for damages resulting from the termination of a real property lease. [11 U.S.C. § 502\(b\)\(6\)](#). If an estate were solvent and the bankruptcy court’s role was merely to enforce the

contract, there would be no limit to the damages a landlord could recover from termination of a real property lease. The bankruptcy courts would be required to abandon the intent of Congress to cap lease rejection claims, and ultimately disregard portions of the Code. The Ninth Circuit has found that such a repercussion was not the intent of Congress, and this Court is bound by that precedent.

IV.

CONCLUSION

Debtor’s estate is solvent, so, for the reasons set forth above and given the binding Ninth Circuit precedent, the Court finds that Debtor must pay postpetition interest under its Plan at the “legal rate”: The Federal Judgment Rate (2.69%). This Memorandum Decision shall be incorporated into the Court’s Findings of Fact and Conclusion of Law confirming the Plan, to be prepared by Debtor.

All Citations

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Footnotes

- ¹ Hereinafter, all section and chapter references are to the Bankruptcy Code, [11 U.S.C. §§ 101 et seq.](#), unless otherwise specified.
- ² Creditors are participating in post-confirmation proceedings that will determine the secured and unsecured status of their claims. Currently both Creditors have an unsecured claim.

In re Cuker Interactive, LLC, 622 B.R. 67 (2020)

In re Bayou Shores SNF, LLC, 828 F.3d 1297 (2016)

Med & Med GD (CCH) P 305,671, 26 Fla. L. Weekly Fed. C 487

 KeyCite Yellow Flag - Negative Treatment
Rejected by [Matter of Benjamin](#), 5th Cir.(Tex.), July 25, 2019

828 F.3d 1297

United States Court of Appeals, Eleventh
Circuit.

IN RE: BAYOU SHORES SNF, LLC, Debtor.
[Florida Agency for Health Care
Administration](#), United States of America,
on behalf of the Secretary of the United
States Department of Health and Human
Services, Plaintiffs–Appellees,
v.
Bayou Shores SNF, LLC,
Defendant–Appellant.

No. 15-13731

|
July 11, 2016

Synopsis

Background: Secretary of Health and Human Services appealed bankruptcy court’s orders enjoining Secretary from terminating Chapter 11 debtor’s Medicare and Medicaid provider agreements. The United States District Court for the Middle District of Florida, No. 8:14-cv-02816-JSM, [James S. Moody Jr., J.](#),  [533 B.R. 337](#), reversed bankruptcy court’s orders, and debtor appealed.

Holdings: The Court of Appeals, Clevenger, Circuit Judge, held that:

[1] bankruptcy court lacked jurisdiction to enjoin Secretary from terminating debtor’s provider agreements;

[2] Secretary’s challenge to bankruptcy court’s orders was not moot; and

[3] debtor’s challenge to Secretary’s termination arose under Medicare.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (14)

[1] [Bankruptcy](#) Scope of review in general

In a bankruptcy case, the Court of Appeals sits as a second court of review, and, thus, examines independently the factual and legal determinations of the bankruptcy court and employs the same standards of review as the district court.

[4 Cases that cite this headnote](#)

[2] [Bankruptcy](#) Conclusions of law; de novo review

[Bankruptcy](#)  Clear error

[Bankruptcy](#)  Review

The Court of Appeals reviews a bankruptcy court’s factual findings for clear error and its legal conclusions de novo, and it reviews the district court’s legal determinations de novo.

[3 Cases that cite this headnote](#)

[3] [Bankruptcy](#) Particular proceedings or issues

Medicare Act’s prohibition of actions against Secretary of Health and Human Services on any claim arising under Act barred bankruptcy court from exercising jurisdiction over Chapter 11 debtor’s request for an injunction enjoining Secretary from terminating its Medicare and Medicaid provider agreements, even though statute granting district courts original and exclusive jurisdiction over all cases filed under Chapter 11 was not specifically mentioned in Act, where a previous version of Act precluded

bankruptcy court review of Medicare claims, a subsequent amendment to Act was a codification and did not substantively change law, and jurisdictional statute did not give bankruptcy courts special jurisdiction over Medicare claims.  28 U.S.C.A. § 1334;  42 U.S.C.A. §§ 405(h), 1395ii.

8 Cases that cite this headnote

- [4] **Statutes**  Plain Language; Plain, Ordinary, or Common Meaning
Statutes  Relation to plain, literal, or clear meaning; ambiguity

When a statute's language is plain, the sole function of the courts, at least where the disposition required by the text is not absurd, is to enforce it according to its terms.

- [5] **Statutes**  Construction of Revised Statutes and Codes

When legislatures codify the law, courts should presume that no substantive change was intended absent a clear indication otherwise.

2 Cases that cite this headnote

- [6] **Bankruptcy**  Moot questions

Challenge by Secretary of Health and Human Services to bankruptcy court's exercise of jurisdiction over Chapter 11 debtor's request for an injunction enjoining Secretary from terminating its Medicare and Medicaid provider agreements was not rendered constitutionally moot by dissolution of

injunction, since injunction, even after being dissolved, prevented Secretary from stopping payments to debtor during pendency of its bankruptcy case and from terminating debtor's provider agreements, and Secretary intended to seek recoupment of payments it made to debtor. U.S. Const. art. 3, § 1 et seq.;  28 U.S.C.A. § 1334;  42 U.S.C.A. §§ 405(h), 1395ii.

1 Cases that cite this headnote

- [7] **Federal Courts**  Rights and interests at stake
Federal Courts  Inception and duration of dispute; recurrence; "capable of repetition yet evading review"

A case is constitutionally moot when the issues presented are no longer live or the parties lack a legally cognizable interest in the outcome. U.S. Const. art. 3, § 1 et seq.

- [8] **Federal Courts**  Available and effective relief
Federal Courts  Inception and duration of dispute; recurrence; "capable of repetition yet evading review"

A case is constitutionally moot when it no longer presents a live controversy with respect to which a court can give meaningful relief. U.S. Const. art. 3, § 1 et seq.

- [9] **Bankruptcy**  Moot questions

Equitable mootness is a discretionary doctrine that permits courts sitting in

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bankruptcy appeals to dismiss challenges when effective relief would be impossible.

[3 Cases that cite this headnote](#)

[10] **Bankruptcy** Moot questions

Central to a finding of equitable mootness in a bankruptcy proceeding is a determination by an appellate court that it cannot grant effective judicial relief.

[4 Cases that cite this headnote](#)

[11] **Federal Courts** Subject-matter jurisdiction in general
Federal Courts Waiver, estoppel, and consent

Subject matter jurisdiction properly comprehended refers to a tribunal's power to hear a case, a matter that can never be forfeited or waived.

[2 Cases that cite this headnote](#)

[12] **Federal Courts** Appellate Jurisdiction and Procedure in General

When a lower court lacks jurisdiction, an appellate court has jurisdiction not of the merits, but merely for the purpose of correcting the error of the lower court in entertaining the suit.

[2 Cases that cite this headnote](#)

[13] **Federal Courts** Jurisdiction, Powers, and Authority in General

Federal Courts Absence or loss of jurisdiction, and effect thereof

Jurisdiction is power to declare the law, and when it ceases to exist, the only function remaining to a court is that of announcing the fact and dismissing the cause.

[2 Cases that cite this headnote](#)

[14] **Health** Suspension or termination of provider participation; penalties
Health Suspension or termination of provider participation; penalties

Skilled nursing facility operator's challenge to termination of its Medicare and Medicaid provider agreements by Secretary of Health and Human Services arose under Medicare Act, and, thus, challenge was subject to Act's prohibition of actions against Secretary on any claim arising under Act, since operator's challenge could be characterized either as a claim of program eligibility or a claim contesting a sanction or remedy. 42 U.S.C.A. §§ 405(h), 1395ii.

[1 Cases that cite this headnote](#)

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In re Bayou Shores SNF, LLC, 828 F.3d 1297 (2016)

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Appeal from the United States District Court for the Middle District of Florida. D.C. Docket Nos. 8:14-bk-09521-MGW; 8:14-cv-02816-JSM.

Before [HULL](#), [JULIE CARNES](#), and [CLEVENGER](#),* Circuit Judges.

Opinion

CLEVENGER, Circuit Judge:

Bayou Shores SNF, LLC (“Bayou Shores”) operates a skilled nursing facility in St. Petersburg, Florida. Most of Bayou Shores’ patients are on Medicare or Medicaid, and over ninety percent of its revenue is derived from Medicare and Medicaid patients. It receives compensation for Medicare and Medicaid services through provider agreements entered into with the federal and state governments. *1300 Bayou Shores’ entitlement to participate in the provider agreements depends on its continued compliance with qualification requirements for such facilities that are established by the Secretary of the Department of Health and Human Services. After an unchallenged exercise of her statutory oversight authority, the Secretary determined that Bayou Shores was not in substantial compliance with the Medicare program participation requirements, and that conditions in its facility constituted an immediate jeopardy to residents’ health and safety. By letter dated July 22, 2014, the Secretary notified Bayou Shores that its Medicare provider agreement “will be terminated at 11:59 pm on August 3, 2014.” The termination of Bayou Shores’ Medicare provider agreement triggered the termination of its Medicaid provider agreement as well.

To avoid the consequences of termination of its provider agreements, Bayou Shores sought protection in the United States Bankruptcy Court for the Middle District of Florida. Rejecting the jurisdictional challenge from the Secretary, the bankruptcy court assumed authority over the Medicare and Medicaid provider agreements as part of the debtor’s estate, enjoined the Secretary from terminating the provider agreements, determined for itself that Bayou Shores was qualified to participate in the provider agreements,

required the Secretary to maintain the stream of monetary benefit under the agreements, reorganized the debtor’s estate, and finally issued its Confirmation Order on December 31, 2014.

On appeal, in a June 26, 2015, Order, the United States District Court for the Middle District of Florida upheld the Secretary’s jurisdictional challenge and reversed the Confirmation Order with respect to the assumption of the debtor’s Medicare and Medicaid provider agreements. See [In re Bayou Shores SNF, LLC](#), 533 B.R. 337, 343 (M.D. Fla. 2015).

Bayou Shores timely appeals the decision of the district court. The appeal turns on the jurisdictional question. From the Social Security Amendments of 1939 until 1984, it is undisputed that bankruptcy courts lacked jurisdiction over Medicare claims. The statute barring such jurisdiction was finally recodified in 1984 to reflect an earlier recodification of the Judicial Code. In cases involving the interpretation of statutory language changed in a recodification, it has long been established that no change in the previous recodified law is recognized unless Congress’s intention to make a substantive change is “clearly expressed.” [United States v. Ryder](#), 110 U.S. 729, 740, 4 S.Ct. 196, 28 L.Ed. 308 (1884). Now the central question is whether the statutory revision in this case demonstrated Congress’s clear intention to vest the bankruptcy courts with jurisdiction over Medicare claims. We think it is abundantly clear that Congress expressed no such intention.

Therefore, after careful review of the record and the parties’ briefs, and with the benefit of oral argument, and for the reasons set forth below, we affirm the district court’s Order.

I. BACKGROUND

The relevant facts of this case are generally undisputed and ably set out by the district court in the opinion below. See [In re Bayou Shores SNF, LLC](#), 533 B.R. 337, 338–40 (M.D. Fla. 2015). A brief summary follows.

A. Bayou Shores' "Skilled Nursing Facility"

As noted above, Bayou Shores operates a "skilled nursing facility" in St. Petersburg, *1301 Florida, and approximately ninety percent of Bayou Shores' revenue is derived from caring for Medicare and Medicaid patients. To be eligible for the Medicare/Medicaid program, Bayou Shores entered into so-called "provider agreements" with the federal and Florida state governments, respectively, which provide reimbursement to Bayou Shores for the provision of medical services to Bayou Shores' Medicare/Medicaid patients. As a condition of payment under these agreements Bayou Shores must comply with certain regulatory requirements pertaining to skilled nursing facilities.² The Plaintiffs in this case are the government agencies primarily tasked with monitoring Bayou Shores' compliance with these regulations: the Florida Agency for Health Care Administration ("AHCA") and the United States Department of Health and Human Services ("HHS") (collectively, "the Government"). AHCA is responsible for conducting surveys of skilled nursing facilities in Florida and administering the state's Medicaid program. HHS administers Medicare nationally, and uses AHCA's surveys to decide whether skilled nursing facilities in Florida are compliant with the regulations, and if not, what remedial action to take. When conditions at a skilled nursing facility pose immediate jeopardy to the health or safety of the facility's patients, the law requires the Secretary to select and execute an appropriate remedy.³

On February 10, 2014, AHCA conducted such a survey at Bayou Shores' skilled nursing facility. As a result of the survey, AHCA reported to HHS that Bayou Shores was not compliant with the relevant regulations. The survey noted a number of problems including failing to correctly track residents' "Do Not Resuscitate" orders, poor patient hygiene, and unsecured expired medications. AHCA determined that at least some of these deficiencies posed a threat of immediate jeopardy to Bayou Shores' patients.⁴ Bayou Shores was given an opportunity to remedy these deficiencies. In a follow-up survey on March 20, 2014, AHCA again found a number of deficiencies. These included Bayou Shores placing a "known sexual offender" in a room with a disabled patient without informing that patient, and subsequently failing to appropriately handle an alleged sexual assault by the "known sexual offender" reported by the disabled patient. As with the previous survey,

AHCA found that at least some of these deficiencies posed a threat of immediate jeopardy to Bayou Shores' patients. Bayou Shores was *1302 again given the opportunity to remedy the deficiencies.

The proverbial "last straw" was a final survey on July 11, 2014, in which further deficiencies were identified, including allowing a mentally impaired resident to leave the facility unaccompanied on a hot Florida day (he was later found at a bus station). AHCA again determined that at least some of these deficiencies placed Bayou Shores' residents in immediate jeopardy. After the third finding of non-compliance, HHS sent Bayou Shores a letter on July 22, 2014 notifying Bayou Shores that its non-compliance posed an "immediate jeopardy to [Bayou Shores'] residents' health and safety," and that HHS was exercising its regulatory discretion to terminate Bayou Shores' Medicare provider agreement. HHS's letter stated that the "Medicare provider agreement will be terminated at 11:59 pm on August 3, 2014."⁵ The termination of Bayou Shores' Medicare provider agreement triggered the termination of Bayou Shores' Medicaid provider agreement.⁶

B. Bankruptcy Court Proceedings

Two days before this looming deadline, on August 1, 2014, Bayou Shores sought emergency injunctive relief from the U.S. District Court for the Middle District of Florida to prevent the termination of the provider agreements. The district court initially granted Bayou Shores' request for a temporary restraining order. However, on motion of HHS, the district court dismissed Bayou Shores' complaint for lack of subject matter jurisdiction. On August 15, 2014, the court found that Bayou Shores had not exhausted its administrative remedies, and thus Medicare's jurisdictional bar ( 42 U.S.C. § 405(h)) prevented the district court from exercising jurisdiction over the termination of the provider agreements. See *Bayou Shores SNF, LLC v. Burwell*, No. 8:14-CV-1849-T-33MAP, 2014 WL 4059900,*6-8 (M.D. Fla. Aug. 15, 2014). Approximately an hour after issuance of the district court's order, Bayou Shores filed a Voluntary Petition for Chapter 11 bankruptcy, and sought an emergency injunction from the bankruptcy court preventing HHS and AHCA from

terminating the provider agreements. The Government, at each opportunity, challenged the bankruptcy court's jurisdiction to order assumption of the provider agreements.

On August 25, 2014, the bankruptcy court issued the preliminary injunction sought by Bayou Shores. The bankruptcy court reasoned that it had jurisdiction pursuant to 28 U.S.C. § 1334,⁷ the provider agreements were property of the estate, and an automatic stay preventing HHS *1303 and AHCA from terminating the agreements was thus proper. At a subsequent evidentiary hearing on August 26, the bankruptcy court heard testimony from doctors, patients, and other Bayou Shores witnesses. Concluding that in its view Bayou Shores' patients did not appear to be in any immediate jeopardy, the bankruptcy court issued an order on September 5, 2014 that (among other things) forbade HHS and AHCA from terminating Bayou Shores' provider agreements.

After further proceedings, on December 31, 2014 the bankruptcy court issued its Confirmation Order. See *In re Bayou Shores SNF, LLC*, 525 B.R. 160 (Bankr. M.D. Fla. 2014). In the Confirmation Order, the bankruptcy court again stated its belief that jurisdiction was proper under 28 U.S.C. § 1334, and rejected HHS and AHCA's argument that the same 42 U.S.C. § 405(h) bar applied to the bankruptcy court as applied to the district court. The bankruptcy court reasoned that the plain language of 42 U.S.C. § 405(h), which refers only to 28 U.S.C. §§ 1331 and 1346, did not prevent the bankruptcy court from exercising jurisdiction over the assumption of the provider agreements under § 1334. *Id.* at 166. The bankruptcy court further concluded that because Bayou Shores appeared to have remedied the deficiencies it was originally cited for, Bayou Shores had provided adequate assurances of future performance under the provider agreements, and thus was eligible to assume them. Finding the remainder of the statutory requirements fulfilled, the bankruptcy court confirmed Bayou Shore's Chapter 11 plan. The bankruptcy court also ordered the dissolution of the automatic stay and preliminary injunction.⁸

HHS and AHCA separately appealed both the bankruptcy court's September 5, 2014 Order, and the Confirmation Order. The appeals were consolidated by the district court. As they had argued to the bankruptcy court, HHS and AHCA asserted to the district court that 42 U.S.C. § 405(h) denied the bankruptcy court jurisdiction over the provider agreements. The district court agreed. While acknowledging that the bankruptcy court's reading of § 405(h) was an issue that the Eleventh Circuit had not squarely addressed, the district court noted that the majority of other circuit courts addressing the issue "have examined Congress' intent when it enacted the jurisdictional bar and concluded that the omission of section 1334 and other jurisdictional grants (like section 1332) was inconsistent with that intent." *In re Bayou Shores*, 533 B.R. at 342. The district court reviewed the relevant statutory language and legislative history, as well as decisions from other courts examining the same. In particular, the district court noted that the absence of § 1334 in the recodified 42 U.S.C. § 405(h) appeared to be the result of a codification error. Based on that analysis, the district court held that it "respectfully disagree[d] [with the bankruptcy court] and align[ed] itself with the majority view" in finding that § 405(h) must be understood to bar jurisdiction under § 1334. *Id.* at 343.

Because it was undisputed that Bayou Shores had yet to exhaust its administrative remedies, and "no other independent basis for jurisdiction existed to enjoin and order the assumption of the Medicare and Medicaid provider agreements," the district *1304 court reversed the orders of the bankruptcy court (with respect to the provider agreements). *Id.*

The district court also noted that a hotly contested issue on appeal was "the exact timing of any termination of the provider agreements." *Id.* However, the district court found that it did not need to resolve that issue, because the timing was irrelevant to whether or not the bankruptcy court lacked jurisdiction to hear the case in the first place. *Id.*⁹

Bayou Shores timely appealed the district court's order.

C. District Court Proceedings

II. STANDARD OF REVIEW

^[1] ^[2]In a bankruptcy case, this Court sits as a second court of review and thus examines independently the factual and legal determinations of the bankruptcy court and employs the same standards of review as the district court. See *Brown v. Gore (In re Brown)*, 742 F.3d 1309, 1315 (11th Cir. 2014). We review the bankruptcy court's factual findings for clear error and its legal conclusions de novo. *Id.* The district court's legal determinations are also reviewed de novo. See *Dionne v. Simmons (In re Simmons)*, 200 F.3d 738, 741 (11th Cir. 2000).

III. BANKRUPTCY COURT JURISDICTION OVER MEDICARE CLAIMS

The primary dispute in this case is purely legal: does *42 U.S.C. § 405(h)* bar a bankruptcy court from exercising *28 U.S.C. § 1334* jurisdiction over claims that arise under the Medicare Act? Bayou Shores' primary argument is that the plain text of *42 U.S.C. § 405(h)* precludes district court jurisdiction under *28 U.S.C. §§ 1331* and *1346* only. The Government argues that the lack of a reference to *§ 1334* is merely a result of a codification error, and that properly construed the statute requires exhaustion of administrative remedies before bringing a Medicare claim before any district court.

Because we conclude that the lack of a reference to *§ 1334* in *42 U.S.C. § 405(h)* is the result of a codification error, we agree with the Government that the bankruptcy court lacked jurisdiction over the termination of the provider agreements. To see why, we turn first to an examination of the history of *42 U.S.C. § 405(h)*.

A. Legislative history of *42 U.S.C. § 405(h)*

The relevant text of the *42 U.S.C. § 405(h)* currently reads (emphasis added):

(h) Finality of Commissioner's decision

The findings and decision of the Commissioner of Social Security after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under *section 1331* or *1346 of Title 28* to recover on any claim arising under this subchapter.¹⁰

*1305 Bayou Shores argues that the third sentence of *42 U.S.C. § 405(h)* forbids only an "action" brought under "*section 1331* [*i.e.* federal question jurisdiction] or *1346* [*i.e.* suits against the federal government] of Title 28." Because Bayou Shores' action was brought under *section 1334 of Title 28* (*i.e.* bankruptcy jurisdiction), Bayou Shores argues that *42 U.S.C. § 405(h)* does not apply. To understand why Bayou Shores is incorrect however requires a thorough examination of the history of *42 U.S.C. § 405(h)*, which reveals that the issue is not as straightforward as Bayou Shores suggests.

The original text of *42 U.S.C. § 405(h)* when passed in 1939 was largely the same as it is today, with the crucial difference for this case emphasized below:

(h) The findings and decision of the Board after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Board shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the Board, or any officer or employee thereof shall be brought under *section 24 of the Judicial Code of the United States* to recover on any claim arising under this title.

See Social Security Amendments of 1939, Pub. L. No. 76-379, 53 Stat. 1360 (1939) (emphasis added). In 1939, “section 24 of the Judicial Code” defined the original jurisdiction granted to district courts, including jurisdiction over bankruptcy claims (see Judicial Code, Pub. L. No. 61-475, 36 Stat. 1087, § 24(19) (1911)), diversity and federal question claims (*id.* at § 24(1)), and claims against the United States (*id.* at § 24(20)). With few exceptions then, section 24 of the Judicial Code originally “contained all of that title’s grants of jurisdiction to United States district courts, save for several special-purpose jurisdictional grants of no relevance to the constitutionality of [Medicare] statutes.” See [Weinberger v. Salfi](#), 422 U.S. 749, 756, n. 3, 95 S.Ct. 2457, 45 L.Ed.2d 522 (1975). It is thus undisputed that under the original text of [§ 405\(h\)](#), bankruptcy court jurisdiction over Medicare claims was barred.

In 1948, however, Congress recodified section 24 of the Judicial Code under title 28 of the U.S. Code.¹¹ As part of that revision, Congress split the district courts’ jurisdictional grants into multiple sections under Title 28. See U.S. Code, Title 28, Pub. L. No. 80-773, 62 Stat. 869 (1948). Among other things, federal question jurisdiction was re-codified to [28 U.S.C. § 1331](#), diversity jurisdiction to [§ 1332](#), suits against the government to [§ 1346](#), and bankruptcy jurisdiction to [§ 1334](#). See *id.* at Ch. 85, §§ 1331-1359 (“District Courts; Jurisdiction”).

After the 1948 re-codification however, the text of [§ 405\(h\)](#) continued to incorrectly refer to “section 24 of the Judicial Code” for approximately the next thirty years. Indeed, the Supreme Court noted this issue in its 1975 [Salfi](#) decision. The text in the body of the Court’s opinion replaced the reference in [§ 405\(h\)](#) to “section 24 of the Judicial Code” with “[§ 1331 et seq.] of Title 28.” See [*1306 Salfi](#), 422 U.S. at 756, 95 S.Ct. 2457. A footnote in the opinion acknowledged the apparent error created by the 1948 Judicial Code recodification. See *id.* at n. 3.

By 1976 (after the [Weinberger](#) decision), the Office of the Law Revision Counsel appears to have recognized the error.¹² In the edition of the U.S. Code published that year, the revisers substituted the phrase “section 24 of the Judicial Code of the United States” in [§ 405\(h\)](#) with the

now current language, “[sections 1331 or § 1346 of title 28](#).” A “Codification” note included in the 1976 revision indicates the following about the change:

In subsec. (h), “[sections 1331 or § 1346 of title 28](#)” was substituted for “section 24 of the Judicial Code of the United States” on authority of act June 25, 1948, ch. 646, 62 Stat. 869, section 1 of which enacted Title 28, Judiciary and Judicial Procedure. Prior to the enactment of Title 28, section 24 of the Judicial Code was classified to section 41 of Title 28.

See [42 U.S.C. § 405 \(1976\)](#). The revisers expanded somewhat on this note in the 1982 version of the code (added text emphasized):

In subsec. (h), “[sections 1331 or § 1346 of title 28](#)” was substituted for “section 24 of the Judicial Code of the United States” on authority of act June 25, 1948, ch. 646, 62 Stat. 869, section 1 of which enacted Title 28, Judiciary and Judicial Procedure. Prior to the enactment of Title 28, section 24 of the Judicial Code was classified to section 41 of Title 28. *Jurisdictional provisions previously covered by section 41 of Title 28 are covered by [sections 1331 to 1348, 1350 to 1357, 1359, 1397, 1399, 2361, 2401, and 2402 of Title 28](#).*

See [42 U.S.C. § 405 \(1982\)](#).

A year later, H.R. 3805, the “Technical Corrections Act of 1983” was introduced to the floor of the House. 129 Cong. Rec. 23,439 (1983) (statement of Rep. Rostenkowski). A report on the bill describes its derivation and purpose as follows:

The technical amendments made by the Technical Corrections Act of 1983 are intended to clarify and conform various provisions adopted by the acts listed above. The bill is based on a review by the staffs of the Joint Committee on Taxation and the Committee on Ways and Means, taking into account the comments submitted to the Congress that concerned changes that would be technical in nature. The bill was developed with the assistance of the Treasury Department, the Social Security Administration, and the Health Care Financing Administration.

See STAFF OF J. COMM. ON TAXATION, 98th CONG., DESCRIPTION OF H.R. 3805 (TECHNICAL CORRECTIONS ACT OF 1983), at 1 (J. Comm. Print 1983) (“H.R. 3805 Rept.”).

Among the numerous “technical amendments” was an amendment to  § 405(h), proposing to enact the prior codification into positive law:

(D) Section 205(h) of such Act is amended by striking out “Section 24 of the Judicial Code of the United States” and inserting in lieu thereof “section 1331 or  1346 of title 28, United States Code.”.

See *Technical Corrections Act of 1983: Hearing on H.R. 3805 Before the H. Comm. on Ways and Means*, 98th Cong. 79 (1984) (draft text of H.R. 3805).¹³ That *1307 section of the act, titled “Sec. 403. Other Technical Corrections in [old age, survivors, and disability insurance] Provisions,”¹⁴

was followed by this in “Sec. 404. Effective Dates”:

(b)(1) Except to the extent otherwise specifically provided in this title, the amendments made by section 403 shall be effective on the date of enactment of this Act; *but none of such amendments shall be construed as changing or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before that date.*

See *id.* at 89–90 (emphasis added). The legislative history of H.R. 3805 appears to characterize this and other “technical corrections” as “certain corrections of spelling, punctuation, and cross-references in title XVIII of the Social Security Act and in cross-references to the Internal Revenue Code.” See H.R. 3805 Rept. at 37.¹⁵ Moreover, the bill’s sponsor, Rep. Dan Rostenkowski, noted when the bill was introduced: “I would like to emphasize that this bill intends simply to correct technical errors and to better reflect the policies established by the Congress in enacting the original legislation.” 129 Cong. Rec. 23321, 23440 (1983). H.R. 3805 did not contain any provisions relating to the jurisdiction of bankruptcy courts.

Although H.R. 3805 did not become law, in 1984 it was merged into another bill, H.R. 4170, which Congress passed as The Deficit Reduction Act of 1984, Pub. L. No. 98–369, 98 Stat. 494 (1984) (hereinafter, the “DRA”).¹⁶ As noted in the bill itself, the general purpose of the DRA was “to provide for tax reform, and for deficit reduction.” See 98 Stat. at 494. The DRA did not contain any provisions relating to the scope of bankruptcy court jurisdiction.

The amendment to  § 405(h) is located in “DIVISION V—SPENDING REDUCTION ACT OF 1984”, “TITLE VI—OASDI, SSI, AFDC, AND OTHER PROGRAMS,” “Subtitle

D—Technical Corrections,” “Sec. 2663. Other technical corrections in the Social Security Act and related provisions.” Consistent with the 1976 and 1982 codification (and the amendment originally proposed in H.R. 3805), section 2663(a)(4)(D) ordered that “Section 205(h) of [the Social Security Act] is amended by striking out ‘section 24 of the Judicial Code of the United States’ and inserting in lieu thereof ‘section 1331 or § 1346 of title 28, United States Code.’” See 98 Stat. at 1162. Section 2664 of the DRA further requires that “[e]xcept to the extent otherwise specifically provided in this subtitle, the amendments made by section 2663 shall *1308 be effective on the date of the enactment of this Act; but none of such amendments shall be construed as changing or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before that date.” See *id.* at 1171–72.

The House committee report on the DRA explains the reasons for the “technical corrections” of certain sections in the bill, but does not specifically address the amendments to § 405(h). The report generally states that the “bill makes certain corrections of spelling, punctuation, cross-references and other clerical amendments to the Social Security Act and related provisions in the Internal Revenue Code.” See H.R. Rep. No. 98-432, pt. 2, at 1663 (1984). Nothing in the report or elsewhere in the legislative history, in so far as we have been able to determine, expresses any intention to change the jurisdiction of bankruptcy courts, let alone to grant bankruptcy courts parallel authority with HHS over Medicare claims.

It thus appears that the current text of § 405(h) is the result of the Office of the Law Revision Counsel’s mistaken codification, an error enacted into positive law by the DRA. While the Supreme Court has yet to speak on this precise issue, the Court has had reason to interpret § 405(h) in a number of cases that are helpful in resolving the current dispute. We thus turn to an examination of those cases before turning back to the codification issue.

B. Supreme Court cases interpreting § 405(h)
The earliest relevant Supreme Court decision,

Salfi, was decided prior to the DRA amendment to § 405(h). In *Salfi* the plaintiff brought suit to challenge the Social Security Administration’s “duration-of-relationship requirements” as unconstitutional. 422 U.S. at 752–53, 95 S.Ct. 2457. The district court exercised jurisdiction over the case pursuant to 28 U.S.C. § 1331. *Id.* at 755, 95 S.Ct. 2457. While deciding the constitutional question against the plaintiff, more relevant for our purposes is the Court’s analysis of the “serious question as to whether the District Court had jurisdiction over this suit” to begin with. See *Salfi*, *Id.* at 756, 95 S.Ct. 2457.

In examining the requirements of § 405(h), the Court found that the third sentence, “No action against the United States, the Secretary, or any officer or employee thereof shall be brought under (§ 1331 et seq.) of Title 28 to recover on any claim arising under (Title II of the Social Security Act)”¹⁷ should be read as more than merely a “codified requirement of administrative exhaustion” because the first two sentences of § 405(h) already require administrative exhaustion. *Id.* at 757, 95 S.Ct. 2457.¹⁸ Those first two sentences prevent review of any decision of the Secretary other than as set out in § 405(g), which prescribes “typical requirements for review of matters before an administrative *1309 agency, including administrative exhaustion.” *Id.* at 758, 95 S.Ct. 2457. The Court thus explained that the third sentence of § 405(h) acted to bar actions under § 1331, even where administrative remedies had been exhausted. *Id.* at 757, 95 S.Ct. 2457.

Somewhat less than a decade later, the Court again considered § 405(h) again in *Heckler v. Ringer*, 466 U.S. 602, 104 S.Ct. 2013, 80 L.Ed.2d 622 (1984). In *Ringer*, the underlying factual dispute involved “challenges to the policy of the Secretary of Health and Human Services (Secretary) as to the payment of Medicare benefits for a surgical procedure known as bilateral carotid body resection (BCBR).” *Id.* at 604–05, 104 S.Ct. 2013. The focus of the case was whether the plaintiff’s claims “arose” under the Medicare Act. See e.g. *id.* at 612–613, 104 S.Ct. 2013. But in characterizing § 405(h) and its own holding in *Salfi*, the Court held that “[t]he third sentence of

42 U.S.C. § 405(h), made applicable to the Medicare Act by 42 U.S.C. § 1395ii, provides that § 405(g), to the exclusion of 28 U.S.C. § 1331, is the sole avenue for judicial review for all ‘claim[s] arising under’ the Medicare Act.” *Id.* at 614–15, 104 S.Ct. 2013.

Perhaps most instructive is a more recent case, decided long after the 1984 DRA amendments to § 405(h), *Shalala v. Illinois Council on Long Term Care, Inc.*, 529 U.S. 1, 120 S.Ct. 1084, 146 L.Ed.2d 1 (2000). The plaintiffs in *Illinois Council* were an association of nursing homes challenging the legality and constitutionality of certain Medicare-related regulations. *Id.* at 5, 120 S.Ct. 1084. As in *Ringer*, the key issue in *Illinois Council* was whether the plaintiff’s claims “arose” under the Medicare Act (and were thus subject to the § 405(h) jurisdictional bar). *Id.* at 9–10, 120 S.Ct. 108.

However, in explaining the application of § 405(h) to the case, the Court again emphasized that the effect of § 405(h) was to reach beyond normal principles of “administrative exhaustion” and “ripeness,” and prevent even the application of normal exceptions to those doctrines. *Id.* at 12, 120 S.Ct. 1084. The Court held that § 405(h) “demands the ‘channeling’ of virtually all legal attacks through the agency.” *Id.* at 13, 120 S.Ct. 1084 (emphasis added). Moreover, the Court explained the balancing policy interests inherent in such a scheme:

[I]t assures the agency greater opportunity to apply, interpret, or revise policies, regulations, or statutes without possibly premature interference by different individual courts applying “ripeness” and “exhaustion” exceptions case by case. But this assurance comes at a price, namely, occasional individual, delay-related hardship. In the context of a massive, complex health and

safety program such as Medicare, embodied in hundreds of pages of statutes and thousands of pages of often interrelated regulations, any of which may become the subject of a legal challenge in any of several different courts, paying this price may seem justified.

Id. at 13, 120 S.Ct. 1084. As the Court noted, whatever one may think of such a policy, it was clearly that chosen by Congress in creating § 405(h).¹⁹

A few salient points about § 405(h) are thus clear from the relevant Supreme Court cases. *Salfi* makes clear that the *1310 first two sentences of § 405(h) require standard administrative exhaustion of remedies prior to bringing Medicare claims before a district court. See *Salfi*, 422 U.S. at 757, 95 S.Ct. 2457. Moreover, § 405(h) “demands the ‘channeling’ of virtually all legal attacks through the agency,” making § 405(g) the “sole avenue for judicial review for all ‘claim[s] arising under’ the Medicare Act.” See *Illinois Council*, 529 U.S. at 13, 120 S.Ct. 1084; *Ringer*, 466 U.S. at 615–14, 104 S.Ct. 2013. However, we must acknowledge a common thread running through all three cases: each involved a suit brought under 28 U.S.C. § 1331, a jurisdictional grant that all parties agree was barred by § 405(h) prior to the 1984 amendments and continues to be barred after the amendments.²⁰ Thus, none of these cases answers the question before us, namely, does § 405(h) bar jurisdiction under § 1334? To further examine the question, we turn to the decisions of our sister circuits.

C. Courts split over the application of § 405(h) to district courts
The decisions of our sister circuits (and the lower

courts) fall into two categories. The first group of cases holds that the jurisdictional bar of § 405(h) applies to cases brought under § 1332 jurisdiction (*i.e.* diversity jurisdiction), notwithstanding the fact that § 1332 (like § 1334) is not mentioned in the statute. The second group of cases directly considers whether § 1334 jurisdiction can lie in the face of § 405(h).

1. Cases holding that § 405(h) bars jurisdiction

The primary case among the first category of § 1332 decisions is from the Seventh Circuit in *Bodimetric Health Servs., Inc. v. Aetna Life & Cas.*, 903 F.2d 480 (7th Cir. 1990). In determining whether a review of plaintiff's claims in a district court was precluded by § 405(h), the Seventh Circuit noted the "curious" fact that § 405(h) on its face appears to bar "actions brought pursuant to federal question jurisdiction and actions brought against the United States but appears to permit actions brought pursuant to diversity jurisdiction." See *id.* at 488. However, the Seventh Circuit then analyzed the codification history described *supra*, holding that in § 2664(b) of the DRA Congress had "clearly expressed" its intent not to substantively change the scope of § 405(h). *Id.* at 489. Thus, because the statute prior to amendment had clearly barred diversity § 1311 jurisdiction, the revised statute continued to bar diversity jurisdiction. *Id.*

Both the Third and Eighth circuits have subsequently adopted the holding and analysis of *Bodimetric*. See *Nichole Med. Equip. & Supply, Inc. v. TriCenturion, Inc.*, 694 F.3d 340, 346–47 (3d Cir. 2012); *Midland Psychiatric Associates, Inc. v. United States*, 145 F.3d 1000, 1004 (8th Cir. 1998). An earlier Third Circuit case, *In re Univ. Med. Ctr., Inc.*, 973 F.2d 1065, 1073–74 (3d Cir. 1992), appears to suggest (but not hold) that § 405(h) may not apply to bankruptcy courts. However, that case involved a claim that HHS had violated an automatic bankruptcy stay. The court's opinion hinged on its holding that such a claim did not "arise" under the Medicare act. *Id.*

at 1073. In *Nichole Med. Equip.*, the Third Circuit explicitly adopted *Bodimetric*, noting that "Congress clearly prohibited federal courts from exercising subject matter jurisdiction or diversity jurisdiction over claims arising under the [Medicare] Act." See 694 F.3d at 347.

Several circuits have thus addressed the question of whether § 405(h) bars districts court jurisdiction other than pursuant only to §§ 1331 and 1346. Those circuits read the history of § 405(h) to conclude that the codification error acts to carry forward the original § 405(h)'s jurisdictional restrictions.²¹

2. Cases holding that § 405(h) does not bar § 1334 jurisdiction

The second category of cases come first from the Ninth Circuit and begin with *In re Town & Country Home Nursing Servs.*, 963 F.2d 1146 (9th Cir. 1991). The court there was asked to determine if the failure to exhaust administrative remedies precluded a bankruptcy court from exercising jurisdiction over state law tort and contract claims "arising out of the government's setoff of Medicare overpayments." *Id.* at 1154. The Ninth Circuit held that "Section 405(h) only bars actions under 28 U.S.C. §§ 1331 and 1346; it in no way prohibits an assertion of jurisdiction under section 1334." *Id.* at 1155. The Ninth Circuit appears to have placed great weight on "section 1334's broad jurisdictional grant over all matters conceivably having an effect on the bankruptcy estate." *Id.* However, the court did not discuss or analyze the legislative history relied on in the *Bodimetric* line of cases.

A later Ninth Circuit case, *Kaiser v. Blue Cross of California*, 347 F.3d 1107, 1114 (9th Cir. 2003), cites favorably to both *Bodimetric* and *Midland Psychiatric* for what those cases say about a claim that "arises under Medicare." It appears that the court in *Kaiser* assumed that

the plaintiffs were proceeding under federal-question jurisdiction (which is indisputably precluded by 28 U.S.C. § 405(h)), and thus the only relevant question was whether their claims “arose” under Medicare. But in a dicta discussion of whether there had been a waiver of sovereign immunity, the court noted that “11 U.S.C. § 106(a), which refers to waivers of sovereign immunity in bankruptcy proceedings, could not apply *1312 since any consideration of claims against the government in [debtor]’s bankruptcy would likely require consideration of the merits of the Medicare claims, again invoking 42 U.S.C. § 405(g).” *Id.* at 1117. Thus, *Kaiser* at least hints that the court would have come to the opposite conclusion of *In re Town & Country*, i.e. by holding that bankruptcy jurisdiction could not trump the exhaustion requirements of 28 U.S.C. §§ 405(g) and 405(h).

A more recent Ninth Circuit decision, *Do Sung Uhm v. Humana, Inc.*, 620 F.3d 1134 (9th Cir. 2010) attempted to address what it characterized as a possible conflict between *Kaiser* and *In re Town & Country*. The *Do Sung Uhm* court cites *Kaiser* for the proposition that “[j]urisdiction over cases ‘arising under’ Medicare exists only under 42 U.S.C. § 405(g), which requires an agency decision in advance of judicial review.” *Id.* at 1140–41. In a footnote though, the court acknowledges the tension between *Kaiser*’s broad reading of 28 U.S.C. § 405(h) and *In re Town & Country*’s more narrow reading, but reconciles the two on the grounds that *In re Town & Country* relied on the “special status” of bankruptcy court jurisdiction over bankruptcy issues. *Id.* at 1141 n. 11. The court concludes that *In re Town & Country*’s reading of 42 U.S.C. § 405(h) applies “only to actions brought under 11 U.S.C. § 1334, while not bearing on the relationship between 28 U.S.C. § 405(h) and other jurisdictional provisions such as § 1332.” *Id.* The Ninth Circuit thus joins the other circuit courts in unanimously opining that 28 U.S.C. § 405(h) bars diversity jurisdiction under § 1332, notwithstanding the omission of § 1332 from the text of 28 U.S.C. § 405(h).

However, the Ninth Circuit is alone among circuit court decisions in reading 28 U.S.C. § 405(h) to permit bankruptcy court jurisdiction over Medicare claims under 11 U.S.C. § 1334. Many lower courts have also considered the issue of 11 U.S.C. § 1334 jurisdiction. These lower courts have split, with some assuming jurisdiction,²² and others deciding jurisdiction was barred.²³ Case going both ways *1313 have recognized and analyzed the codification error that led to the present omission of 11 U.S.C. § 1334 from the text of 28 U.S.C. § 405(h). Compare e.g. *In re Nurses’ Registry & Home Health Corp.*, 533 B.R. 590, 593–97 (Bankr. E.D. Ky. 2015) (assuming jurisdiction under 11 U.S.C. § 1334) to *In re St. Johns Home Health Agency, Inc.*, 173 B.R. 238, 245–46 (Bankr. S.D. Fla. 1994) (holding that 11 U.S.C. § 1334 jurisdiction is barred).

We also note some limited scholarship addressing this issue as well. Articles written by members of the bankruptcy bar argue that under the “plain meaning” doctrine, bankruptcy courts’ 11 U.S.C. § 1334 jurisdiction is not barred by 28 U.S.C. § 405(h). See Samuel R. Maizel & Michael B. Potere, *Killing the Patient to Cure the Disease: Medicare’s Jurisdictional Bar Does Not Apply to Bankruptcy Courts*, 32 Emory Bankr. Dev. J. 19, 66 (2015); Peter R. Roest, *Recovery of Medicare and Medicaid Overpayments in Bankruptcy*, 10 Annals Health L. 1, 1 (2001). Conversely, an article written by current and former counsel for HHS argues that, based on the legislative history, the amended 28 U.S.C. § 405(h) should have the same effect as the prior version, i.e. barring bankruptcy court jurisdiction. See John Aloysius Cogan Jr. & Rodney A. Johnson, *Administrative Channeling Under the Medicare Act Clarified: Illinois Council, Section 405(h), and the Application of Congressional Intent*, 9 Annals Health L. 125, 125 (2000).

3. Mandamus jurisdiction and § 405(h)

We note in passing a related issue: whether 28 U.S.C. § 405(h) bars mandamus jurisdiction exercised pursuant to 28 U.S.C. § 1361. As noted *supra*, n. 20, this circuit has not decided that issue. See

Lifestar Ambulance Serv., Inc. v. United States, 365 F.3d 1293, 1295 n. 3 (11th Cir. 2004). The Supreme Court has also repeatedly declined to decide whether mandamus jurisdiction is prohibited by § 405(h). See e.g., *Your Home Visiting Nurse Servs., Inc. v. Shalala*, 525 U.S. 449, 456 n. 3, 119 S.Ct. 930, 142 L.Ed.2d 919 (1999). However, the great weight of authority from other circuits has almost uniformly found that § 405(h) does not necessarily deprive district courts of mandamus jurisdiction over Medicare claims.²⁴

Superficially at least, there is some commonality between the issue in those cases regarding § 1361, and the issue in our case involving § 1334, because both jurisdictional provisions are not listed in the text of § 405(h). The commonality is just that though, superficial. As Judge Friendly of the Second Circuit accurately explained, when § 405(h) was passed in 1939, mandamus jurisdiction was not one of the jurisdictional provisions contained in Section 24 of the Judicial Code. See *Ellis v. Blum*, 643 F.2d 68, 81 (2d Cir. 1981).²⁵ Thus, unlike § 1334, there is no argument to be made that the codification of section 24 into Title 28 had any impact on the availability of § 1314 of mandamus relief under § 1361. See *id.*; see also *Ganem v. Heckler*, 746 F.2d 844, 851 (D.C. Cir. 1984) (noting that absence of § 1361 was unrelated to codification error because even in original version of § 405(h), § 24 of the Judicial Code did not include District of Columbia's common law jurisdiction to issue mandamus writs).

However, the issue of whether a district court can exercise mandamus jurisdiction related to Medicare claims, notwithstanding the § 405(h) bar, is neither in front of the court, nor necessary to resolve the current dispute. As previously, we thus decline to decide the issue. See *Lifestar Ambulance Serv.*, 365 F.3d at 1295 n. 3.

D. The Bankruptcy Court Lacked Jurisdiction Under § 405(h)

^[3]With that considerable background in mind, we turn now to the issue in this case: did § 42 U.S.C.

§ 405(h) bar the bankruptcy court below from taking jurisdiction over Bayou Shore's Medicare provider agreement under § 28 U.S.C. § 1334? Because we are persuaded that the 1984 amendments to § 405(h) were a codification and not a substantive change, we align ourselves with the Seventh, Eighth, and Third Circuits and hold that § 405(h) bars § 1334 jurisdiction over claims that "arise under [the Medicare Act]."

1. The Deficit Reduction Act of 1984 amendment to § 405(h) was a codification and did not substantively change the law.

^[4]Bayou Shores' primary argument, and the primary argument of courts holding that § 1334 jurisdiction is not barred by § 405(h), is relatively straightforward: the text of the third sentence of § 405(h) does not mention § 1334, and thus, under the "plain meaning" of the statute § 1334 jurisdiction is not barred by § 405(h). Bayou Shores is certainly correct that "when [a] statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Lamie v. U.S. Tr.*, 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004) (internal quotation marks and citations removed); see also *Owner-Operator Indep. Drivers Ass'n, Inc. v. Landstar Sys., Inc.*, 622 F.3d 1307, 1327 (11th Cir. 2010) (holding that "[t]here is no reason for this Court to rewrite a statute because of an alleged scrivener error unless a literal interpretation would lead to an absurd result.")

^[5]But that is not the end of the analysis because this case is governed by a particular canon in statutory construction regarding the codification of law, *i.e.* the process of converting and organizing the Statutes at Large into the U.S. Code. Since virtually the founding of the Republic, it has been recognized that when legislatures codify the law, courts should presume that no substantive change was intended absent a clear indication otherwise. For example, in the oldest case we have been able to locate,²⁶ *Taylor v. Delancy*, 2 Cai. Cas. 143, 151 (N.Y. Sup. Ct. 1805), the New York

Supreme Court of Judicature²⁷ held “that where the law, antecedently to the revision was settled, either by clear expressions in the statutes, or adjudications on them, the mere change of phraseology shall not be deemed or construed a change of the law, unless such phraseology evidently purports an intention in the legislature to work a change.”

The Supreme Court appears to have recognized the canon at least as early as *Stewart v. Kahn*, 78 U.S. 493, 502, 11 Wall. 493, 20 L.Ed. 176 (1870), where the Court held that “[a] change of language in a revised statute will not change the law from what it was before, unless it be apparent that such was the intention of the legislature.” The Court reiterated the principle in *United States v. Ryder*, 110 U.S. 729, 740, 4 S.Ct. 196, 28 L.Ed. 308 (1884), holding that “[i]t will not be inferred that the legislature, in revising and consolidating the laws, intended to change their policy, unless such intention be clearly expressed.” This canon of statutory construction has remained undisturbed since that time. See e.g. *McDonald v. Hovey*, 110 U.S. 619, 629, 4 S.Ct. 142, 28 L.Ed. 269 (1884); *Logan v. United States*, 144 U.S. 263, 302, 12 S.Ct. 617, 36 L.Ed. 429 (1892), *abrogated on other grounds*, *Witherspoon v. State of Ill.*, 391 U.S. 510, 88 S.Ct. 1770, 20 L.Ed.2d 776 (1968); *Holmgren v. United States*, 217 U.S. 509, 520, 30 S.Ct. 588, 54 L.Ed. 861 (1910); *Anderson v. Pac. Coast S.S. Co.*, 225 U.S. 187, 199, 32 S.Ct. 626, 56 L.Ed. 1047 (1912); *United States v. Sischo*, 262 U.S. 165, 168–69, 43 S.Ct. 511, 67 L.Ed. 925 (1923); *Hale v. Iowa State Bd. of Assessment & Review*, 302 U.S. 95, 102, 58 S.Ct. 102, 82 L.Ed. 72 (1937); *Fourco Glass Co. v. Transmirra Products Corp.*, 353 U.S. 222, 227, 77 S.Ct. 787, 1 L.Ed.2d 786 (1957); *United States v. FMC Corp.*, 84 S.Ct. 4, 7, 11 L.Ed.2d 20 (Goldberg, Circuit Justice 1963); *United States v. Welden*, 377 U.S. 95, 98 n. 4, 84 S.Ct. 1082, 12 L.Ed.2d 152 (1964); *Tidewater Oil Co. v. United States*, 409 U.S. 151, 162, 93 S.Ct. 408, 34 L.Ed.2d 375 (1972); *Cass v. United States*, 417 U.S. 72, 82, 94 S.Ct. 2167, 40 L.Ed.2d 668 (1974); *Aberdeen & Rockfish R. Co. v. Students Challenging Regulatory Agency Procedures (S.C.R.A.P.)*, 422 U.S. 289, 309 n. 12, 95 S.Ct. 2336, 45 L.Ed.2d 191 (1975); *Muniz v. Hoffman*, 422 U.S. 454, 470, 95 S.Ct. 2178, 45

L.Ed.2d 319 (1975); *Fulman v. United States*, 434 U.S. 528, 538, 98 S.Ct. 841, 55 L.Ed.2d 1 (1978); *Walters v. Nat’l Ass’n of Radiation Survivors*, 473 U.S. 305, 318, 105 S.Ct. 3180, 87 L.Ed.2d 220 (1985); *Finley v. United States*, 490 U.S. 545, 554, 109 S.Ct. 2003, 104 L.Ed.2d 593 (1989); *Ankenbrandt v. Richards*, 504 U.S. 689, 700, 112 S.Ct. 2206, 119 L.Ed.2d 468 (1992); **1316 Keene Corp. v. United States*, 508 U.S. 200, 209, 113 S.Ct. 2035, 124 L.Ed.2d 118 (1993); *Scheidler v. Nat’l Org. for Women, Inc.*, 547 U.S. 9, 20, 126 S.Ct. 1264, 164 L.Ed.2d 10 (2006); *John R. Sand & Gravel Co. v. United States*, 552 U.S. 130, 136, 128 S.Ct. 750, 169 L.Ed.2d 591 (2008).

As it happens, a number of these cases from the 20th century arise from an event that directly touches on the issues in our case: the 1948 recodification of the Judicial Code.²⁸

In one of the earlier cases to examine the 1948 recodification, *Fourco Glass Co. v. Transmirra Products Corp.*, 353 U.S. 222, 77 S.Ct. 787, 1 L.Ed.2d 786 (1957), the Court considered whether the recodification had substantively changed venue rules in patent cases. The issue was whether or not the specific patent venue statute, 28 U.S.C. § 1400(b) was supplemented by the more general (and more expansive) civil suit venue statute, 28 U.S.C. § 1391. *Id.* at 222, 77 S.Ct. 787. The Court first noted that in a pre-1948 recodification case, *Stonite Products Co. v. Melvin Lloyd Co.*, 315 U.S. 561, 62 S.Ct. 780, 86 L.Ed. 1026 (1942), the Court had already determined that the more specific patent venue provisions in the old Judicial Code of 1911 trumped more general venue provisions for civil suits.²⁹ The only issue therefore was whether the 1948 recodification (which recodified § 48 of the Judicial Code to 28 U.S.C. § 1400(b)) had substantively changed the patent venue statute. *Fourco Glass*, 353 U.S. at 225, 77 S.Ct. 787. Noting that neither the legislative history, nor the Reviser’s Notes, indicated that any substantive change was intended, the Court reasoned that “[t]he change of arrangement, which placed portions of what was originally a single section in two separated sections cannot be regarded as altering the scope and purpose of the enactment. For it will not be inferred that Congress, in revising and consolidating the laws, intended to change

their effect, unless such intention is clearly expressed.” *Id.* at 227, 77 S.Ct. 787 (internal quotation marks and citations omitted) (quoting from *Anderson v. Pac. Coast S.S. Co.*, 225 U.S. 187, 198, 32 S.Ct. 626, 56 L.Ed. 1047 (1912)). The Court thus held that no substantive change to 28 U.S.C. § 1400(b) had occurred during the 1948 recodification and the result in *Stonite Products* dictated the outcome of the case. *Id.* at 227–28, 77 S.Ct. 787.

Similarly, in *Tidewater Oil Co. v. United States*, 409 U.S. 151, 162, 93 S.Ct. 408, 34 L.Ed.2d 375 (1972), the Court rejected the argument that the 1948 Judicial Code revisions substantively changed the existing law concerning appellate court jurisdiction over interlocutory appeals in Government civil antitrust cases. The 1948 revision to 28 U.S.C. § 1292(a)(1) allowed interlocutory appeals of district court order to the courts of appeals, “except where a direct review may be had in the Supreme Court.” *Id.* Under then-existing law, appellate courts had no jurisdiction over any appeals in Government civil antitrust cases (which were appealed directly to the Supreme Court), and interlocutory appeals to the Supreme Court in Government civil antitrust cases were not permitted. *Id.* at 154–56, 160, 93 S.Ct. 408. The Court thus reasoned that a possible interpretation of the new language added by the 1948 revisions, *1317 “except where a direct review may be had in the Supreme Court,” was that appellate court jurisdiction over interlocutory appeals in Government civil anti-trust cases was now available (contrary to prior law) because “direct review” in the Supreme Court of an interlocutory appeal could not “be had.” *Id.* at 162, 93 S.Ct. 408.

Citing to *Fourco Glass*, the Court rejected that interpretation because no such change to existing law had been “clearly expressed” by the 1948 revisions. “To the contrary, the Revisers’ Notes fail to reveal any intention to expand the scope of the pre-existing jurisdiction of the courts of appeals over interlocutory appeals; the new § 1292 is described merely as a consolidation of a number of previously separate code provisions—including the general interlocutory appeals provision—‘with necessary changes in phraseology to effect the consolidation.’ ” *Id.* at 162–63, 93 S.Ct. 408. The Court thus concluded that the 1948 revisions

did not substantively expand the jurisdiction of appellate courts. *Id.* at 163, 93 S.Ct. 408.

Muniz v. Hoffman, 422 U.S. 454, 456–57, 95 S.Ct. 2178, 45 L.Ed.2d 319 (1975) arose out of a labor dispute between the San Francisco Typographical Union and a local daily newspaper, in which the union and its officers had been cited for criminal contempt in violating certain court orders and subsequently denied a jury trial in the criminal contempt proceedings. A key issue in the case was whether the Wagner and Taft-Hartley Acts,³⁰ which authorized courts to grant certain injunctions, permitted jury trials to those found in contempt of the injunctions. *Id.* at 461, 95 S.Ct. 2178. The parties appeared to agree that prior to the 1948 revisions of the Criminal Code,³¹ a contemnor had no right to a jury trial in contempt actions to enforce injunctions issued under the Wagner and Taft-Hartley Acts, notwithstanding the jury requirements in § 11 of the earlier passed Norris-LaGuardia Act.³² Petitioners argued however that in recodifying § 11 of Norris-LaGuardia as 18 U.S.C. § 3692 in 1948, Congress had overruled its prior policy of not permitting jury trials in contempt actions to enforce injunctions issued under the Wagner and Taft-Hartley Acts. *Id.* at 467, 95 S.Ct. 2178.

The Court rejected this argument, holding that “[w]e cannot accept the proposition that Congress, without expressly so providing, intended in § 3692 to change the rules for enforcing injunctions,” which rules existed when § 11 was originally passed. See *Muniz*, 422 U.S. at 468, 95 S.Ct. 2178. The Court examined the legislative history of the recodification and the Reviser’s Notes, which consistently expressed that no substantive change was intended by the revision. *Id.* at 467–469, 95 S.Ct. 2178. Citing *Fourco Glass*, the Court reiterated the longstanding rule that “[n]o changes of law or policy ... are to be *1318 presumed from changes of language in the revision unless an intent to make such changes is clearly expressed.” *Id.* at 472, 95 S.Ct. 2178 (internal quotation marks omitted). The Court thus expressed some incredulity at the proposition that the major policy change petitioners argued for could be effected by Congress without any mention of it in any of the legislative history or notes:

In view of the express disavowals in the House and Senate Reports on the revisions of both the Criminal Code and the Judicial Code, it would seem difficult at best to argue that a change in the substantive law could nevertheless be effected by a change in the language of a statute without any indication in the Revisers' Note of that change. It is not tenable to argue that the Revisers' Note to § 3692, although it explained in detail what words were deleted from and added to what had been § 11 of the Norris-LaGuardia Act, simply did not bother to explain at all, much less in detail, that an admittedly substantial right was being conferred on potential contemnors that had been rejected in the defeat of the Ball amendment the previous year and that, historically, contemnors had never enjoyed.

See *id.* at 472, 95 S.Ct. 2178.

Finley v. United States, 490 U.S. 545, 553–54, 109 S.Ct. 2003, 104 L.Ed.2d 593 (1989), involved a question of whether the 1948 recodification of the Judicial Code substantively created new “pendent-party” jurisdiction when it recodified the Federal Tort Claims Act, 28 U.S.C. § 1346(b) (the “FTCA”).³³ Writing for the Court, Justice Scalia rejected that argument, holding that “[u]nder established canons of statutory construction, it will not be inferred that Congress, in revising and consolidating the laws, intended to change their effect unless such intention is clearly expressed.” *Id.* at 554, 109 S.Ct. 2003 (internal quotation marks omitted) (quoting from *Anderson v. Pac. Coast S.S. Co.*, 225 U.S. 187, 32 S.Ct. 626, 56 L.Ed. 1047 (1912) and citing to *United States v. Ryder*, 110 U.S. 729, 740, 4 S.Ct. 196, 28 L.Ed. 308 (1884)). Finding “no suggestion, much less a

clear expression, that the minor rewording at issue here imported a substantive change,” the Court held that the pre-codification interpretation of the statute continued to hold (*i.e.* no “pendent-party” jurisdiction under the FTCA). *Id.* at 554–56, 109 S.Ct. 2003.

Finally, our own court has recently applied this canon in *Koch Foods, Inc. v. Sec’y, U.S. Dep’t of Labor*, 712 F.3d 476 (11th Cir. 2013). There we held that certain amendments to 49 U.S.C. § 31105 enacted by the Revision of Title 49, United States Code Annotated, “Transportation”, Pub. L. No. 103–272, 108 Stat. 745 (1994) were simply revisions and codifications, and thus did not change the pre-amendment scope of the law.

Koch Foods, 712 F.3d at 485. We noted in *Koch Foods* that (much like § 2664(b) of the DRA amendments here) the recodification statute cautioned that the revisions and codifications were enacted “without substantive change,” and that the legislative history (like the legislative history of the DRA here) emphasized that the changes were *1319 not substantive. *Id.* The interpretive canon used in *Koch Foods* is the one we use in this case: “As the Supreme Court has observed, ‘it will not be inferred that Congress, in revising and consolidating the laws, intended to change their effect unless such intention is clearly expressed.’ ” *Id.* at 486 (quoting from *Finley*, 490 U.S. at 554, 109 S.Ct. 2003).

We turn then to applying the recodification canon of statutory construction to our case. It is clear that the Office of the Law Revision Counsel made an error in revising § 405(h) in 1976 (and again in 1982). Rather than include the full range of jurisdictional grants that were clearly forbidden under the prior law,³⁴ the Law Revision Counsel (who it must be recalled has no authority to pass laws or alter the jurisdiction of federal district courts)³⁵ mistakenly decided to update the cross-reference only to § 1346 and § 1331 of the new Title 28. We find no indication whatsoever, let alone a “clear indication,” in the Law Revision Counsel’s Codification note that the revisers intended or were suggesting an expansion of district court jurisdiction to review Medicare and Social Security claims, thereby reversing forty years of Congressional policy. On the contrary, the title of the note (“Codification”) and its contents indicate that the change was a mere codification

(i.e. updating the cross-reference to “section 24 of the Judicial code” to its new location in Title 28 of the U.S. Code), and not a substantive change. One would expect that if the revisers intended the kind of fundamental change in policy and expansion of the jurisdiction of bankruptcy courts that Bayou Shores suggests, it would merit *some* mention. See [Muniz](#), 422 U.S. at 472, 95 S.Ct. 2178 (“It is not tenable to argue that the Revisers’ Note ..., although it explained in detail what words were deleted ... and added ..., simply did not bother to explain at all, much less in detail, that an admittedly substantial right was being conferred ...”).

Moreover we do not find it significant, contrary to Bayou Shores’ suggestion, that Congress enacted the error into positive law when it passed the DRA in 1984. There is no evidence in the DRA that Congress “clearly expressed” an intention to reverse decades of Medicare and Social Security Act policy and give bankruptcy courts parallel jurisdiction with HHS to adjudicate Medicare claims (and parallel jurisdiction with the Social Security Administration to adjudicate Social Security claims). Again, if Congress intended such an important expansion of bankruptcy court jurisdiction to be enacted in a recodification, one would expect to find some indication in the statute or legislative history stating as much. See [Tidewater Oil](#), 409 U.S. at 162–63, 93 S.Ct. 408 (finding no indication in Reviser’s Notes or legislative history that Congress intended recodification to expand federal appellate court jurisdiction). Bayou Shores points to no such indication, nor are we able to find one.

To the contrary, the *statute itself* tells us that the amendment in question is not to be interpreted as making any substantive change to the law: “none of such amendments shall be construed as changing *1320 or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before that date.” See DRA, § 2664(b); see also [Koch Foods](#), 712 F.3d at 485 (noting that the statute “expressly states that no substantive change is intended by the revisions to the language”).³⁶ The legislative history of the bill similarly emphasizes that the amendments in § 2663 (including the amendment to [§ 405\(h\)](#)) were not intended to be substantive. See [H.R. Rep. No. 98-432](#), pt. 2, at 1663 (1984) (noting that the bill “makes certain corrections of spelling,

punctuation, cross-references and other clerical amendments to the Social Security Act and related provisions in the Internal Revenue Code”). Rep. Dan Rostenkowski (the original sponsor of H.R. 3805, containing the “technical corrections” that were merged into the DRA) “emphasize[d] that this bill intends simply to correct technical errors and to better reflect the policies established by the Congress in enacting the original legislation.” 129 Cong. Rec. 23321, 23440 (1983).

Per long standing Supreme Court precedent, we “will not ... infer[] that the legislature, in revising and consolidating [[§ 405\(h\)](#)] intended to change their policy, unless such intention be clearly expressed.” See [United States v. Ryder](#), 110 U.S. 729, 740, 4 S.Ct. 196, 28 L.Ed. 308 (1884). Here, we find no clear expression of any intent to change Congressional policy with respect to bankruptcy court jurisdiction over Medicare claims. To the contrary, the statute and legislative history detailed above expresses an intent *not* to substantively amend [§ 405\(h\)](#).³⁷

In reply, Bayou Shores attempts to downplay the mandate of § 2664(b) in the DRA by arguing that despite the statute’s command that the amendments are not to be interpreted as substantive, certain of the amendments were in fact substantive. See Appellant’s Reply Br. at 2-9. We are not persuaded by this argument. As an initial matter, Bayou Shores essentially asks us to ignore § 2664(b) and Congress’s command that the amendments are not substantive, which we are clearly not free to do. In [Muniz](#) the Supreme Court indicated that “[t]he nature of the revision process itself requires the courts, including this Court, to give particular force to the many express disavowals in the House and Senate Reports of any intent to effect substantive changes in the law.” See [Muniz](#), 422 U.S. at 472 n. 11, 95 S.Ct. 2178. Here we think it most reasonable to give force to Congress’s express disavowals in the DRA itself and in the legislative history “of any intent to effect substantive changes in the law.”

Moreover, the two examples that Bayou Shores cites as “substantive” amendments *1321 in § 2663 of the DRA are, on closer review, at least arguably non-substantive. First, Bayou Shores argues that § 2663(e)(3) of the DRA expanded criminal liability for impersonating certain persons in order to obtain information about their Social Security benefits.

Appellant's Reply Br. at 3-4. The language in § 2663(e)(3) orders that "Section 1107(b) of [the Social Security Act] is amended by striking out 'former wife divorced,' each place it appears and inserting in lieu thereof 'divorced wife, divorced husband, surviving divorced wife, surviving divorced husband, surviving divorced mother, surviving divorced father,'" The House committee report on the bill indicates that this amendment was intended to bring Section 1107(b) into conformity with an earlier amendment eliminating gender-based distinctions in the Social Security Act.³⁸ Thus, arguably the earlier amendment had already eliminated gender distinctions in Section 1107(b), and the DRA amendments merely revised the text of Section 1107(b) to correctly reflect those earlier amendments.³⁹

Second, Bayou Shores points to § 2663(a)(15)(C), and characterizes it as denying certain benefits to college students that they otherwise would have received under the prior version of the statute. Appellant's Reply Br. at 5. The relevant text of the amendment orders that "(C) Section 222(b)(4) of such Act is amended by striking out 'full-time student' and inserting in lieu thereof 'full-time elementary or secondary school student'." See DRA at § 2663(a)(15)(C). A close reading of the legislative history suggests that Bayou Shores is mistaken about this provision as well. Section 222(b)(4) of the Social Security Act (codified at 42 U.S.C. § 422) was added by Congress in 1965.⁴⁰ At the time § 222(b)(4) was added to the larger section, the term "full-time student" was "as defined and determined under section 202(d)."⁴¹ Turning then to Section 202(d), that section was amended in 1981 (prior to the DRA in 1984) in a section titled "Elimination of child's insurance benefits in the case of children age 18 through 22 who attend postsecondary schools."⁴² The 1981 amendment makes clear that "full time student" was to be defined as elementary and high-school students, not college students.⁴³ A Senate report issued the following year noted that under the prior law children beneficiaries could receive benefits until they were 22 as long as they were in school, while the 1981 amendments eliminated those benefits for anyone over 18 attending post-secondary schooling.⁴⁴ It thus appears that the 1984 amendment in the DRA referenced by Bayou Shores was a "technical correction" because it simply updated § 222(b)(4) of the statute to be consistent with the definitions in the earlier amended § 202(d).

Finally, even if we assume for the sake of argument that Bayou Shores has correctly identified two substantive changes in § 2663, the examples Bayou Shores relies on are minor substantive amendments at best, compared to the massive shift in policy that giving bankruptcy courts parallel authority to adjudicate Medicare disputes would represent. This is akin to finding a few hidden firecrackers in the bill and thus inferring the presence of an atomic bomb. In other words, the presence of two minor substantive changes in § 2663 (assuming they are substantive), can hardly justify interpreting the amendment to § 405(h) as enacting a significant change in Congressional policy by creating bankruptcy court jurisdiction over Medicare claims.

Therefore, we conclude that because the previous version of § 405(h) precluded bankruptcy court review of Medicare claims under § 1334, so too must the newly revised § 405(h) bar such actions.

2. § 1334 does not give bankruptcy courts special jurisdiction over Medicare claims

In light of the above explanation, this Court is constrained to disagree with the Ninth Circuit's *In re Town & Country* opinion, and thus holds that § 405(h) bars a bankruptcy court acting pursuant to § 1334 from exercising jurisdiction over Medicare claims. However, both the Ninth Circuit in *Do Sung Uhm v. Humana, Inc.*, 620 F.3d 1134 (9th Cir. 2010) and Bayou Shores here argue that § 1334 has a "special status" that is different and distinct from other jurisdictional provisions (such as § 1332).⁴⁵ In particular, Bayou Shores argues that the text of § 1334(b) itself defines the expansive nature of bankruptcy court jurisdiction: "notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11." See 28 U.S.C. § 1334(b). However,

we read the Supreme Court's opinion in *Bd. of Governors of Fed. Reserve Sys. v. MCorp Fin., Inc.*, 502 U.S. 32, 112 S.Ct. 459, 116 L.Ed.2d 358 (1991) as effectively foreclosing that argument.

*1323 In *MCorp Fin.*, the Court held that bankruptcy law's automatic stay provision (11 U.S.C. § 362) could not stay an administrative proceeding by the Board of Governors of the Federal Reserve System against MCorp Financial. The Court first found that the administrative proceeding fell squarely into the exception in § 362 for proceedings to enforce a "governmental unit's police or regulatory power." *Id.* at 39–40, 112 S.Ct. 459.⁴⁶ The Court rejected MCorp Financial's argument that for the exception to apply, the bankruptcy court would need to determine in the first instance whether the exercise of regulatory power was legitimate; the Court held that such a reading "would require bankruptcy courts to scrutinize the validity of every administrative or enforcement action brought against a bankrupt entity," and that "[s]uch a reading is problematic, both because it conflicts with the broad discretion Congress has expressly granted many administrative entities and because it is inconsistent with *the limited authority Congress has vested in bankruptcy courts.*" *Id.* at 40, 112 S.Ct. 459 (emphasis added).

Importantly, the Court rejected MCorp's broad reading of 28 U.S.C. § 1334(b), holding that "[s]ection 1334(b) concerns the allocation of jurisdiction between bankruptcy courts and other 'courts,' and, of course, an administrative agency such as the Board is not a 'court.'" *Id.* at 41–42, 112 S.Ct. 459. That is precisely the situation here: Bayou Shores' provider agreement was terminated by the Centers for Medicare & Medicaid Services ("CMS"), which is an administrative agency within HHS and not a "court." Thus, § 1334(b) does not concern the allocation of jurisdiction between the bankruptcy court and HHS, and cannot trump the § 405(h) jurisdictional bar.

Bayou Shores raises an additional argument relating to the 1984 amendments to § 1334. Bayou Shores points out that the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98–353, 98 Stat 333 (July 10, 1984)

(the "Bankruptcy Act") was passed only eight days prior to passage of the DRA, and among other things significantly enlarged the scope of bankruptcy court jurisdiction.⁴⁷ According to Bayou Shores, because "28 U.S.C. § 1334 was enacted first, and 42 U.S.C. § 405(h) was enacted days later," Congress's failure to include § 1334 in § 405(h) indicates a positive intent to expand the scope of bankruptcy court jurisdiction. Appellant's Br. at 45. We disagree. See *N. L. R. B. v. Plasterers' Local Union No. 79, Operative Plasterers' & Cement Masons' Int'l Ass'n, AFL-CIO*, 404 U.S. 116, 129–30, 92 S.Ct. 360, 30 L.Ed.2d 312 (1971) ("The Court has frequently cautioned that it is at best treacherous to find in Congressional silence alone the adoption of a controlling rule of law.") (quotation marks omitted).

As an initial matter, reading too much into the significance of the timing of the passage of these acts is at best speculative, particularly since the DRA had nothing to do with bankruptcy court jurisdiction, nor *1324 does Bayou Shores point to any evidence suggesting that Congress had the Bankruptcy Act in mind when passing the DRA.⁴⁸ Moreover Bayou Shores' timing argument also cuts the opposite way: one would equally expect that if Congress were inclined to expand the jurisdiction of bankruptcy courts to include hearing Medicare and Social Security claims, it would have done that in the Bankruptcy Act that it had just passed, rather than burying it as a "Technical Correction" in a bill wholly unrelated to bankruptcy courts (*i.e.* the DRA).

3. Barring bankruptcy court jurisdiction is consistent with Congressional Medicare policy

The bankruptcy court also relied on what was essentially a policy argument about the wisdom of allowing a bankruptcy court rather than HHS to adjudicate Medicare claims:

Consider the following hypothetical: a debtor that operates a skilled nursing

facility has its Medicare provider agreement terminated because it was improperly cited for noncompliance. The debtor immediately appeals the finding of noncompliance. But because CMS stops payment for Medicare residents, the debtor is forced to file for bankruptcy. If the Court were to adopt HHS's view, the debtor in that hypothetical scenario could never assume its Medicare provider agreement since it is highly unlikely the appeals process will be complete before the debtor files for bankruptcy.

See *In re Bayou Shores*, 525 B.R. at 169.⁴⁹ In other words, unless the bankruptcy court can take jurisdiction over the provider agreements, Bayou Shores would cease to exist as a going concern long before the HHS administrative appeals process could complete.⁵⁰

While we are not unsympathetic to this argument, the choice of whether the bankruptcy court or HHS is best positioned to adjudicate Medicare claims is a policy decision *1325 that the bankruptcy court was not empowered to make. As explained at length above, § 405(h) and (g) restricts the role of district courts to a limited review of final HHS decisions, thus reflecting Congressional policy to let HHS adjudicate those claims in the first instance. The Supreme Court explained in *Illinois Council* that the review provisions of § 405(h) and (g) give HHS a greater opportunity to “apply, interpret, or revise policies, regulations, or statutes without possibly premature interference by different individual courts.” See 529 U.S. at 13, 120 S.Ct. 1084.

Indeed, the bankruptcy court's actions here illustrate the kind of “premature interference” that *Illinois Council* had in mind. While the bankruptcy court went to great length to deny that it was reviewing the merits of HHS's findings or decisions (see e.g. *In re Bayou Shores SNF*, 525

B.R. at 168), that is effectively what the bankruptcy court did. After holding an evidentiary hearing on the conditions at Bayou Shores' facility, the bankruptcy court apparently decided that the three deficiencies Bayou Shores was cited for were not particularly serious. *Id.* at 163. The court also decided that Bayou Shores had corrected each of the deficiencies it was cited for and provided adequate assurances that it would be in compliance with the Medicare regulations in the future. *Id.* at 170–171. Notwithstanding HHS's determination to the contrary, the bankruptcy court deemed the health and safety of Bayou Shores' patients free of immediate jeopardy. The practical outcome of the bankruptcy court's decision was thus a reversal of HHS's decision: the bankruptcy court rolled back the termination, gave Bayou Shores back its provider agreements, and effectively prevented HHS from terminating Bayou Shores from the Medicare/Medicaid program for its repeated deficiencies. That was functionally a decision on the merits of the underlying HHS decision, and an interference with HHS's role in deciding who is eligible to participate in Medicare/Medicaid.⁵¹

The Government for its part disputes the bankruptcy court's version of the facts. With respect to the three violations, the picture painted by the Government suggests far more serious issues with the care provided by Bayou Shores to its patients. Federal Appellee Br. at 14-16; State Appellee's Br. at 3-4.⁵² Moreover, the Government argues that simply coming back into compliance after each violation was not the issue. Rather, terminating repeat offenders like Bayou Shores was a key part of *1326 Congress's overhaul of nursing home regulations, and was intended to stop “instances in which substandard providers had avoided termination from Medicare by claiming that they had cured serious violations of safety standards, only to lapse back into noncompliance after the threat of administrative sanction was removed.” Federal Appellee's Br. at 50-51.

In any event, we do not need to decide whose version of the facts is correct, nor do we need decide whether the bankruptcy court's decision on the merits of HHS's action was correct. HHS, not the bankruptcy court, has been charged by Congress with administering the Medicare Act and regulating Medicare providers. Indeed, the bankruptcy court's action here stymied the direct statutory mandate from Congress to HHS to take appropriate action (including potentially

terminating a provider agreement) when, as here, a survey determines that a nursing home's condition "immediately jeopardize[s] the health or safety of its residents." See 42 U.S.C. § 1395i-3(h)(2).⁵³ And though charged with broad jurisdiction to deal with issues related to a debtor's bankruptcy estate, bankruptcy courts generally lack the institutional competence or technical expertise of HHS to oversee the health and welfare of nursing home patients or to interpret and administer a "massive, complex health and safety program such as Medicare." See *Illinois Council*, 529 U.S. at 13, 120 S.Ct. 1084. Or at least, that is the judgment of Congress we derive from the enactment of § 405(h) in 1939 (and the recodification in 1984).

4. § 405(h) clearly requires administrative exhaustion

Finally, while much of the above dispute concerns the third sentence of § 405(h) and whether it completely bars bankruptcy jurisdiction under § 1334, we do not overlook the effect of the first two sentences as well. The bankruptcy court dismissed the second sentence as merely limiting "the ability of federal courts to review the findings of fact or an agency decision." *In re Bayou Shores SNF*, 525 B.R. at 167. Though correct in a minimalist sense, we think that is an overly narrow understanding of the statute. The Supreme Court made clear in *Salfi* that the first two sentences of § 405(h) "assure that administrative exhaustion will be required" and "prevent review of decisions of the Secretary save as provided in the Act, which provision is made in § 405(g)." 422 U.S. at 757, 95 S.Ct. 2457. The third sentence, according to the Court in *Salfi*, means that no action may be brought pursuant to any jurisdiction other than § 405(g), even where administrative remedies have been exhausted. *Id.*; see also *Illinois Council*, 529 U.S. at 13, 120 S.Ct. 1084.

Bayou Shores does not dispute that its claims have not been administratively exhausted; in fact, as of the date of the oral argument, Bayou Shores' administrative appeal was still pending in front of an administrative law judge at HHS. See Oral

Argument, March 29, 2016. Putting aside the jurisdictional question then, neither Bayou Shores nor the bankruptcy court has explained why standard principles of administrative exhaustion should not prevent *1327 a district court from hearing Bayou Shores' case. See e.g. *In re Rodriguez*, No. 09-93431-JB, 2010 WL 2035733, at *3-5 (Bankr. N.D. Ga. Mar. 23, 2010) (relying on § 405(g) and (h) to hold that bankruptcy court would not entertain non-administratively exhausted Social Security claims). Bayou Shores has also not shown that any exception to standard administrative exhaustion principles should apply here. See *McCarthy v. Madigan*, 503 U.S. 140, 146-149, 112 S.Ct. 1081, 117 L.Ed.2d 291 (1992) (explaining the "three broad sets of circumstances" in which exceptions to administrative exhaustion may apply).

Thus, even if we were to assume that § 405(h) does not bar jurisdiction under § 1334, the bankruptcy court erred by not dismissing Bayou Shores' claim for failure to exhaust Bayou Shores' administrative remedies first.

IV. OTHER ARGUMENTS

Bayou Shores raises a number of other issues that it contends warrant reversal of the district court's Order. For the reasons below, we do not find these arguments persuasive.

A. Mootness

¹⁶Bayou Shores argues that this dispute is either constitutionally moot or equitably moot. With respect to constitutional mootness, Bayou Shores contends that because the bankruptcy court's injunction and automatic stay have been dissolved, no live controversy between the parties remains. The Government contends that at least two live issues remain. First, the bankruptcy court's stay and injunction (even if now dissolved) prevented the Government from stopping payments to Bayou Shores during the pendency of the bankruptcy case. The Government argues that it intends to seek recoupment of these payments if the bankruptcy court's orders are found to be invalid. Second,

contrary to Bayou Shores' contention that the injunction and stay have dissolved, the Government contends that the bankruptcy court's Confirmation Order continues to indefinitely enjoin the Government from terminating the provider agreements.⁵⁴

[7] [8] A case is constitutionally moot when "when the issues presented are no longer 'live' or the parties lack a legally cognizable interest in the outcome." *Powell v. McCormack*, 395 U.S. 486, 496, 89 S.Ct. 1944, 23 L.Ed.2d 491 (1969). Put another way, "[a] case is moot when it no longer presents a live controversy with respect to which the court can give meaningful relief."

Florida Ass'n of Rehab. Facilities, Inc. v. State of Fla. Dep't of Health & Rehab. Servs., 225 F.3d 1208, 1216–17 (11th Cir. 2000) (internal quotations and citations omitted). Here, a holding that the bankruptcy court lacked subject matter jurisdiction would allow the Government to go forward with its efforts to terminate Bayou Shores from the Medicare/Medicaid program, as well as allow the Government to try and recover payments made to Bayou *1328 Shores since the filing of the bankruptcy court action.⁵⁵ Meaningful relief is thus available, and this case is not constitutionally moot.

[9] [10] Bayou Shores argues alternatively that the case is equitably moot because its Chapter 11 plan has been substantially consummated. Equitable mootness is a discretionary doctrine that permits courts sitting in bankruptcy appeals to dismiss challenges (typically to confirmation plans) when effective relief would be impossible. See *In re Nica Holdings, Inc.*, 810 F.3d 781, 786 (11th Cir. 2015). Central to a finding of mootness is a determination by an appellate court that it cannot grant effective judicial relief. *Id.* (quoting from *First Union Real Estate Equity & Mortg. Invs. v. Club Assocs. (In re Club Assocs.)*, 956 F.2d 1065, 1069 (11th Cir.1992)). The equitable mootness doctrine seeks to avoid an appellate decision that "would knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court." *Id.* at 787 (citing *Miami Ctr., Ltd. P'ship v. Bank of NY*, 838 F.2d 1547, 1555 (11th Cir.1988)).

[11] [12] [13] Here however, we are reviewing whether the district court was correct in dismissing for lack of subject matter jurisdiction. "Subject-matter

jurisdiction properly comprehended ... refers to a tribunal's power to hear a case, a matter that can never be forfeited or waived." See *Union Pac. R. Co. v. Bhd. of Locomotive Engineers & Trainmen Gen. Comm. of Adjustment, Cent. Region*, 558 U.S. 67, 81, 130, 130 S.Ct. 584, 175 L.Ed.2d 428 (2009) (internal quotation marks omitted; citations omitted; emphasis added). Because we agree with the district court that the bankruptcy court lacked subject matter jurisdiction over the assumption of Bayou Shores' provider agreements, that must end the inquiry. When the lower court "lack[s] jurisdiction, we have jurisdiction on appeal, not of the merits but merely for the purpose of correcting the error of the lower court in entertaining the suit." See *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 541, 106 S.Ct. 1326, 89 L.Ed.2d 501 (1986). "Without jurisdiction the court cannot proceed at all in any cause. Jurisdiction is power to declare the law, and when it ceases to exist, the only function remaining to the court is that of announcing the fact and dismissing the cause." *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 94, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998). The Supreme Court in *Steel Co.* characterized this threshold inquiry as "inflexible and without exception." See *id.* at 94–95, 118 S.Ct. 1003 (quoting from *Mansfield, C. & L.M.R. Co. v. Swan*, 111 U.S. 379, 382, 4 S.Ct. 510, 28 L.Ed. 462 (1884)).

Thus, even assuming for the sake of argument that Bayou Shores is correct that this situation justifies the application *1329 of equitable mootness, the absence of jurisdiction precludes the exercise of that discretionary authority. Our only role here is to correct the bankruptcy court's error by affirming the district court's Order.⁵⁶

B. Bayou Shores' claims "arise" under the Medicare Act

[14] Bayou Shores additionally argues that its claims do not "arise" under the Medicare Act, and thus are not subject to the *§ 405(h)* jurisdictional bar. According to Bayou Shores, "[n]either the September 5 Order nor the Confirmation Orders had anything to do with recovering a claim (a right to payment) arising under the Medicare Act." Appellant's Br. at 58.

Bayou Shores' position however has already been rejected by the Supreme Court. In [Illinois Council](#) the Court rejected the argument that claims "arising under" the Medicare Act were limited to monetary claims:

Nor can we accept a distinction that limits the scope of [§ 405\(h\)](#) to claims for monetary benefits. Claims for money, claims for other benefits, *claims of program eligibility*, and *claims that contest a sanction or remedy* may all similarly rest upon individual fact-related circumstances, may all similarly dispute agency policy determinations, or may all similarly involve the application, interpretation, or constitutionality of interrelated regulations or statutory provisions. *There is no reason to distinguish among them in terms of the language or in terms of the purposes of* [§ 405\(h\)](#) ... Nor for similar reasons can we here limit those provisions to claims that involve "amounts."

[Id.](#) at 14, 120 S.Ct. 1084 (emphasis added).

Here, the determination of whether Bayou Shores is allowed to keep its provider agreements could be characterized as either a "claim[] of program eligibility" (*i.e.* whether Bayou Shore is eligible to participate in Medicare) or a "claim[] that contest[s] a sanction or remedy" (*i.e.* the sanction of terminating Bayou Shores from the Medicare program). In either case, the Supreme Court made clear in [Illinois Council](#) that Bayou Shores' claims fall within the ambit of [§ 405\(h\)](#)'s "claim[s] arising under" the Medicare Act.

C. Bayou Shores' Medicaid claims rise and fall with its Medicare claims

The parties also dispute whether the termination of Bayou Shores' Medicare [*1330](#) provider agreement resulted in the termination of Bayou Shores' Medicaid provider agreement. In its briefing, Bayou Shores contends that AHCA failed to use the required procedures under Florida state law to terminate a Medicaid agreement. The Government argues that Medicaid agreements terminate by operation of law when Medicare agreements terminate. See [42 U.S.C. § 1396a\(a\)\(39\)](#).

Without resolving this dispute, we note that the only issue necessary to decide is whether the bankruptcy court was barred by [§ 405\(h\)](#) from taking jurisdiction over Bayou Shores' Medicaid provider agreements. Courts have held that the Medicare and Medicaid statutory and regulatory provisions "provide that when a dually certified facility challenges a determination that it is not in substantial compliance with the common Medicaid and Medicare regulations and a termination of its participation in both programs, the facility must seek review of this determination through the Medicare administrative appeals procedure."

[Cathedral Rock of N. Coll. Hill, Inc. v. Shalala](#), 223 F.3d 354, 366 (6th Cir. 2000); see also

[Michigan Ass'n of Homes & Servs. for Aging, Inc. v. Shalala](#), 127 F.3d 496, 503 (6th Cir. 1997)

("The Medicaid Act's inclusion of [§ 405\(g\)](#) is clear textual support for the proposition that Congress intended the exhaustion of administrative remedies to apply in cases [involving dual Medicare/Medicaid providers]"); [Health Equity Res. Urbana, Inc. v. Sullivan](#), 927 F.2d 963, 967 (7th Cir. 1991).

Bayou Shores cannot avoid the jurisdictional bar in [§ 405\(h\)](#) by attempting to re-characterize its claim to the Medicaid provider agreement as separate from its claim to the Medicare provider agreement. See [Cathedral Rock](#), 223 F.3d at 366–67. Indeed, it can hardly be said that Bayou Shores has a separate Medicaid claim, notwithstanding the two separate provider agreements: the sole reason for termination of

Bayou Shores' Medicaid provider agreement was the termination of its Medicare provider agreement for Bayou Shores' failure to comply with Medicare laws and regulations. Allowing Bayou Shores to go forward with only its Medicaid claims would thus put the bankruptcy court in the untenable position of adjudicating a dispute fundamentally about Medicare laws and regulations (*i.e.* whether Bayou Shores was in compliance with the relevant Medicare laws and regulations), despite being barred from adjudicating Bayou Shores' Medicare claims. See [Rhode Island Hosp. v. Califano](#), 585 F.2d 1153, 1162 (1st Cir. 1978) ("Were we to assume § 1331 jurisdiction over the Hospital's Medicaid claim we would find ourselves in the peculiar posture of hearing a case that consists entirely of a challenge to the limits promulgated under [the Medicare Act], when we are expressly barred by [the Medicare Act] from entertaining that challenge at this time.").

Accordingly, Bayou Shores "cannot avoid the Medicare Act's administrative channeling requirement simply because as a dual Medicare and Medicaid provider, its claims also fall under Medicaid Act." [Cathedral Rock](#), 223 F.3d at 367.⁵⁷

D. Termination of the provider agreements

On appeal, the parties continue to dispute whether

the provider agreements in question terminated before or after the *1331 filing of Bayou Shores' bankruptcy petition. Because we have determined that the bankruptcy court lacked jurisdiction over the termination of the provider agreements, we decline to rule on the issue of whether or not the agreements terminated prior to the filing of the bankruptcy petition.

V. Conclusion

We agree with the district court that the bankruptcy court erred as a matter of law when it exercised subject matter jurisdiction over the provider agreements in this case. The bankruptcy court was without [§ 1334](#) jurisdiction under the [§ 405\(h\)](#) bar to issue orders enjoining the termination of the provider agreements and to further order the assumption of the provider agreements.

Thus, finding no reversible error in the district court's June 26, 2015, Order ([In re Bayou Shores](#), 533 B.R. at 343) we AFFIRM.

All Citations

828 F.3d 1297, Med & Med GD (CCH) P 305,671, 26 Fla. L. Weekly Fed. C 487

Footnotes

* Honorable Raymond C. Clevenger, III, United States Circuit Judge for the Federal Circuit, sitting by designation.

¹ A "skilled nursing facility" is statutorily defined at [42 U.S.C. § 1395i-3\(a\)](#).

² See *e.g.* 42 C.F.R. Part 483, Subsection B.

³ The Secretary of HHS's duty to take remedial action in the face of immediate jeopardy to a facility's patients is explained in [42 U.S.C. § 1395i-3\(h\)\(2\)](#), where Congress specified that the Secretary "shall" take remedial action in response to immediate jeopardy. See [42 U.S.C. § 1395i-3\(h\)\(2\)\(A\)-\(B\)](#) (statutorily defined remedies include termination from program, denial of payments, civil monetary penalties, and appointment of temporary management); see also *id.* at (f)(1) ("It is the duty and responsibility of the Secretary to assure that requirements which govern the provision of care in skilled nursing facilities under this subchapter, and the enforcement of such requirements, are adequate to protect the health, safety, welfare, and

rights of residents and to promote the effective and efficient use of public moneys.”).

- 4 Immediate jeopardy exists if the nursing home’s noncompliance has caused or is likely to cause “serious injury, harm, impairment or death to a resident.” 42 C.F.R. § 488.301. The regulation only requires that the nursing home’s noncompliance is likely to cause harm to “a resident.” Though correctly quoting the regulation, the bankruptcy court appears to have incorrectly believed that actual harm is required for a finding of “immediate jeopardy.” See *In re Bayou Shores SNF, LLC*, 525 B.R. 160, 163 (Bankr. M.D. Fla. 2014). However, actual harm is not a prerequisite for a finding of immediate jeopardy.
- 5 The statute permits HHS to terminate a provider agreement in light of a finding of immediate jeopardy without a pre-termination hearing for the provider. See 42 U.S.C. § 1395i-3(h)(2)(a); see also *Cathedral Rock of N. Coll. Hill, Inc. v. Shalala*, 223 F.3d 354, 366 (6th Cir. 2000) (no pre-termination hearing required under Due Process Clause); *Northlake Cmty. Hosp. v. United States*, 654 F.2d 1234, 1241–43 (7th Cir. 1981) (same).
- 6 Though Bayou Shores disputes whether Florida has followed the correct procedure to “finalize” the termination of their Medicaid provider agreement, Bayou Shores does not appear to dispute that such termination will be the end result of the termination of the Medicare provider agreement. See e.g. 42 U.S.C. § 1396a(a)(39); Fla. Stat. § 409.913(14); see also *Livingston Care Ctr., Inc. v. United States*, 934 F.2d 719, 720 (6th Cir. 1991) (“The Secretary of Health and Human Services’s termination of the plaintiffs’ Medicare certification automatically triggered termination of plaintiffs’ Medicaid certification as well”).
- 7 28 U.S.C. § 1334, titled “Bankruptcy cases and proceedings,” generally defines the original and exclusive jurisdiction of district courts over bankruptcy proceedings.
- 8 See Bankr. ECF No. 285 at 12-13 (ordering that “all injunctions and stays previously provided for in this case pursuant to sections 105 and/or 362 of the Bankruptcy Code shall remain in full force and effect until the Effective Date.”). As explained further *infra*, the parties dispute what effect this dissolution has on the issues in this case.
- 9 The Government argues that the provider agreements terminated prior to Bayou Shores filing their bankruptcy petition, thus depriving the bankruptcy court of jurisdiction over the provider agreements. Bayou Shores (for various reasons) contests that argument. For reasons we explain below, we do not find it necessary to resolve this dispute.
- 10 § 405(h) applies to Medicare via 42 U.S.C. § 1395ii, which states that “any reference therein to the Commissioner of Social Security or the Social Security Administration shall be considered a reference to the Secretary or the Department of Health and Human Services, respectively.”
- 11 Codification refers generally to the process of arranging and organizing the Statutes at Large into the U.S. Code. See *generally* Proceedings of the Fifty-First Annual Meeting of the American Association of Law Libraries, Fifth General Session, 51 Law Libr. J. 388 (1958) (remarks of Dr. Charles Zinn, Law Revision Counsel, explaining the process of codification); see also William W. Barron, *The Judicial Code*, 8 F.R.D. 439 (1949) (the “Chief Reviser, Title 28, U.S. Code, Judiciary and Judicial Procedure, and Title 18, U.S. Code, Crime and Criminal Procedure” explaining generally the 1948 Judicial Code revisions).
- 12 The Office of the Law Revision Counsel, created in 1974, is a body within the U.S. House of Representatives whose principal purpose is to codify the laws of the U.S. and periodically

publish updates to the U.S. Code. See 2 U.S.C. §§ 285 *et. seq.*

- 13 The U.S. Code is not necessarily “positive law.” Rather, the text of the U.S. Code is *prima facie* evidence of the law of the United States; where the code conflicts with the Statutes at Large however, the Statutes at Large trump. See [U.S. Nat. Bank of Oregon v. Indep. Ins. Agents of Am., Inc.](#), 508 U.S. 439, 448, 113 S.Ct. 2173, 124 L.Ed.2d 402 (1993). Additionally, some parts of the code have been enacted into positive law; when this happens, the text of the code becomes evidence of the law. See [id.](#) at 448 n. 3, 113 S.Ct. 2173 (citing to 1 U.S.C. § 204(a)); see generally Alice I. Youmans, et. al., *Questions & Answers*, 78 Law. Libr. J. 585, 590 (1986) (explaining the relationship between the U.S. Code, Statutes at Large, and positive law).
- 14 See e.g. H.R. 3805 Rept. at 20.
- 15 The report similarly notes that where no descriptions are provided, the amendments are “clerical in nature.” *Id.* at 1.
- 16 See H.R. Rep. No. 98-432, pt. 2, at 1027 (1984) (explaining that “Title VI—Technical Corrections” of H.R. 4170 originated as the amended H.R. 3805).
- 17 As noted previously, the third sentence of [§ 405\(h\)](#) at the time incorrectly referred to title 24 of the Judicial Code, and the Court’s opinion inserted the correct cross-reference to the relevant section of Title 28 of the U.S. Code. See [id.](#) at 756 n. 3, 95 S.Ct. 2457. While surely strong evidence of how the Supreme Court reads [§ 405\(h\)](#), [Salfi](#) did not raise the interpretive issue at the heart of this case, and thus does not dispose of the issue.
- 18 The first two sentences read: “The findings and decisions of the Secretary after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Secretary shall be reviewed by any person, tribunal, or governmental agency except as herein provided.” [42 U.S.C. § 405\(h\)](#).
- 19 See [id.](#) at 13, 120 S.Ct. 1084 (noting that “[i]n any event, such was the judgment of Congress as understood in [Salfi](#) and [Ringer](#)”).
- 20 Similarly, to the extent our Court has addressed the reach of the jurisdictional bar of [§ 405\(h\)](#) since the 1984 DRA amendments, it appears that the cases have been [§ 1331](#) cases. See e.g. [Dial v. Healthspring of Alabama, Inc.](#), 541 F.3d 1044, 1047–48 (11th Cir. 2008); [Cochran v. U.S. Health Care Fin. Admin.](#), 291 F.3d 775, 778–79 (11th Cir. 2002); [United States v. Blue Cross & Blue Shield of Alabama, Inc.](#), 156 F.3d 1098, 1101 (11th Cir. 1998); [Am. Acad. of Dermatology v. Dep’t of Health & Human Servs.](#), 118 F.3d 1495, 1499 n. 8 (11th Cir. 1997); [Am. Fed’n of Home Health Agencies, Inc. v. Heckler](#), 754 F.2d 896, 897–98 (11th Cir. 1984). Both parties cite and discuss [V.N.A. of Greater Tift Cty., Inc. v. Heckler](#), 711 F.2d 1020 (11th Cir. 1983). Though [V.N.A.](#) was decided before the 1984 amendments, it appears the Court in that case cited to the Law Revision Counsel’s 1976 (or 1982) re-codified version of the statute in its opinion. See [V.N.A.](#), 711 F.2d at 1024. In a footnote of the opinion, the Court notes that “[t]here can be no question that [§ 405\(h\)](#) fully applies to the present case, because the district court’s jurisdiction is founded on 28 U.S.C. § 1331.” [Id.](#) at n. 5. We also note [Lifestar Ambulance Serv., Inc. v. United States](#), 365 F.3d 1293, 1295 n. 3 (11th Cir. 2004), in which this Court assumed, but did not decide, that mandamus jurisdiction under § 1361 was not barred under [§ 405\(h\)](#). These cases do not address the issue of

whether actions brought under § 1334 are barred by § 405(h).

²¹ Although not squarely deciding the issue, a number of other circuit court decisions have suggested that § 405(h) bars jurisdictions other than pursuant to only §§ 1331 and 1346. See *BP Care, Inc. v. Thompson*, 398 F.3d 503, 515 n. 11 (6th Cir. 2005) (citing favorably to *Bodimetric* analysis); *St. Vincent's Med. Ctr. v. United States*, 32 F.3d 548, 550 (Fed. Cir. 1994) (holding that Court of Federal claims jurisdiction barred by § 405(h)). The First Circuit has recognized the issue, but declined to address it. See *In re Ludlow Hosp. Soc., Inc.*, 124 F.3d 22, 25 n. 7 (1st Cir. 1997) (recognizing, but avoiding, § 405(h) jurisdictional issue by deciding case on merits).

²² See e.g. *In re Nurses' Registry & Home Health Corp.*, 533 B.R. 590, 593–97 (Bankr. E.D. Ky. 2015); *In re Slater Health Ctr., Inc.*, 294 B.R. 423, 428 (Bankr. D.R.I. 2003), *vacated in part*, 306 B.R. 20 (D.R.I. 2004), *aff'd*, 398 F.3d 98 (1st Cir. 2005); *In re Healthback, L.L.C.*, 226 B.R. 464, 472–74 (Bankr. W.D. Okla. 1998), *vacated*, *In re HealthBack, L.L.C.*, Case No. 97–22616–BH, 1999 WL 35012949 (Bankr. W.D. Okla. May 28, 1999); *First Am. Health Care of Georgia Inc. v. Dep't of Health & Human Servs.*, 208 B.R. 985, 988–90 (Bankr. S.D. Ga. 1996), *vacated and superseded sub nom.*, *First Am. Health Care of Georgia, Inc. v. U.S. Dep't of Health & Human Servs.*, Case No. 96–2007, 1996 WL 282149 (Bankr. S.D. Ga. Mar. 11, 1996); *In re Healthmaster Home Health Care, Inc.*, Case No. 95–10548, 1995 WL 928920, at *1 (Bankr. S.D. Ga. Apr. 13, 1995); *In re Shelby Cty. Healthcare Servs. of AL, Inc.*, 80 B.R. 555, 557–60 (Bankr. N.D. Ga. 1987).

²³ *Excel Home Care, Inc. v. U.S. Dep't of Health & Human Servs.*, 316 B.R. 565, 572–574 (D. Mass. 2004); *In re Hodges*, 364 B.R. 304, 305–06 (Bankr. N.D. Ill. 2007); *In re House of Mercy, Inc.*, 353 B.R. 867, 869–73 (Bankr. W.D. La. 2006); *In re Fluellen*, Case No. 05–40336, 2006 WL 687160, at *1 (Bankr. S.D.N.Y. Mar. 13, 2006); *U.S., Dep't of Health & Human Servs. v. James*, 256 B.R. 479, 481–82 (W.D. Ky. 2000); *In re Hosp. Staffing Servs., Inc.*, 258 B.R. 53, 57–58 (S.D. Fla. 2000); *In re Mid-Delta Health Sys., Inc.*, 251 B.R. 811, 814–15 (Bankr. N.D. Miss. 1999); *In re Tri Cty. Home Health Servs., Inc.*, 230 B.R. 106, 108 n. 1 (Bankr. W.D. Tenn. 1999); *In re S. Inst. for Treatment & Evaluation, Inc.*, 217 B.R. 962, 965 (Bankr. S.D. Fla. 1998); *In re Home Comp Care, Inc.*, 221 B.R. 202, 206 (N.D. Ill. 1998); *In re AHN Homecare, LLC*, 222 B.R. 804, 807–10 (Bankr. N.D. Tex. 1998); *In re Orthotic Ctr., Inc.*, 193 B.R. 832, 835 (N.D. Ohio 1996); *In re St. Johns Home Health Agency, Inc.*, 173 B.R. 238, 245–46 (Bankr. S.D. Fla. 1994); *In re Upsher Labs., Inc.*, 135 B.R. 117, 117–20 (Bankr. W.D. Mo. 1991); *In re St. Mary Hosp.*, 123 B.R. 14, 16–18 (E.D. Pa. 1991).

²⁴ See e.g. *Randall D. Wolcott, M.D., P.A. v. Sebelius*, 635 F.3d 757, 766 (5th Cir. 2011); *Cordoba v. Massanari*, 256 F.3d 1044, 1047 (10th Cir. 2001); *Buchanan v. Apfel*, 249 F.3d 485, 491–92 (6th Cir. 2001); *Briggs v. Sullivan*, 886 F.2d 1132, 1142 (9th Cir. 1989); *Burnett v. Bowen*, 830 F.2d 731, 738 (7th Cir. 1987); *Ganem v. Heckler*, 746 F.2d 844, 851–52 (D.C. Cir. 1984); *Kuehner v. Schweiker*, 717 F.2d 813, 819 (3d Cir. 1983), *judgment vacated sub. nom. on other grounds*, *Heckler v. Kuehner*, 469 U.S. 977, 105 S.Ct. 376, 83 L.Ed.2d 312 (1984); *Belles v. Schweiker*, 720 F.2d 509, 513 (8th Cir. 1983); *Ellis v. Blum*, 643 F.2d 68, 81 (2d Cir. 1981).

²⁵ In fact, at that time only district courts in the District of Columbia could exercise mandamus

jurisdiction, pursuant to an uncodified grant of authority dating back to the early nineteenth century and the District of Columbia's adoption of Maryland law. See [id.](#) District courts elsewhere in the country were granted mandamus jurisdiction explicitly when Congress passed the Mandamus and Venue Act, Pub. L. No. 87-748, 76 Stat. 744 (1962). Judge Friendly reasoned that Congress likely did not intend to bar District of Columbia courts' mandamus jurisdiction when it passed [§ 405\(h\)](#) because that uncodified jurisdiction was not specifically excluded, and Congress similarly did not intend mandamus jurisdiction to suddenly become subject to [§ 405\(h\)](#) when mandamus jurisdiction was extended to other courts in 1962. See [Ellis](#), 643 F.2d at 81.

- 26 The difficulties inherent in codifying and organizing the law are older still, and plagued even the earliest democracy. Aristotle notes that after the Athenian statesmen Solon "had organized the [Athenian] constitution in the manner stated, people kept coming to him and worrying him about his laws, criticizing some points and asking questions about others," causing him to leave Greece for Egypt for the next ten years. See ARISTOTLE, THE ATHENIAN CONSTITUTION, Ch. 11 (H. Rackham trans., Cambridge, MA, Harvard University Press 1952).
- 27 The Supreme Court of Judicature was the "highest common-law" state court in New York at that time. See [William J. Jenack Estate Appraisers & Auctioneers, Inc. v. Rabizadeh](#), 22 N.Y.3d 470, 478, 982 N.Y.S.2d 813, 5 N.E.3d 976 (2013).
- 28 The 1948 recodification moved "section 24 of the Judicial Code" to Title 28 of the U.S. Code, but [42 U.S.C. § 405\(h\)](#) continued to refer to "section 24 of the Judicial Code" until the DRA amendment in 1984.
- 29 Compare Judicial Code, Pub. L. No. 61-475, 36 Stat. 1087, § 48 (1911) with [id.](#) at § 52.
- 30 National Labor Relations Act, Pub. L. No. 74-198, 49 Stat. 449 (1935) (the "Wagner Act"); Labor Management Relations Act, Pub. L. No. 80-101, 61 Stat. 136 (1947) (the "Taft-Harley Act").
- 31 As the Court notes, the 1948 revision to the Criminal Code followed a "parallel course" to the revision to the Judicial Code, and was prepared by the same staff of experts. See [Muniz](#), 422 U.S. at 470 n. 10, 95 S.Ct. 2178.
- 32 Injunctions in Labor Disputes, Pub. L. No. 72-65, 47 Stat. 70 (1932) (the "Norris-LaGuardia Act"). § 11 of the Norris-LaGuardia Act provided jury trials in certain contempt actions, but unquestionably did not provide a jury right in contempt actions arising out of injunctions issued pursuant to the Wagner or Taft-Harley Acts. See [Muniz](#), 422 U.S. at 462-463, 95 S.Ct. 2178.
- 33 "Pendent-party" jurisdiction is "jurisdiction over parties not named in any claim that is independently cognizable by [a] federal court." See [Finley](#), 490 U.S. at 549, 109 S.Ct. 2003. As opposed to "pendent-claim" jurisdiction, which is "jurisdiction over nonfederal claims between parties litigating other matters properly before the court." [Id.](#) at 548, 109 S.Ct. 2003.
- 34 I.e. each district court jurisdictional grant listed in Section 24 of the Judicial Code of 1911.
- 35 See e.g. [N. Dakota v. United States](#), 460 U.S. 300, 311 n. 13, 103 S.Ct. 1095, 75 L.Ed.2d 77 (1983) (noting that the editorial decisions made by a codifier without the approval of Congress should be given no weight in interpreting a statute).

- 36 The bankruptcy court referred to § 2664(b) as “legislative history.” See *In re Bayou Shores*, 525 B.R. at 167. Strictly speaking, that is not correct. “Legislative history” refers to “proceedings leading to the enactment of a statute, including hearings, committee reports, and floor debates.” *Black’s Law Dictionary* (10th ed. 2014). Conversely, § 2664(b) of the DRA is positive law: it is part of a statute that was passed by Congress and signed into law by the President.
- 37 The Seventh Circuit’s *Bodimetric* decision (and thus the decisions of the Third and Eighth Circuits adopting *Bodimetric*) recognized and correctly applied this recodification canon of statutory interpretation. See *Bodimetric*, 903 F.2d at 489 (citing to *Muniz* and *U.S. v. Ryder*). Conversely, the cases holding that § 405(h) does not bar jurisdiction under § 1334 do not appear to have recognized the existence of the canon, let alone analyzed whether it applies to this issue. It is clear that in ignoring a canon of statutory construction that courts have been applying for more than a century, these latter courts erred.
- 38 See H.R. Rep. No. 98-432, pt. 2, at 1659 (1984) (“While the Social Security Amendments of 1983 sought to eliminate all gender-based distinctions in the Social Security Act, this gender-based distinction was not eliminated by those amendments. In order to assure that the Social Security Act provides the same penalty for fraud regardless of sex, the bill provides that the penalty for fraud would also apply to an individual who falsely represents that he is the divorced husband of a worker or beneficiary.”)
- 39 Even assuming Bayou Shores is correct that this provision substantively changed existing law, it would not change the result in this case. The House report indicates the “clear intent” behind the amendment to Section 1107(b) (whether substantive or not), whereas nothing in the legislative history indicates a “clear intent” to change the jurisdiction of bankruptcy courts with the amendment to § 405(h). Thus, the amendment to Section 1107(b) is not analogous to the amendment to § 405(h). It is certainly possible that Congress intended to make substantive amendments in the codification and revision section of the DRA. However, under *United States v. Ryder* and its progeny we require some indication that a substantive change in the revision was intended. See e.g. *Ex parte Collett*, 337 U.S. 55, 65–71, 69 S.Ct. 944, 93 L.Ed. 1207 (1949), *Ex parte Collett*, 337 U.S. 55, 65–71, 69 S.Ct. 944, 93 L.Ed. 1207 (1949), (explaining that reviser’s notes and legislative history made clear that addition of 28 U.S.C. § 1404(a), which made forum non conveniens transfers available in any district court civil action, was a substantive amendment enacted by the 1948 Judicial Code revision).
- 40 See Social Security Amendments of 1965, Pub. L. No. 89–97, 79 Stat. 286 at § 306(14) (1965).
- 41 Section 202 of the Social Security Act is codified at 42 U.S.C. § 402. The current statute continues to refer to section 202 for its definition of “full-time elementary or secondary school student.”
- 42 See Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97–35, 95 Stat. 357 at § 2210 (1981).
- 43 See *id.* (“SEC. 2210. (a)(1) Section 202(d) of the Social Security Act is amended ... by striking out ‘full-time student’ each place it appears and inserting in lieu thereof ‘full-time elementary or secondary school student’.”)
- 44 See S. Rep. No. 97-314S. Rep. No. 97-314, Vol. I, at 106 (1982).
- 45 See e.g. Appellant’s Reply Br. at 9-12.

- ⁴⁶ The parties dispute a similar question on appeal. However, our decision that the bankruptcy court lacked subject matter jurisdiction over the provider agreements renders moot the question of whether HHS's actions fall in § 362's exceptions. We thus decline to decide that issue.
- ⁴⁷ The Bankruptcy Act added subsection 1334(b), discussed *supra*. See Bankruptcy Act at § 101(a).
- ⁴⁸ Approximately forty-some public laws were passed by Congress in July of 1984. See <https://www.congress.gov/public-laws/98th-congress>. We are skeptical of the suggestion that the temporal proximity between any one of these laws and the Bankruptcy Act, standing alone, has any particular significance in interpreting any of these laws.
- ⁴⁹ See also Samuel R. Maizel & Michael B. Potere, *Killing the Patient to Cure the Disease: Medicare's Jurisdictional Bar Does Not Apply to Bankruptcy Courts*, 32 Emory Bankr. Dev. J. 19, 27-29 (2015) (noting that because of the length of the HHS appeals process, a hospital could be faced with the "fatal dilemma" of being put out of business before being able to challenge an adverse HHS decision); but see *Oakland Med. Grp., P.C. v. Sec'y of Health & Human Servs., Health Care Fin. Admin.*, 298 F.3d 507, 511 (6th Cir. 2002) ("[T]he government has a strong interest in expediting provider-termination procedures because: (1) the Secretary's responsibility for insuring the safety and care of elderly and disabled Medicare patients is of primary importance, and (2) the government has a strong interest in minimizing the expenses of administering the Medicare program.") (internal quotation marks and citations omitted); *Northlake Cmty. Hosp. v. United States*, 654 F.2d 1234, 1242 (7th Cir. 1981) (explaining that "a provider's financial need to be subsidized for the care of its Medicare patients is only incidental to the purpose and design of the (Medicare) program.") (internal quotation marks and citations omitted).
- ⁵⁰ This assumes of course that Bayou Shores will be successful in regaining the provider agreements in the administrative appeals process. That in turn is a dubious proposition as an administrative law judge in that appeal has already granted summary judgment against Bayou Shores on the issue of the termination of the provider agreements. See Bankr. ECF No. 261-1, Administrative Law Judge Ruling on Motion for Partial Summary Judgement (Dec. 16, 2015).
- ⁵¹ We have explained previously that where both parties to a Medicare claim dispute "engage in extensive discovery and presentation of their whole cases on the merits, the district court does exactly what [HHS] is expected to do," and therefore "[i]t is simply not realistic to say that the district court in such a case does not address and decide the merits of the case." *V.N.A. of Greater Tift Cty., Inc. v. Heckler*, 711 F.2d 1020, 1032 (11th Cir. 1983). Such a merits-review is contrary to the policy embodied by the Medicare Act's limited judicial review provisions. See *id.*
- ⁵² Most disturbingly perhaps, the bankruptcy court's opinion describes the result of the second incident somewhat innocuously: "[T]he patient with the history of abuse—who was in the facility for less than 24 hours—did not touch or otherwise harm the other resident." *In re Bayou Shores SNF*, 525 B.R. at 163. But the Government contends that the "patient with the history of abuse" "sexually molest[ed]" his roommate during those 24 hours. Federal Appellee Br. at 14-16; State Appellee's Br. at 3-4. According to the underlying report, the roommate reported in an interview that the patient with the history of abuse "put his hand under the curtain and moved his hand on the sheet to about ¼ inch from my private parts." See *In re Bayou Shores*, Bankr. ECF No. 42-2 at 17.
- ⁵³ If the deficiencies immediately jeopardize the health and safety of a facility's residents, "the Secretary shall take immediate action to remove the jeopardy and correct the deficiencies

through the remedy specified in subparagraph (B)(iii), *or terminate the facility's participation under this subchapter* and may provide, in addition, for one or more of the other remedies described in subparagraph (B).” [42 U.S.C. § 1395i-3\(h\)\(2\)](#) (emphasis added).

⁵⁴ For example, we note that the Confirmation Order contains the following: “Nothing set forth in the Amended Plan or this Order shall limit the power and authority of AHCA to take action related to the renewal or revocation of the Debtor’s license necessary to protect public health, safety and welfare, ***provided however, that any such actions related to the renewal or revocation of the license may not be based upon the termination of the Medicare and Medicaid provider agreements that have been assumed by the Debtor.***” *In re Bayou Shores*, Bankr. ECF No. 285 at 14. At oral argument, Bayou Shores conceded that this second issue was not constitutionally moot.

⁵⁵ Bayou Shores argues that the Government has no claim to damages because the Government “would be required to pay for the care of Bayou’s patients, if not at Bayou, somewhere, because the vast majority of Bayou’s patients are indigent.” Appellant’s Reply Br. at 28. That argument misses the mark though. The Government is not seeking to claw back the money merely to pocket the funds or to avoid paying for the care of Bayou Shores’ patients. Rather, the Government (as required by statute) will not pay a facility such as Bayou Shores that fails to comply with health and safety regulations. In other words, while the Government may be required to pay for the care of Bayou Shores’ patients, it reasonably wants to pay someone other than Bayou Shores for that service.

⁵⁶ Of course, we are addressing only the issue of the bankruptcy court’s authority to adjudicate Bayou Shores’ claim to ownership of the provider agreements terminated by the Government. To the extent Bayou Shores has other property in its bankruptcy estate, nothing in this opinion addresses or reaches the bankruptcy court’s actions with respect to that property. Further, while we do not rule on the equitable mootness issue, we note that the limited factual record in front of us suggests it would not be appropriate to do so in this situation. Although the Government did not obtain a stay, it appears from our review of the record that it was not for lack of trying. See [In re Nica Holdings](#), 810 F.3d at 787 (“On this record, we cannot fault [appellant] for not getting a stay.”). Moreover, the simplicity of the transactions and amounts of money involved here appear more akin to the “simpler” transactions in [In re Nica Holdings](#), 810 F.3d at 788 (no equitable mootness) than in the complex multi-million dollar transactions that justified equitable mootness in [In re Club Assocs.](#), 956 F.2d 1065 and [Miami Ctr., Ltd. P’ship v. Bank of NY](#), 820 F.2d 376 (11th Cir.1987). Finally, the reliance interests of Bayou Shores’ creditors, who we must presume understood they were lending money to a nursing home that the Government was attempting to shut down for violating health and safety regulations, also do not weigh much in favor of applying equitable mootness.

⁵⁷ We do not need to decide here whether a different result would accrue in a case where a party presents only Medicaid claims to a bankruptcy court.

Matter of Benjamin, 932 F.3d 293 (2019)

272 Soc.Sec.Rep.Serv. 58

932 F.3d 293
United States Court of Appeals, Fifth Circuit.

In the MATTER OF Kenneth Wayne
BENJAMIN, Debtor
Kenneth Wayne Benjamin, Appellant
v.

United States of America, Social Security
Administration, Appellee

No. 18-20185
|
FILED July 25, 2019

Synopsis

Background: Chapter 7 debtor brought adversary proceeding against the Social Security Administration (SSA), alleging that the SSA had illegally collected \$ 6,000 from him as alleged overpayment of benefits in violation of its own regulations, and demanding repayment in full. The United States Bankruptcy Court for the Southern District of Texas granted motion to dismiss for lack of subject matter jurisdiction, and debtor appealed. The District Court, [Nancy F. Atlas, J.](#), [2018 WL 572998](#), affirmed, and debtor appealed.

[Holding:] The Court of Appeals, [Edith Brown Clement](#), Circuit Judge, held that jurisdictional bar had to be interpreted in accordance with its plain terms, as barring only the types of federal jurisdiction specifically listed, and as not barring bankruptcy court from exercising bankruptcy jurisdiction over benefits overpayment dispute.

Reversed and remanded.

Opinion, 924 F.3d 180, superseded.

Procedural Posture(s): On Appeal; Motion to Dismiss for Lack of Jurisdiction.

West Headnotes (8)

[1] [Federal Courts](#) Jurisdiction

Whether subject matter jurisdiction exists over a given claim is a question that the Court of Appeals reviews de novo on appeal.

[2] [Federal Courts](#) Presumptions and burden of proof

Plaintiff invoking a federal court's jurisdiction bears the burden of establishing that such jurisdiction exists.

1 Cases that cite this headnote

[3] [Federal Courts](#) Weight and sufficiency

On motion to dismiss for lack of subject matter jurisdiction, plaintiff need only allege a plausible set of facts establishing jurisdiction. *Fed. R. Civ. P. 12(b)(1)*.

1 Cases that cite this headnote

[4] [Bankruptcy](#) Particular proceedings or issues
[Social Security](#) Judicial Review or Intervention

Language in the Social Security Act providing that “[n]o action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under [federal question statute] or [statute governing claims against the United States]” had to be interpreted in accordance with its plain terms, as barring only the types of federal jurisdiction specifically listed, and as not barring bankruptcy court from exercising

bankruptcy jurisdiction over benefits overpayment dispute between Chapter 7 debtor, as designated beneficiary of his sister's disability benefits, and the Social Security Administration; federal statute providing for bankruptcy jurisdiction was not among those enumerated. 28 U.S.C.A. §§ 1331, 1334, 1346; Social Security Act, § 205(h), as amended, 42 U.S.C.A. § 405(h).

4 Cases that cite this headnote

[5] **Statutes** Continuation or alteration of existing law by codification

While the recodification canon, under which courts generally presume that no substantive change is intended in connection with legislature's codification of existing law, is a useful rule of statutory construction in some instances, it applies only in absence of clear indication from Congress that it intended to change the law's substance.

[6] **Statutes** Continuation or alteration of existing law by codification

When general assertion in legislation of no intent to change existing law is contradicted by an unquestionable change in a specific provision, the specific will control over the general.

[7] **Statutes** Express mention and implied exclusion; *expressio unius est exclusio alterius*

Bedrock canon of statutory interpretation is the *expressio unius* canon, that the

expression of one thing implies the exclusion of others.

[8] **Social Security** Decisions Reviewable

Channeling provision of the Social Security Act, providing that "[n]o findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency," except as provided in preceding subsection of same statute, should be interpreted as applying only when would-be plaintiff is challenging a disability determination by the Commissioner, for which the statute requires a hearing. Social Security Act, § 205(g, h), as amended, 42 U.S.C.A. § 405(g, h).

6 Cases that cite this headnote

*294 Appeal from the United States District Court for the Southern District of Texas, *Nancy F. Atlas*, U.S. District Judge

Attorneys and Law Firms

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Abby Christine Wright, *Mark Bernard Stern*, Esq., U.S. Department of Justice Civil Division, Appellate Section, Washington, DC, *Michael Jonathan Carey*, Social Security Administration, Office of the General Counsel Region VI, Dallas, TX, for Appellee.

Before *CLEMENT*, *GRAVES*, and *OLDHAM*, Circuit Judges.

Opinion

EDITH BROWN CLEMENT, Circuit Judge:

We withdraw our prior opinion, [924 F.3d 180](#), and substitute the following:

The question presented is whether [42 U.S.C. § 405\(h\)](#)—which states that no claim arising under the Social Security Act can be brought under [28 U.S.C. §§ 1331](#) and [1346](#)—also bars bankruptcy courts from exercising their jurisdiction under § 1334 to hear Social Security claims. The district court answered yes, relying on the recodification canon to read into [§ 405\(h\)](#) a bar on § 1334 jurisdiction. But because we follow [§ 405\(h\)](#)'s plain text, we answer no and reverse.

I.

Kenneth Benjamin was the designated beneficiary of his sister's disability benefits. In September 2013, the Social Security Administration ("SSA") notified Benjamin that it had become aware of his sister's return to work. The SSA determined that her benefits had expired in April 2012. But because it did not sever her disability check until September 2013, the SSA would recoup the overpayment, [*295](#) which totaled \$19,286.90. Benjamin and his sister requested reconsideration of the overpayment determination and a waiver of overpayment.

Under [20 C.F.R. § 404.506\(b\)](#), the SSA should not have begun collecting the overpayment until after it had considered Benjamin's waiver request, which it did not do until July 2016. Nonetheless, in August 2014, the SSA sent Benjamin a letter (his sister had died the month before) informing him that it would withhold his full social-security check until the overpayment was recovered. Four days later, Benjamin reached an agreement with the SSA to withhold only \$536 a month from him. The SSA recovered roughly \$6,000 from Benjamin in this way until September 2015, when, for reasons unknown, it abruptly stopped withholding the money.

Eventually, in July 2016, the SSA turned to Benjamin's request for a waiver of the overpayment, which it denied. Benjamin asked for a personal conference with the SSA to reconsider its decision. After the conference, the SSA again

ruled against Benjamin. Benjamin filed a timely appeal to an administrative law judge. The appeal has yet to be decided.

After it denied his waiver request, the SSA resumed withholding \$536 a month from Benjamin's social-security check. The burden soon became too much: In May 2017, Benjamin filed for Chapter 7 bankruptcy. He then lodged an adversarial proceeding against the SSA in bankruptcy court. He alleged that the SSA collected \$6,000 from him illegally and in violation of its own regulations. He demanded repayment in full. He also demanded the return of the \$536 collected from him in May due to the collection's proximity to his bankruptcy filing.¹

The SSA moved to dismiss Benjamin's claims for lack of subject matter jurisdiction, claiming Benjamin had alleged only regulatory violations, which must first be exhausted through the administrative-appeal process. Even if the court had jurisdiction, the SSA contended that the claims should be dismissed under Rule 12(b)(6). The bankruptcy court granted the SSA's motion to dismiss for "the reasons stated in the [m]otion." Benjamin appealed to the district court, which affirmed on jurisdictional grounds. This appeal followed. The sole issue is whether the bankruptcy court had jurisdiction to hear Benjamin's claims.

II.

^[1] ^[2] ^[3] Whether subject matter jurisdiction exists over a given claim is a question we review de novo. [Family Rehab., Inc. v. Azar](#), 886 F.3d 496, 500 (5th Cir. 2018). Benjamin has the burden of establishing jurisdiction. [Id.](#) As this case is at the Rule 12(b)(1) stage, he need only "allege a plausible set of facts establishing jurisdiction." [Id.](#) (quotation omitted).

III.

Under 42 U.S.C. § 405(h), federal courts' ability to hear claims arising under the Social Security Act is largely curtailed:

[1] The findings and decision of the Commissioner of Social Security after a hearing shall be binding upon all individuals who were parties to such hearing. *296 [2] No findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as [provided in § 405(g)]. [3] No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under [Title II of the Social Security Act].²

The Supreme Court has held that § 405(h) “purports to make exclusive the judicial review method set forth in § 405(g)” for claims falling within its scope. *Shalala v. Ill. Council on Long Term Care, Inc.*, 529 U.S. 1, 10, 120 S.Ct. 1084, 146 L.Ed.2d 1 (2000). It does so by two means (though the means are listed in inverse order). The third sentence strips district courts of the most obvious sources of federal jurisdiction for any claims arising under Title II of the Social Security Act. The second sentence then channels a certain class of those claims into § 405(g), which, in turn, grants jurisdiction to district courts to review final agency decisions made after a hearing.³ 42 U.S.C. § 405(g).

The question before us is whether § 405(h)'s third sentence bars bankruptcy courts from relying on their general bankruptcy jurisdictional grant found at 28 U.S.C. § 1334(b) to hear Benjamin's claims. The district court answered yes to this question. We disagree.

A.

⁴The third sentence of § 405(h) states that “[n]o action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under [Title II of the Social Security Act].” Benjamin would have us read that sentence for what it says: as a bar on jurisdiction under §§ 1331 and 1346—but not under § 1334. The SSA, in contrast, asks us to interpret the sentence as barring § 1334 jurisdiction as well. This is the position the district court adopted, and it is a position that has garnered the support of the Third, Seventh, Eighth, and Eleventh Circuits. Only the Ninth Circuit has adopted Benjamin's reading.

The Seventh Circuit was the first court to read § 405(h)'s third sentence as including a hidden jurisdictional bar. In *Bodimetric Health Services Inc. v. Aetna Life & Casualty*, the court considered whether the third sentence stripped courts of their § 1332 diversity jurisdiction to hear claims arising under the Medicare Act.⁵ 903 F.2d 480, 488–90 (7th Cir. 1990). The court began by reviewing the history of § 405(h). *Id.* at 488. As originally enacted in 1939, it barred all actions brought under 28 U.S.C. § 41, which at the time contained virtually all the jurisdictional grants to the federal courts—including the diversity grant—now scattered throughout Title 28. *Id.* (citing Social Security Act Amendments of 1939, *297 Pub. L. No. 76-379, § 205(h), 53 Stat. 1360, 1371 (1939)).⁶ In 1976, the Office of Law Revision Counsel revised § 405(h) to its current form, and in 1984, Congress adopted the revised language by passing the Deficit Reduction Act (“DRA”). *Id.* at 488–89 (citing Pub. L. No. 98-369, § 2663(a)(4)(D), 98 Stat. 494, 1162 (1984)). The revision was in a section entitled “Technical Corrections.” *Id.* at 489 (quoting 98 Stat. at 1156). In a neighboring section, Congress instructed that none of the technical changes “shall be construed as changing or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before [their

effective] date.” *Id.* (quoting 98 Stat. at 1171–72).

This language, the Seventh Circuit said, clearly expressed Congress’s “intent not to alter the substantive scope of [section 405\(h\)](#). Because the previous version of [section 405\(h\)](#) precluded judicial review of diversity actions, so too must newly revised [section 405\(h\)](#) bar these actions.” *Id.* The Third and Eighth Circuits adopted the Seventh Circuit’s reasoning to reach the same conclusion. See [Nichole Med. Equip. & Supply, Inc. v. TriCenturion, Inc.](#), 694 F.3d 340, 346–47 (3d Cir. 2012); [Midland Psychiatric Assocs., Inc. v. United States](#), 145 F.3d 1000, 1004 (8th Cir. 1998).

In [In re Bayou Shores SNF, LLC](#), the Eleventh Circuit built on this body of caselaw by deciding that [§ 405\(h\)](#)’s third sentence barred bankruptcy jurisdiction under [§ 1334](#). [828 F.3d 1297, 1314 \(11th Cir. 2016\)](#). It too relied on [Bodimetric](#) to hold that “the 1984 amendments to [§ 405\(h\)](#) were a codification and not a substantive change.” *Id.* at 1314. The court argued that its conclusion was supported by the recodification canon, which states that “when legislatures codify the law, courts should presume that no substantive change was intended absent a clear indication otherwise.” *Id.* In applying this canon to [§ 405\(h\)](#), it reasoned that the Office of Law Revision Counsel must have made an error by not including the full range of jurisdictional grants listed under the prior version. *Id.* at 1319. It was not concerned that “Congress enacted the error into positive law.” *Id.* There was no evidence, the court said, that Congress had clearly expressed an intention to change decades of social-security policy and bankruptcy law by enacting the DRA: “[I]f Congress intended such an important expansion of bankruptcy court jurisdiction to be enacted in a recodification, one would expect to find some indication in the statute or legislative history stating as much.” *Id.*

The only circuit to read [§ 405\(h\)](#)’s third sentence according to its plain text is the Ninth Circuit. It has held that [§ 405\(h\)](#) “only bars actions under 28 U.S.C. §§ 1331 and [1346](#); it in

no way prohibits an assertion of jurisdiction under [section 1334](#).” [In re Town & Country Home Nursing Servs., Inc.](#), 963 F.2d 1146, 1155 (9th Cir. 1991).⁷

***298** We must now take sides in this circuit split. With respect to the majority of our sister circuits, we reject the non-textual approach exemplified by the Eleventh Circuit and join the Ninth Circuit in applying the third sentence’s plain meaning—a meaning that, everyone agrees, does not bar [§ 1334](#) jurisdiction.

^[5] ^[6] ^[7] While the recodification canon is useful in some instances, it only applies—as the Eleventh Circuit noted—in the absence of a clear indication from Congress that it intended to change the law’s substance. See [In re Bayou Shores SNF, LLC](#), 828 F.3d at 1314. While the Eleventh Circuit could not find any such indication, it overlooked the most obvious source of congressional intent—the actual words of [§ 405\(h\)](#)’s third sentence. See [Hotze v. Burwell](#), 784 F.3d 984, 997 (5th Cir. 2015) (noting that “the best evidence of Congress’s intent is the statutory text” (quotation omitted)); see also [United Motorcoach Ass’n v. City of Austin](#), 851 F.3d 489, 492 (5th Cir. 2017). “The new text is the law, and where it clearly makes a change, that governs. This is so even when the legislative history ... expresses the intent to make no change.” A. SCALIA & B. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* § 40, p. 257 (2012). This principle applies even if the statute has a general accompanying instruction eschewing any substantive changes: “When the general assertion of no change is contradicted by an unquestionable change in a specific provision, the specific will control over the general.” *Id.* at 259. By failing to recognize the importance of the third sentence’s words, the Eleventh Circuit not only misapplied the recodification canon; it also violated another bedrock canon of statutory interpretation: the *expressio unius* canon. See *id.* at § 10, p. 107 (“The expression of one thing implies the exclusion of others”).

The Supreme Court’s opinion in [United States v. Wells](#) is a good example of how to correctly apply the clear-indication exception to the recodification canon. [519 U.S. 482, 117 S.Ct. 921, 137 L.Ed.2d 107 \(1997\)](#). [Wells](#) confronted

the omission of the “materiality” requirement in Congress’s 1948 recodification of the false-statement crime. *Id.* at 490–98, 117 S.Ct. 921. The convicted defendants argued that Congress must have made a mistake by removing the materiality requirement because the Reviser’s Note stated that the recodification “was without change of substance.” *Id.* at 496–97, 117 S.Ct. 921. The Court disagreed, saying that the legislative history “does nothing to muddy the ostensibly unambiguous provision of the statute as enacted by Congress.” *Id.* at 497, 117 S.Ct. 921.

Attempting to undermine the principle animating *Wells*, the SSA marshals four cases—two from the Supreme Court and two from this court—to show that the recodification canon can be used to trump clear text, but the cases show nothing of the sort. In each, the challenged text was ambiguous or was subject to multiple reasonable interpretations.

Leading the charge for the SSA is *Tidewater Oil Co. v. United States*, in which the Supreme Court interpreted the recodified version of the interlocutory-appeal provision found at 28 U.S.C. § 1292(a)(1). *Id.* 409 U.S. 151, 162–63, 93 S.Ct. 408, 34 L.Ed.2d 375 (1972). The statutory text allowed interlocutory orders of the district courts involving injunctions “to be appealed to the courts of appeals ‘except where a direct review may be had in the Supreme Court.’” *Id.* at 162, 93 S.Ct. 408 (alteration in original) (quoting 28 U.S.C. § 1292(a)(1) (1952)). The court explained that § 1291(a)(1)’s final clause was “susceptible of two plausible constructions” depending on whether “may be had” meant “may be *299 had immediately” or “may be had eventually,” after final judgment. *Id.* Only after finding this ambiguity, did the Court apply the recodification canon to opt for the latter interpretation. *Id.*

Next up is *Southern Pacific Transportation Co. v. San Antonio*, 748 F.2d 266 (5th Cir. 1984). In that case, this court found that the deletion of certain election-of-remedies language from the Interstate Commerce Act during a recodification created ambiguity in the provision’s remaining language. *Id.* at 271 n.11. The court resolved the ambiguity by relying on the recodification canon to hold that Congress had not intended to

change the statute’s meaning. *Id.*

And in *American Bankers Insurance Co. of Florida v. United States*, this court declined to adopt the literal meaning of the word “taxable” in favor of an alternative reasonable interpretation. *Id.* 388 F.2d 304, 305 (5th Cir. 1968) (per curiam). It did so in part because it did not think that Congress had intended a drastic change in policy by replacing the word “describe” with the word “taxable” in the statute during the recodification. *Id.* But the district court’s opinion, which this court cited approvingly,⁸ makes clear that the literal meaning of “taxable” became “clouded with ambiguity and uncertainty” when it was read in connection with its surrounding text, rather than in isolation. *Am. Bankers Ins. Co. of Fla. v. United States*, 265 F. Supp. 67, 74–75 (S.D. Fla. 1967).

Section 405(h)’s third sentence is different from the statutory provisions in those cases. Unlike in *Tidewater Oil* and *Southern Pacific*, the third sentence is not susceptible to two plausible constructions; it is not ambiguous. It bars actions under §§ 1331 and 1346—no more, no less. There is no plausible way to read “section 1331 or 1346 of Title 28” as secretly including § 1334 (or § 1332 for that matter). For the same reason the deletion of “materiality” was dispositive in *Wells*, the deletion of § 1334 jurisdiction is dispositive here. And the third sentence’s plain meaning does not become clouded with ambiguity when one’s gaze is expanded to the surrounding statutory text, as was the case in *American Bankers*.

The SSA’s final case deserves a separate discussion. In *Ankenbrandt v. Richards*, the Court addressed the 1948 recodification of the diversity-jurisdiction statute. *Id.* 504 U.S. 689, 112 S.Ct. 2206, 119 L.Ed.2d 468 (1992). The recodification changed the statute’s language from granting federal courts diversity jurisdiction over “all suits of a civil nature at common law or in equity” to granting it over “all civil actions.” *Id.* at 698, 112 S.Ct. 2206. In a line of cases going back 100 years, the Court had interpreted the pre-1948 statute as not covering certain domestic-relations cases. *Id.* at 700, 112 S.Ct.

2206. The question for the Court was whether the new language overturned that exception. The Court answered no, relying on the recodification canon.

Id. at 700–01, 112 S.Ct. 2206.

At first blush, *Ankenbrandt* may seem to ignore the statute's plain text. Domestic-relations cases certainly fall within the category of "all civil actions." Just as the *Ankenbrandt* Court used the recodification canon to read out of the statute a category clearly included in the general language, the SSA asks us to do the inverse: to read into § 405(h) a category not listed. This argument flounders, however, when a distinction is brought to light. The words "all civil actions" can plausibly be interpreted as a shorthand or synonym for "suits of a civil nature at common law or in equity." So it was reasonable for the Court to assume that Congress did not change a 100-year-old policy by using a synonym for the past language. This distinction does not hold with the revision to § 405(h)'s third sentence. Replacing "section 41 of Title 28" with "section 1331 or 1346 of [T]itle 28" cannot plausibly be interpreted as a shorthand way of naming the near-30 grants that were originally included in 28 U.S.C. § 41, now scattered across Title 28. And unlike in *Ankenbrandt*, this case does not involve combining the recodification canon with longstanding congressional acquiescence.

In a final attempt to undermine the plain meaning of § 405(h)'s third sentence, the SSA reverts to policy. It tells us that allowing § 1334 jurisdiction would be ill-advised because doing so would deprive the bankruptcy court of the SSA's expertise in handling benefits claims. This argument is reminiscent of the EPA's position in *Utility Air Regulatory Group v. EPA*, 573 U.S. 302, 134 S.Ct. 2427, 189 L.Ed.2d 372 (2014). There, Congress required facilities emitting more than 100 tons per year ("tpy") of certain pollutants to apply for permits. The EPA interpreted the number "100 tpy" to mean "100,000 tpy." *Id.* at 325, 134 S.Ct. 2427. The Supreme Court responded: "We are not willing to stand on the dock and wave goodbye as [the] EPA embarks on this multiyear voyage of discovery. We reaffirm the core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate."

Id. at 328, 134 S.Ct. 2427. The same could be said of the SSA's interpretation of § 405(h)'s third sentence.

In sum, we interpret the third sentence to mean what it says. And it says nothing about § 1334. The district court erred by concluding that the third sentence barred the bankruptcy court's § 1334 jurisdiction.

B.

Our holding on § 405(h)'s third sentence necessitates reversal of the district court's decision and a remand to the bankruptcy court. However, as our interpretation of the third sentence raises possible questions for § 405(h)'s second sentence, we offer the following guidance for the remand.

Our precedent has largely failed to give adequate attention to the conceptual differences between § 405(h)'s second and third sentences. Most of the time, our cases refer to § 405(h) as a whole. See *Family Rehab., Inc. v. Azar*, 886 F.3d 496, 500–01 (5th Cir. 2018); *S.W. Pharmacy Solutions, Inc. v. Ctrs. for Medicare and Medicaid Servs.*, 718 F.3d 436, 440 (5th Cir. 2013); *Physician Hospitals of Am. v. Sebelius*, 691 F.3d 649, 652–53 (5th Cir. 2012). But see *Wolcott, M.D., P.A. v. Sebelius*, 635 F.3d 757, 764–65 (5th Cir. 2011). But as the following shows, the second sentence has a distinct function and should be treated separately from the third.

Recall that § 405(h)'s second sentence states that "[n]o findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as [stated in § 405(g)]." 42 U.S.C. § 405(h). This sentence does two things. First, it channels claims challenging a certain type of agency decision (described below) into § 405(g). Second, it ensures that § 405(g) is the sole jurisdictional avenue for the channeled claims. So the primary question for the remand is this: Do

Benjamin's claims challenge the type of administrative decisions *301 that § 405(h)'s second sentence channels into § 405(g)?

We will not now parse the details of Benjamin's claims—that is a task for remand. But we will clarify what type of decision § 405(h)'s second sentence channels. It will be for the bankruptcy court to decide if Benjamin's claims are challenging that type of decision.

^[8]At first glance, § 405(h)'s second sentence looks like it might apply to every and any decision by the Commissioner. But upon closer inspection, we believe that § 405(h)'s second sentence applies only where the would-be plaintiff is challenging a decision regarding his entitlement to benefits. The key is reading § 405(h) and § 405(g) alongside § 405(b)(1):

Section 405(b)(1): The Commissioner of Social Security is directed to make findings of fact, and decisions as to the rights of any individual applying for a payment under this subchapter. ... Upon request by any such individual ... who makes a showing in writing that his or her rights may be prejudiced by any decision the Commissioner of Social Security has rendered, the Commissioner shall give such applicant ... reasonable notice and opportunity for a hearing with respect to such decision

Section 405(h): The findings and decision of the Commissioner of Social Security after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Commissioner of Social Security shall be reviewed by any person, tribunal, or governmental agency except as [provided in § 405(g)].

Section 405(g): Any individual, after any final decision of the Commissioner of Social Security made after a hearing to which he was a party, irrespective of the amount in controversy, may obtain a review of such decision by a civil action commenced within sixty days after the mailing to him of notice of such decision

Section 405(b)(1) directs the Commissioner to make “findings” and “decisions” on “the rights of

any individual applying for a payment” and says that when those decisions prejudice the rights of the individuals, those individuals shall be given a hearing if they request one. **Section 405(h)** parrots that language, saying the Commissioner's “findings” and “decision” are binding “after a hearing” and that any review of the Commissioner's “findings” and “decision” must proceed as provided in § 405(g). **Section 405(g)** authorizes a person to seek judicial review of the Commissioner's “final decision ... made after a hearing.” As we interpret them, § 405(h) and § 405(g) refer to the same findings, decisions, and hearings referenced in § 405(b)—findings, decisions, and hearings regarding “the rights of individuals applying for a payment under [Subchapter II].” Put differently, where an individual is *not* challenging a decision regarding his entitlement to benefits made after an application for payment and therefore *not* receiving the statutorily-prescribed hearing under subsection (b)(1), his claim never gets channeled under § 405(h)'s second sentence or reviewed by a court under § 405(g).⁹ See *Smith v. Berryhill*, — U.S. —, 139 S. Ct. 1765, 1772, 204 L.Ed.2d 62 (2019) (holding that § 405(b)(1) provides “all eligible *302 claimants—that is, people seeking benefits—with an opportunity for a hearing with respect to such decision[s]” (alteration in original)).

The Supreme Court said as much in *Califano v. Sanders*, 430 U.S. 99, 97 S.Ct. 980, 51 L.Ed.2d 192 (1977). In that case, a beneficiary sued to challenge the Commissioner's decision denying his motion to reopen earlier disability-determination proceedings, arguing he could proceed under § 405(g). *Id.* at 103, 97 S.Ct. 980. The Court disagreed that § 405(g) permitted the suit by pointing to § 405(b): “This provision [§ 405(g)] clearly limits judicial review to a particular type of agency action, a ‘final decision of [the Commissioner] made after a hearing.’ But a petition to reopen a prior final decision may be denied without a hearing as provided in [§ 405(b)].” *Id.* at 108, 97 S.Ct. 980 (quoting § 405(g)). It did not matter that agency regulations provided for a hearing on motions to reopen. *Id.*; see *id.* at 102, 97 S.Ct. 980 (citing 20 C.F.R. §§ 404.957–404.958 (1976)). The statute channeled only decisions of the Commissioner for

which the *statute* prescribed a hearing—namely, claims addressing the entitlement to benefits.

With this guidance in mind, the bankruptcy court should examine Benjamin’s claims and determine whether they are primarily about his entitlement to benefits—that is, a payment of money because he (or his sister) is disabled—or claim for money because the SSA failed to comply with its own regulations in recouping the overpayment. The former claim would be channeled by § 405(h)’s second sentence into § 405(g); the latter would not be. And if Benjamin’s claims are not channeled, then the bankruptcy court had jurisdiction under § 1334 to hear Benjamin’s

claims.

* * *

For the foregoing reasons, the judgment of the district court is REVERSED, and this case is REMANDED to the bankruptcy court for further proceedings consistent with this opinion.

All Citations

932 F.3d 293, 272 Soc.Sec.Rep.Serv. 58

Footnotes

- ¹ In his original complaint and throughout his many amended complaints, Benjamin alleged other violations and eventually requested over \$150,000 in additional relief, citing injuries such as emotional distress. On appeal, however, Benjamin challenges only the dismissal of the claims related to the \$6,000 withheld from 2014 through 2015 and the \$536 withheld in May 2017. His failure to adequately argue the other claims in his brief renders them abandoned. See, e.g., *DeLoach v. Bryan*, 144 F. App’x 377, 378 (5th Cir. 2005) (per curiam).
- ² “Title II contains the old-age, survivors, and disability insurance programs codified at 42 U.S.C. § 401 *et seq.*” *Weinberger v. Salfi*, 422 U.S. 749, 760 n.7, 95 S.Ct. 2457, 45 L.Ed.2d 522 (1975).
- ³ Ordinarily, this means that a plaintiff must run the gauntlet of the SSA’s four-level-review process, which culminates in a decision from the Appeals Council. See generally 20 C.F.R. § 404.900 (describing the administrative process).
- ⁴ These provisions grant federal courts subject matter jurisdiction over federal questions and certain cases in which the United States is a defendant. See 28 U.S.C. §§ 1331, 1346.
- ⁵ Section 405(h) is made applicable to the Medicare Act by 42 U.S.C. § 1395ii.
- ⁶ The Social Security Act Amendments of 1939 barred actions under “section 24 of the Judicial Code of the United States.” Pub. L. No. 76-379, § 205(h), 53 Stat. 1360, 1371 (1939). But section 24 was codified at 28 U.S.C. § 41. See *id.*; 28 U.S.C. § 41 (1940).
- ⁷ The SSA argues that the Ninth Circuit has retreated from this case. It cites to *Kaiser v. Blue Cross of California* for support. 347 F.3d 1107 (9th Cir. 2003). In *Kaiser*, the court held that § 405(h)’s third sentence barred diversity actions under § 1332. *Id.* at 1115. Interestingly, *Kaiser* was written by the same judge, sitting by designation, who wrote *Bodimetrix*. He did not acknowledge the Ninth Circuit’s contrary precedent in *Town & Country*. The Ninth Circuit has decided to live with this tension in its precedent, holding that *Town & Country* continues to apply to § 1334 while *Kaiser* applies to § 1332. See

 *Do Sung Uhm v. Humana, Inc.*, 620 F.3d 1134, 1141 n.11 (9th Cir. 2010).

- ⁸ This court largely adopted the district court's opinion without adding much analysis of its own. See  *Am. Bankers*, 388 F.2d at 305 ("The intricacies of the statutes, their changes, and the legal argument based thereon are set forth in the District Court's opinion. The Court held the contracts were subject to the tax. We agree and affirm." (citation omitted)).
- ⁹ This interpretation of  § 405(h)'s second sentence is fully consistent with our decision in  *Wolcott, M.D., P.A. v. Sebelius*, 635 F.3d 757 (5th Cir. 2011). There, we said that the second sentence applies when a "judicial decision favorable to the plaintiff would affect the merits of whether the plaintiff is entitled to ... benefits."  *Id.* at 764. We are simply explaining the statutory underpinnings of this conclusion.

Faculty

Amir Gamliel is a partner with Perkins Coie LLP in Los Angeles and focuses on litigation, bankruptcy and out-of-court restructuring work for clients in such industry sectors as finance, health care, aerospace, entertainment, CMBS, real estate, manufacturing, apparel, retail and technology. In his bankruptcy practice, he counsels financially troubled entities; parties that have invested in, supplied from or managed such entities; and parties aiming to acquire these entities or their distressed assets. Mr. Gamliel has presented programs on complex bankruptcy transactions, preferences, constructive and intentional fraudulent transfers, national retail tenant bankruptcies, and crossover issues between bankruptcy and family law, as well as bankruptcy and director-and-officer liability insurance. He also has first- and second-chair trial experience in arbitration and state and federal courts, and he has successfully appealed decisions in both state and federal courts. Mr. Gamliel represents parties in complex litigation involving financial transactions, contract disputes, business tort claims, trade secret claims, real estate, receiverships, product liability, and disputes concerning directors and shareholders. As an active participant in Perkins Coie's *pro bono* efforts, he has also represented a diverse array of clients, such as an asylum recipient, a victim of bankruptcy fraud, tenants in eviction proceedings, senior and low-income tenants challenging rent-stabilization ordinances, a nonprofit company seeking to wind down its affairs, and Holocaust survivors seeking reparations. Mr. Gamliel serves on the firm's Professional Development Committee, as well as the Hiring and Summer Associate Committees for its Los Angeles office. He has also served on the firm-wide Associate and Counsel Committee and on the Los Angeles Diversity Committee, and he frequently has interviewed and mentored associate candidates at law schools across Southern California. Mr. Gamliel received his B.A. in business economics *magna cum laude* and Phi Beta Kappa from the University of California, Los Angeles in 2006 and his J.D. in 2009 from UCLA School of Law, and he completed an executive program in 2017 at UCLA Anderson School of Management.

David B. Golubchik is a partner with Levene, Neale, Bender, Yoo & Brill, L.L.P. in its Los Angeles office and focuses on business reorganization, creditors' rights, litigation, negotiations and workouts. He is a frequent speaker and a member of the Los Angeles Bankruptcy Forum and the Financial Lawyers Conference. Mr. Golubchik was listed in *Southern California Super Lawyers* from 2005-09, is vice chair of the Executive Committee of the Beverly Hills Bar Association's Bankruptcy Section, and is on the advisory board of ABI's annual Bankruptcy Battleground West conference. He is admitted to practice in California and before the Ninth Circuit Court of Appeals, the U.S. District Courts for the Central, Southern, Eastern and Northern Districts of California, and the U.S. District Court for the District of Columbia. Mr. Golubchik received his B.A. in economics with an emphasis in computer programming from the University of California at Los Angeles in 1992 and his J.D. in 1996 from Pepperdine University School of Law, where he received the American Jurisprudence Award in Business Reorganization in Bankruptcy, was vice chair of the Moot Court Board and was vice magistrate of Phi Delta Phi, an international legal fraternity.

Kenneth P. Kansa is a partner in the Restructuring group of Sidley Austin LLP in Chicago, where he represents clients in a wide range of in-court and out-of-court restructuring matters, with particular areas of experience in representing corporate clients in connection with their restructuring proceedings, mass tort-driven restructuring proceedings and cross-border insolvency matters. His public and

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Hon. William J. Lafferty, III is a U.S. Bankruptcy Judge for the Northern District of California in Oakland, appointed in April 2011. He also serves on the U.S. Bankruptcy Appellate Panel for the Ninth Circuit. Prior to his appointment to the Bankruptcy Court, Judge Lafferty was a director with Howard Rice Nemerovski Canady Falk & Rabkin from 1993-2011, joining the firm in 1987. His affiliations have included vice president of the California Bankruptcy Forum, past president of the Bay Area Bankruptcy Forum, past president of the Bar Association of San Francisco's Commercial Law and Bankruptcy Section, and the Bankruptcy & Reorganization Practice Group. He received his undergraduate degree from the University of California, Berkeley and his J.D. from the University of California, Hastings College of the Law.

Jordana L. Renert is a partner in the Bankruptcy and Financial Restructuring Group of Arent Fox LLP in New York and has experience in all aspects of financial restructurings, distressed situations and bankruptcy reorganization, municipality and liquidation proceedings. Her practice involves representing committees of unsecured creditors, secured creditors, indenture trustees, bondholder and noteholder groups, DIP lenders and other entities in chapter 11 proceedings and out-of-court restructurings. Ms. Renert has a range of restructuring experience across a number of industries, including oil and gas; energy; mining and exploration; publishing; retail; and health care. Over the last year, she has played a lead role in several significant corporate reorganizations, including the chapter 11 cases of Gulfport Energy Corp., Exide Holdings Inc., PG&E Corp., Dean & DeLuca New York Inc. and Rubie's Costume Company Inc. Prior to joining Arent Fox, she was an associate at Willkie, Farr & Gallagher LLP. Ms. Renert co-chairs ABI's Business Reorganization Committee, and she is a member of the New York Institute of Credit and International Women's Insolvency & Restructuring Confederation. Additionally, she participates in the Family Court Clinic Project, where she provides free legal consultations in Manhattan and Brooklyn Family Court relating to matters of child support, paternity, custody, visitation, guardianship and family offense. Ms. Renert received her B.S. in 2003 in industrial and labor relations from Cornell University and her J.D. *magna cum laude* in 2007 from Brooklyn Law School, where she received the Professor Barry L. Zaretsky Bankruptcy Fellowship.