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## Bankruptcy Law

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## BANKRUPTCY LAW

*The Honorable Douglas O. Tice, Jr.* \*

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### I. INTRODUCTION

This article continues the survey of bankruptcy and insolvency case law that was initiated in November 2009.<sup>1</sup> The article covers both consumer and business bankruptcy issues and is restricted primarily to decisions published by courts in the Fourth Circuit and the Supreme Court of the United States since the 2009 article. It is the desire of the authors to provide an interesting sampling of the most common issues from the bankruptcy and insolvency field. Perhaps the most significant decision of all, and certainly the most discussed during the past year, is the Supreme Court's 2011 ruling in *Stern v. Marshall* limiting the authority of bankruptcy judges to enter final orders involving issues arising under state law.<sup>2</sup> The full impact of *Stern* both nationally and in the Fourth Circuit remains to be seen. However, the authors believe most matters of bankruptcy administration will continue to be carried out by the bankruptcy courts with little impact from *Stern*. It is the authors' goal to provide practitioners with a useful tool for research in the various areas covered in the article.

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1. Hon. Douglas O. Tice, Jr., Suzanne E. Wade & K. Elizabeth Sieg, *Annual Survey of Virginia Law: Bankruptcy Law*, 44 U. RICH. L. REV. 201 (2009).

2. 564 U.S. \_\_\_, \_\_\_, 131 S. Ct. 2594, 2620 (2011).

## II. ABSOLUTE PRIORITY

An issue that appears destined for the Supreme Court is whether the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) amendments to the Bankruptcy Code abrogated the absolute priority rule for individual debtors in Chapter 11, as courts across the country have reached opposite but equally plausible conclusions via a multitude of different rationales and arguments. The Fourth Circuit recently became the first court of appeals to address the issue in the case of *In re Maharaj*.<sup>3</sup> Acknowledging that the language of the BAPCPA is ambiguous, the court analyzed the history of the absolute priority rule and the legislative history of the BAPCPA, and concluded that Congress did not intend to repeal the absolute priority rule in individual Chapter 11 cases.<sup>4</sup>

The debtors, Ganess and Vena Maharaj, were the owners and operators of an auto body repair shop in Chantilly, Virginia.<sup>5</sup> After falling victim to an apparent fraud that saddled them with considerable debt, the debtors filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, as their debts exceeded the limits for proceeding under Chapter 13.<sup>6</sup> The debtors’ Chapter 11 plan of reorganization proposed that the debtors “would continue to own and operate their auto body business and use income from the business to pay” their creditors.<sup>7</sup> After one class of general unsecured creditors voted to reject the plan, the debtors attempted to “cram down” the plan over the unsecured creditors’ objection under 11 U.S.C. § 1129(b), arguing that the absolute priority rule no longer applied to individual Chapter 11 debtors and that the debtors could permissibly retain their ownership interest in the business.<sup>8</sup> The bankruptcy court disagreed, however, and denied confirmation of the debtors’ plan.<sup>9</sup>

Prior to the BAPCPA amendments in 2005, there was no doubt that the absolute priority rule applied to individual Chapter 11 debtors. Section 1129(b)(2)(B)(ii) stated that in order to be fair

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3. 681 F.3d 558, 560 (4th Cir. 2012).

4. *See id.* at 575.

5. *Id.* at 566.

6. *Id.*

7. *Id.* at 567.

8. *See id.*

9. *See id.*

and equitable, a plan must provide that “the holder of any claim or interest that is junior to the claims of such [dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property . . . .”<sup>10</sup> Post-BAPCPA, § 1129(b)(2)(B)(ii) now states that, to be fair and equitable, a plan must provide that

the holder of any claim or interest that is junior to the claims of such [dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(4) of [§ 1129].*<sup>11</sup>

Section 1115, which was added to the Bankruptcy Code by the BAPCPA,<sup>12</sup> in turn provides:

(a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541—

- (1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and
- (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.<sup>13</sup>

The court then discussed the split of authority that has developed across the country in response to these amendments. Courts adopting the “broad view” of the BAPCPA amendments have found that by including in § 1129(b)(2)(B)(ii) a cross-reference to § 1115, which references § 541 defining property of the bankruptcy estate, Congress intended to authorize an individual Chapter 11 debtor to retain all property of the estate and therefore effectively abrogated the absolute priority rule.<sup>14</sup> Courts adopting the “narrow view,” however, have found “that Congress did not intend such a sweeping change to” the Bankruptcy Code and have held that the BAPCPA amendments only permit an individual Chap-

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10. *Id.* at 562 (quoting 11 U.S.C. § 1129(b)(2)(B)(ii) (2006)) (internal quotation marks omitted).

11. 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added).

12. Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, § 321, 119 Stat. 23, 94-95 (2005) (codified as amended at 11 U.S.C. § 1115 (2006)).

13. 11 U.S.C. § 1115.

14. *In re Maharaj*, 681 F.3d at 563.

ter 11 debtor “to retain property and earnings acquired after the commencement of the case.”<sup>15</sup>

In *In re Maharaj*, the Fourth Circuit began its analysis by finding that the language of the statute was ambiguous and that both the broad and narrow interpretations of the BAPCPA amendments espoused plausible interpretations of congressional intent.<sup>16</sup> As such, the court then analyzed the context in which the amendments were enacted and the broader context of the BAPCPA.<sup>17</sup> The court noted that prior to the BAPCPA, property of the estate did not include post-petition earnings.<sup>18</sup> Post-petition property and earnings therefore could be retained by a debtor without violating the absolute priority rule.<sup>19</sup> As § 1115 now has added post-petition earnings and property to the property of the estate, revised § 1129(b)(2)(B)(ii), which exempted from the absolute priority rule property added to the estate by § 1115, preserves only the pre-BAPCPA status quo by permitting a debtor to retain *post-petition* earnings and property.<sup>20</sup>

The court further found that the Supreme Court’s strong aversion to implied repeal, especially in the bankruptcy context, supported its conclusion that the BAPCPA amendments did not abrogate the absolute priority rule.<sup>21</sup> Citing the 2010 decision in *Hamilton v. Lanning*, the court stated that “courts ‘will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.’”<sup>22</sup> The court then analyzed the history of prior amendments to the Bankruptcy Code, finding that when Congress amended the prior Bankruptcy Act in 1952 to eliminate the “fair and equitable” requirement underlying the absolute priority rule, it did so in a clear manner and explained its actions in the accompanying legislative history.<sup>23</sup> The court concluded that “[h]istory shows that Congress knows how to abrogate the absolute priority rule, and it

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15. *Id.*

16. *Id.* at 569.

17. *Id.*

18. *Id.* (quoting *In re Karlovich*, 456 B.R. 677, 681 (Bankr. S.D. Cal. 2010)).

19. *Id.* (quoting *In re Karlovich*, 456 B.R. at 681).

20. *Id.* at 570 (quoting *In re Karlovich*, 456 B.R. at 681).

21. *Id.*

22. *Id.* at 571 (citing *Hamilton v. Lanning*, 560 U.S. \_\_\_, \_\_\_, 130 S. Ct. 2464, 2467 (2010)).

23. *Id.* at 572.

has not done so here.”<sup>24</sup> Accordingly, the court held that the absolute priority rule was not abolished by the BAPCPA amendments and remains in full force in individual Chapter 11 cases.<sup>25</sup>

### III. ABUSE

Section 707 of the Bankruptcy Code furnishes courts with a powerful weapon to police perceived abuses of the bankruptcy process by Chapter 7 debtors.<sup>26</sup> Faced with the dismissal or conversion of their cases, debtors understandably have sought to restrict the application of § 707. In the Fourth Circuit case of *Calhoun v. United States Trustee*, the debtor appealed a decision of the bankruptcy court that a court may dismiss a case for abuse of the provisions of 11 U.S.C. § 707(b)(3) even if a presumption of abuse does not arise under the means test imposed by § 707(b)(2).<sup>27</sup> After incurring significant debt from a home renovation, followed by an unexpected decline in the balance of their investment accounts, the debtors entered into a payment plan with a credit management company that paid their creditors \$2638 per month.<sup>28</sup> The debtors continued this payment plan for twenty-two months, whereupon they chose to discontinue the plan because the budget imposed by the plan did not leave sufficient income for unexpected expenses.<sup>29</sup> The debtors then filed for bankruptcy under Chapter 7 of the Bankruptcy Code.<sup>30</sup>

Under § 707(b)(1), as amended by the BAPCPA, a court may dismiss “a case filed by an individual debtor under [Chapter 7] whose debts are primarily consumer debts . . . if it finds that the granting of relief would be an abuse of the provisions of this chapter.”<sup>31</sup> A rebuttable presumption of abuse arises under § 707(b)(2) if the debtor’s income exceeds the highest median family income of the applicable state for the debtor’s family size and the debtor’s income and expenses do not satisfy the “means test,” a complex formula that takes into account the debtor’s income and certain

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24. *Id.* at 573.

25. *Id.* at 574.

26. *See* 11 U.S.C. § 707(b) (2006 & Supp. IV 2010).

27. 650 F.3d 338, 341–42 (4th Cir. 2011).

28. *Id.* at 340.

29. *Id.*

30. *Id.*

31. 11 U.S.C. § 707(b)(1).

deductible expenses.<sup>32</sup> Section 707(b)(3) also permits a court to dismiss a case for abuse if the debtor filed the petition in bad faith or if the “totality of the circumstances . . . of the debtor’s financial situation demonstrates abuse.”<sup>33</sup>

For purposes of the means test under § 707(b)(2), the debtors received \$7313 in monthly income, excluding Social Security income, and were eligible for \$7330.19 in monthly deductions.<sup>34</sup> Although the debtors exceeded the relevant highest median family income, the debtors’ expenses, when subtracted from their income, left a net monthly income that did not give rise to a presumption of abuse under § 707(b)(2).<sup>35</sup> The bankruptcy court, however, dismissed the debtors’ case under § 707(b)(3) on the grounds that the “totality of the [debtors’] financial situation evidenced an abuse of Chapter 7” because there was no illness, calamity, disability, or unemployment that precipitated the debtors’ bankruptcy filing, and the debtors had the ability to repay their debts.<sup>36</sup>

On appeal, the debtors contended, *inter alia*, that the means test is conclusive of eligibility for Chapter 7 relief.<sup>37</sup> The Fourth Circuit rejected this argument, holding that the means test provides only a formula by which a court can presume abuse and dismiss a case.<sup>38</sup> As the test is not conclusive and the presumption is rebuttable, a court still may find abuse under § 707(b)(3) even if a presumption of abuse does not arise under the means test.<sup>39</sup> The court then found that the bankruptcy court recited “a multitude of factors weighing in favor of abuse” and found no error in the bankruptcy court’s findings.<sup>40</sup> Accordingly, the court affirmed the dismissal of the debtors’ case.<sup>41</sup>

In *In re Lassiter*, the Bankruptcy Court for the Eastern District of Virginia confronted the issue of whether § 707(b) of the Bank-

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32. *Calhoun*, 650 F.3d at 340–41 (citing 11 U.S.C. § 707(b)(2), (6), (7)).

33. 11 U.S.C. § 707(b)(3)(B).

34. *Calhoun*, 650 F.3d at 341.

35. *Id.*

36. *Id.* at 342.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* at 339.

ruptcy Code applies to converted Chapter 7 cases.<sup>42</sup> The debtors in *Lassiter* filed a petition for relief under Chapter 13 and later converted the case to Chapter 7.<sup>43</sup> After the United States trustee filed a statement of abuse pursuant to § 704(b)(1)(A) because the debtors' monthly income exceeded the limitations imposed by the means test, the debtors filed a motion to convert the case back to Chapter 13.<sup>44</sup> The debtors then filed an amended motion to convert, asserting "that they should not be forced to reconvert their case" because § 707(b), which permits a bankruptcy court to convert or dismiss a Chapter 7 case for "abuse of the provisions of [Chapter 7]," does not apply to cases filed under another chapter of the Bankruptcy Code and subsequently converted to Chapter 7.<sup>45</sup>

The court rejected this argument.<sup>46</sup> First noting that the language of § 707(b) is ambiguous and not susceptible to a single clear reading, the court analyzed similar provisions in other chapters of the Bankruptcy Code to gain insight into Congress's intent.<sup>47</sup> Sections 1112(b)(1), 1208(b), and 1307(b)—all dealing with conversion or dismissal of cases under their respective chapters—include the phrase "dismiss a case under this chapter" without the additional language present in § 707(b).<sup>48</sup> The court found that as these sections "permit the court to dismiss *any* case *pending* under the respective chapter, not just cases *filed* under the respective chapter," Congress intended § 707(b) to operate in a similar manner.<sup>49</sup> By inserting "filed by an individual debtor" in § 707(b), the court concluded, Congress thereby meant only to prevent courts from dismissing Chapter 7 cases filed by corporations or other business entities.<sup>50</sup>

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42. 65 Collier Bankr. Cas. 2d (MB) 1615, 1616 (Bankr. E.D. Va. May 24, 2011).

43. *Id.* at 1616–17.

44. *Id.* at 1617.

45. *Id.* The language of § 707(b) at issue here states,

After notice and a hearing, the court . . . may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter.

11 U.S.C. § 707(b)(1) (2006).

46. *In re Lassiter*, 65 Collier Bankr. Cas. 2d (MB) at 1618.

47. *Id.* at 1618, 1619, 1620 (quoting 11 U.S.C. § 707(b)(1)).

48. *Id.* at 1619 (citing 11 U.S.C. §§ 1112(b)(1), 1208(b), 1307(b), 707(b)(1) (2006)).

49. *Id.* (emphasis added).

50. *Id.* at 1619–20.

The court also noted that this interpretation would prevent the creation of two classes of Chapter 7 debtors: those who file under Chapter 7 initially and are subject to § 707(b) and those who convert their case to Chapter 7 and are immune from § 707(b)'s strictures.<sup>51</sup> This result would create an avenue for those debtors unable to meet the requirements of the means test to bypass the means test altogether and enjoy the benefits of Chapter 7 simply by filing under another chapter and later converting the case.<sup>52</sup> Accordingly, the court held that the word "filed" as used in § 707(b) incorporated the conversion of cases from other chapters of the Bankruptcy Code.<sup>53</sup>

In *In re Penninger*, the Schedule J filed by the debtors on the petition date showed an income of \$408 per month.<sup>54</sup> Over the ensuing seven months, the debtors' income drastically increased, prompting the United States bankruptcy administrator to file a motion to dismiss the debtors' case for abuse under §§ 707(b)(1) and 707(b)(3) of the Bankruptcy Code.<sup>55</sup> At the time of the hearing on the administrator's motion, the debtors' income had risen to \$1407 per month.<sup>56</sup> The debtors did not dispute that their income, as of the hearing date, could provide a one hundred percent distribution to creditors and would have been abusive under § 707(b) had the case been filed on that date.<sup>57</sup>

The debtors nevertheless opposed the administrator's motion on the grounds that abuse for the purposes of §§ 707(b)(1) and 707(b)(3) should be determined as of the petition date and that subsequent changes to the debtor's financial situation should not be considered in the abuse analysis.<sup>58</sup> The Bankruptcy Court for the Middle District of North Carolina agreed with the administrator, however, holding that the plain language of § 707(b) permits a court to consider a debtor's financial circumstances at the time of the hearing.<sup>59</sup> According to the court, § 707(b) "focuses on whether granting a Chapter 7 discharge would be an abuse, not

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51. *Id.* at 1622.

52. *Id.* at 1623.

53. *Id.* at 1620.

54. No. 10-52061, 2011 WL 2709321, at \*1 (Bankr. M.D.N.C. July 8, 2011).

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.* at \*2.

59. *See id.*

whether the filing of the petition was an abuse.”<sup>60</sup> The court also noted that § 707(b)(3) permits a court to consider “the totality of the circumstances . . . of the debtor’s financial situation.”<sup>61</sup> The court thus granted the administrator’s motion, finding that the totality of the debtors’ financial situation constituted an abuse of Chapter 7 under § 707(b)(3).<sup>62</sup>

#### IV. AVOIDANCE ACTIONS

In *Goldman v. Capital City Mortgage Corp.*, the Chapter 7 trustee brought suit against several defendants to avoid a series of transfers of a parcel of real estate originally owned by the debtor.<sup>63</sup> The initial and secondary transferees of the property entered into consent orders with the trustee avoiding the transfers.<sup>64</sup> The tertiary transferee, Capital City Mortgage Corporation (“CCM”), a lender specializing in high-interest loans to high-risk individuals and businesses, asserted that the transfer was not avoidable pursuant to § 550(b)(1) as it had taken the property “for value, . . . in good faith, and without knowledge of the voidability of the transfer.”<sup>65</sup>

While there was no dispute that CCM had taken the property for value, and while the court found that CCM did not have actual knowledge of the voidability of the transfer, the court found that the transfer was avoidable because CCM had not taken the property in good faith.<sup>66</sup> The court first reaffirmed its holding in *Smith v. Mixon* that “knowledge” includes only actual notice but clarified that the “knowledge” requirement is satisfied where a transferee knew facts that would lead a reasonable person to believe that the transfer was recoverable.<sup>67</sup> Although a transferee has no duty to investigate where nothing suggests that a transfer may be avoidable, actual knowledge of facts that would lead a

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60. *Id.* (citing 11 U.S.C. § 707(b)(1) (2006)).

61. *Id.* (citing 11 U.S.C. § 707(b)(3) (2006)) (internal quotation marks omitted).

62. *See id.* at \*3.

63. 648 F.3d 232, 233–34 (4th Cir. 2011) (per curiam).

64. *Id.* at 236.

65. *See id.* at 234, 237 (alteration in original) (citing 11 U.S.C. § 550(b)(1) (2006)).

66. *Id.* at 240–41.

67. *Id.* at 237, 238 (citing *Smith v. Mixon*, 788 F.2d 229, 232 (4th Cir. 1988); *IRS v. Nordic Vill, Inc.* (*In re Nordic Vill, Inc.*), 915 F.2d 1049, 1055 (6th Cir. 1990)).

reasonable person to believe that a transfer is voidable is sufficient to permit the avoidance of a mediate transfer.<sup>68</sup>

The court then addressed the good faith requirement of § 550(b)(1), holding that good faith must be viewed under an objective standard.<sup>69</sup> The court held that a transferee does not act in good faith when it has sufficient actual knowledge to put it on inquiry notice of the debtor's possible insolvency or the avoidability of a transfer.<sup>70</sup> Reviewing the actions of CCM prior to the transfer, the court found that, despite numerous red flags indicating that the transfer of the property from the secondary transferee to CCM might be fraudulent, CCM failed to verify the credentials of the transferee, to investigate the title history of the property, or to take any steps to ensure the legitimacy of the transfer that would be expected of a reasonable lender in similar circumstances.<sup>71</sup> Accordingly, the court found that CCM's failure to investigate constituted bad faith that precluded CCM from asserting § 550(b)(1) as a defense to the transfer.<sup>72</sup>

In *Siegel v. Russellville Steel Co. (In re Circuit City Stores, Inc.)*, a liquidating trustee sought, under § 547(b) of the Bankruptcy Code, to avoid and recover several payments made by the debtor within ninety days of the petition date.<sup>73</sup> While conceding that the transfers were preferences under § 547(b), the defendant asserted that the payments were made in the ordinary course of business and were therefore not avoidable pursuant to § 547(c)(2)(A).<sup>74</sup> The primary issue to be decided by the court was the relevant baseline to determine the ordinary course of business between the debtor and the defendant.<sup>75</sup>

The trustee argued that the court should consider the entire business relationship between the debtor and the defendant to identify the ordinary payment practices between the parties.<sup>76</sup> The defendant, in contrast, advanced an arbitrary and fixed

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68. *Id.* (citations omitted).

69. *Id.*

70. *Id.* at 238 (citing *Gold v. Laines (In re Laines)*, 352 B.R. 397, 406 (Bankr. E.D. Va. 2005)).

71. *See id.* at 241–42.

72. *Id.* at 241.

73. No. 08-35653, 2012 WL 1981781, at \*1 (Bankr. E.D. Va. June 1, 2012).

74. *Id.* at \*1, \*3.

75. *Id.* at \*3.

76. *Id.*

twelve-month lookback period.<sup>77</sup> Finding that twelve-month lookback period advocated by the defendant would unnecessarily constrain the court's ability to ascertain the parties' "ordinary" course of conduct, the court determined that it was appropriate to consider the entire business history between the debtor and the defendant.<sup>78</sup>

Following the Fourth Circuit's decision in *Advo-System, Inc. v. Maxway Corp.*, the court then held that the ordinary course of business between the parties must be determined by their conduct prior to the onset of insolvency.<sup>79</sup> The court noted that following a significant decline in the liquidity of the debtor, which the court found marked the onset of insolvency for purposes of this case, the payment practices between the debtor and the defendant changed significantly.<sup>80</sup> Comparing the pre- and post-insolvency payment practices, the court held that the payments in question were not made in the ordinary course of business and were therefore avoidable.<sup>81</sup>

In *In re Circuit City Stores, Inc.*, Mitsubishi Digital Electronics America, Inc., filed an administrative priority claim under § 503(b)(9) of the Bankruptcy Code for the value of goods transferred to the debtors during the twenty-day period immediately preceding the petition date.<sup>82</sup> The debtor filed an objection to this claim under § 502(d) on the grounds that Mitsubishi had received preferential transfers under § 547, and sought to temporarily disallow the § 503(b)(9) claim pending the resolution of the preference issue.<sup>83</sup> The debtors and Mitsubishi entered into a settlement agreement establishing a fully funded reserve, for the exclusive benefit of Mitsubishi, sufficient to pay the § 503(b)(9) claim, from which funds would be released to pay any ultimately allowed amount of the claim.<sup>84</sup>

Following the initiation of an adversary proceeding seeking to avoid and recover the alleged preferential transfers, Mitsubishi

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77. *Id.* at \*4.

78. *Id.*

79. *Id.* at \*4–5 (citing *Advo-System, Inc. v. Maxway Corp.*, 37 F.3d 1044, 1049 (4th Cir. 1994)).

80. *Id.* at \*5–6 & n.9.

81. *Id.* at \*6.

82. 64 *Collier Bankr. Cas.* 2d (MB) 1314, 1317 (Bankr. E.D. Va. Dec. 1, 2010).

83. *Id.*

84. *Id.* at 1317–18.

asserted a defense under the new value exception set forth in § 547(c)(4) contending that the value of the transferred goods comprising the § 503(b)(9) claim also can serve as “new value.”<sup>85</sup> The debtors filed a motion for partial summary judgment, asserting that Mitsubishi could not use the goods transferred within the twenty days preceding the petition date as a basis for both a new value defense and a § 503(b)(9) administrative claim.<sup>86</sup>

After analyzing the text of § 547(c)(4), the court agreed with the debtor. As the parties stipulated that Mitsubishi did make a contribution of new value to the debtors, the court examined whether Mitsubishi had received an “otherwise unavoidable transfer” from the debtors on account of the new value.<sup>87</sup> The court first concluded that the establishment of the fully funded reserve constituted a “transfer to or for the benefit of [the] creditor’ on account of the subsequent new value” because the debtors had “parted with their interest in the monies that have been set aside in the reserve fund for the exclusive benefit of Mitsubishi.”<sup>88</sup> The allowance of the claim had been only temporarily deferred pending resolution of the preference issue, and the right of Mitsubishi to the total amount of any allowed § 503(b)(9) claim for the value of the transferred goods was absolute.<sup>89</sup> Next, finding that § 549 did not apply because the creation of the reserve fund was approved by the court and that §§ 544, 547, 548, and 553(b) apply only to pre-petition transfers, the court concluded that the transfer was “otherwise unavoidable.”<sup>90</sup> Thus, the court held that Mitsubishi either could claim an administrative expense under § 503(b)(9) or use the value of the goods provided to support a § 547(c)(4) new value defense, but it could not do both.<sup>91</sup>

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85. *Id.*

86. *Id.* at 1318–19.

87. *Id.* at 1322 (quoting 11 U.S.C. § 549(c)(4)(B) (2006)).

88. *Id.* at 1322–23 (alteration in original) (quoting 11 U.S.C. § 547(c)(4)(B) (2006)).

89. *Id.* at 1322.

90. *Id.* at 1324–25 (quoting 11 U.S.C. § 547(c)(4)(B)) (internal quotation marks omitted).

91. *Id.* at 1327.

V. CRAM DOWN OF SECURITY INTEREST IN CHAPTER 13,  
DEBTOR'S PRINCIPAL RESIDENCE

“Cram down” refers to, among other things, a debtor’s ability to bifurcate a secured creditor’s claim into secured and unsecured portions when the value of the property is less than the total amount that remains owing on the debt.<sup>92</sup> For example, if a debtor owes \$150,000 to her mortgage lender, but the house is worth only \$100,000, under certain circumstances, a debtor could treat only \$100,000 as a secured claim and treat the remaining \$50,000 as an unsecured claim. When the debtor is in Chapter 13, and the debt is secured by “a security interest in real property that is the debtor’s principal residence,” however, cram down is unavailable under § 1322(b)(2).<sup>93</sup>

In *Ennis v. Green Tree Servicing (In re Ennis)*, the Fourth Circuit, in a direct appeal from the bankruptcy court, addressed a question left open by the BAPCPA addition of a definition of the “debtor’s principal residence” as including a mobile home even if it is not attached to underlying real property.<sup>94</sup> In that case, the Chapter 13 joint debtors owned a mobile home and filed a Chapter 13 plan that proposed cramming down the lender’s security interest in the mobile home.<sup>95</sup> The lender objected and asserted that the plan could not be confirmed under § 1322(b)(2) because the debtors used the mobile home as their principal residence.<sup>96</sup> The bankruptcy court agreed with the lender, but on appeal the Fourth Circuit disagreed and reversed.<sup>97</sup> The Fourth Circuit held that § 1322(b)(2) contains two distinct requirements—first, that the security interest must be in real property, and second, that the real property must be the debtor’s principal residence.<sup>98</sup> The court explained:

The definition of “debtor’s principal residence” addresses only the second requirement, “leaving the explicit ‘real property’ [requirement], untouched.” Not only does the “debtor’s principal residence” definition avoid defining “real property,” but the definition also makes

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92. See *Shaw v. Aurgroup Fin. Credit Union*, 552 F.3d 447, 449–451 (6th Cir. 2009) (internal citations omitted).

93. 11 U.S.C. § 1322(b)(2) (2006).

94. 558 F.3d 343, 344–45 (4th Cir. 2009) (internal quotation marks omitted).

95. See *id.* at 345.

96. *Id.*

97. *Id.* at 344.

98. *Id.* at 345–46.

clear that whether a structure is a principal residence is independent of whether it might be real property. Specifically, the definition states that a “debtor’s principal residence . . . means a residential structure . . . without regard to whether that structure is attached to real property.”<sup>99</sup>

In short, the Fourth Circuit held that “the real property requirement of § 1322(b)(2)’s anti-modification clause survives the definition of ‘debtor’s principal residence.’”<sup>100</sup> Thus, the anti-modification clause of § 1322(b)(2) applies only to real property that is a debtor’s principal residence.<sup>101</sup>

## VI. DISPOSABLE INCOME CALCULATION

In *Hamilton v. Lanning*, the Supreme Court resolved a longstanding dispute over how to calculate a debtor’s “projected disposable income” for purposes of § 1325(b)(1).<sup>102</sup> Under this section, if the trustee or an unsecured creditor objects to the confirmation of a debtor’s Chapter 13 plan, the plan only may be approved if the creditor’s claim is paid in full or if the plan provides that “the debtor’s projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.”<sup>103</sup> While “projected disposable income” is not defined by the Bankruptcy Code, “[d]isposable income” is . . . defined as ‘current monthly income received by the debtor’ less ‘amounts reasonably necessary to be expanded’ for the debtor’s maintenance and support.”<sup>104</sup> “Current monthly income” is calculated by averaging the debtor’s monthly income during the six months prior to the petition date.<sup>105</sup>

The debtor in *Hamilton* received a one-time buyout from her former employer during the six months prior to the petition date, thus significantly inflating her “current monthly income” calcula-

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99. *Id.* at 346 (alteration in original) (internal citations and quotation marks omitted).

100. *Id.*

101. *See id.*

102. 560 U.S. \_\_\_, \_\_\_, 130 S. Ct. 2464, 2469 (2010).

103. 11 U.S.C. § 1325(b)(1) (2006).

104. *Hamilton*, 560 U.S. at \_\_\_, 130 S. Ct. at 2469 (quoting 11 U.S.C. §§ 1325(b)(2)(A)(i), (ii)).

105. *Id.* at \_\_\_, 130 S. Ct. at 2470 (citing 11 U.S.C. § 101(10A)(A)(i) (2006)) (internal quotation marks omitted).

tion.<sup>106</sup> Due to this buyout, the debtor reported a disposable income of \$1114.98 on her Form 22C.<sup>107</sup> On the debtor's Schedule I and Schedule J, however, the debtor reported the income from her new job as \$1922 per month with expenses of \$1772.97, leaving a monthly disposable income of only \$149.03.<sup>108</sup> Based on her new income, the debtor filed a plan that required her to pay \$144 per month for thirty-six months.<sup>109</sup>

The Chapter 13 trustee objected on the grounds that the debtor was not committing all of her "projected disposable income" to the plan, arguing that her projected disposable income should be calculated by multiplying the disposable income listed on the debtor's Form 22C by the applicable commitment period.<sup>110</sup> According to the trustee, this "mechanical approach" required a payment of \$756 per month for a period of sixty months.<sup>111</sup> The bankruptcy court rejected the mechanical approach favored by the trustee and upheld the debtor's proposed \$144 monthly payment, but required a sixty-month plan period.<sup>112</sup> On appeal by the trustee, both the Tenth Circuit Bankruptcy Appellate Panel and the Tenth Circuit Court of Appeals affirmed the bankruptcy court's ruling.<sup>113</sup>

In affirming the lower courts, the Supreme Court held that, while the mechanical approach advocated by the trustee is appropriate in most cases, the forward-looking approach utilized by the debtor is permissible "where significant changes in a debtor's financial circumstances are known or virtually certain."<sup>114</sup> The Court first examined the meaning of "projected disposable income," finding that, as the term is not defined by the Bankruptcy Code, the ordinary meaning of "projected" should control.<sup>115</sup> Thus, "While a projection takes past events into account, adjustments

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106. *Id.* at \_\_\_, 130 S. Ct. at 2470 (internal quotation marks omitted).

107. *Id.* at \_\_\_, 130 S. Ct. at 2470.

108. *Id.* at \_\_\_, 130 S. Ct. at 2470.

109. *Id.* at \_\_\_, 130 S. Ct. at 2470.

110. *Id.* at \_\_\_, 130 S. Ct. at 2470 (internal quotation marks omitted).

111. *Id.* at \_\_\_, 130 S. Ct. at 2470.

112. *Id.* at \_\_\_, 130 S. Ct. at 2470 (citing *In re Lanning*, Nos. 06-41037, -41260, 2007 WL 1451999, at \*8 (Bankr. D. Kan. May 15, 2007)).

113. *Id.* at \_\_\_, 130 S. Ct. at 2471 (citing *In re Lanning*, 380 B.R. 17, 19 (2007); *In re Lanning*, 595 F.3d 1269, 1270 (2008)).

114. *Id.* at \_\_\_, 130 S. Ct. at 2471.

115. *Id.* at \_\_\_, 130 S. Ct. at 2471 (quoting *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995)).

are often made based on other factors that may affect the final outcome.<sup>116</sup> The Court next noted that “projected,” as used in other federal statutes, rarely means simple multiplication.<sup>117</sup> Had Congress intended that “projected disposable income” involve a simple mathematical calculation, it would have specified so by using the term “multiplied” as it does in other areas of the Bankruptcy Code.<sup>118</sup> Third, the Court found that pre-BAPCPA courts permitted debtors to deviate from the mechanical approach, as the debtor proposed to do, when the circumstances warranted.<sup>119</sup> As BAPCPA did not clearly alter this practice, the Court refused to “read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.”<sup>120</sup> The Court therefore concluded that a debtor’s projected disposable income calculation “may account for changes in the debtor’s income or expenses that are known or virtually certain at the time of confirmation.”<sup>121</sup>

*Ransom v. FIA Card Services, N.A.* resolved a split among the circuits regarding whether a Chapter 13 debtor may properly claim expenses on the means test calculation imposed by § 1325(b)(3) that the debtor does not actually incur.<sup>122</sup> Under Chapter 13, a debtor must pay creditors a sum equal or greater to the debtor’s monthly disposable income multiplied by the number of months in the plan term.<sup>123</sup> Section 1325(b)(2) “defines ‘disposable income’ as ‘current monthly income’ less ‘amounts reasonably necessary to be expended’ for ‘maintenance or support,’ business expenditures, and certain charitable contributions.”<sup>124</sup> If a debtor’s income exceeds the median income for the applicable state, the means test set forth in § 707 defines the expenses that qualify as “amounts reasonably necessary” to support the debtor.<sup>125</sup> Section 707 provides that a debtor’s monthly expenses are

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116. *Id.* at \_\_\_, 130 S. Ct. at 2472 (citing *In re Kibbe*, 361 B.R. 302, 312 n.9 (B.A.P. 1st Cir. 2007)).

117. *Id.* at \_\_\_, 130 S. Ct. at 2472 (citations omitted).

118. *Id.* at \_\_\_, 130 S. Ct. at 2472 (internal quotation marks and citations omitted).

119. *Id.* at \_\_\_, 130 S. Ct. at 2472 (citations omitted).

120. *Id.* at \_\_\_, 130 S. Ct. at 2473 (internal quotation marks and citations omitted).

121. *Id.* at \_\_\_, 130 S. Ct. at 2478.

122. 562 U.S. \_\_\_, \_\_\_, 131 S. Ct. 716, 723 (2011) (citing *Ransom v. MBNA*, 559 U.S. \_\_\_, 130 S. Ct. 2097 (2012)).

123. *Id.* at \_\_\_, 131 S. Ct. at 721.

124. *Id.* at \_\_\_, 131 S. Ct. at 721 (citing 11 U.S.C. §§ 1325(b)(2)(A)(i), (ii) (2006 & Supp. IV 2010)).

125. *Id.* at \_\_\_, 131 S. Ct. at 721–22.

determined by the monthly amounts specified under the National Standards and Local Standards guidelines issued by the Internal Revenue Service for the area in which the debtor resides.<sup>126</sup>

In *Ransom*, the debtor owned a 2004 Toyota Camry free of any debt.<sup>127</sup> On the means test, the debtor claimed a car ownership deduction in the amount of \$471 as well as a separate car operating costs deduction in the amount of \$338.<sup>128</sup> The creditor, FIA Card Services, subsequently objected to the debtor's Chapter 13 plan, asserting that the debtor improperly lowered his disposable income calculation by claiming the car ownership deduction for a car on which he made no loan or lease payments.<sup>129</sup> The bankruptcy court denied confirmation of the debtor's plan, holding that he only could deduct vehicle-ownership expenses if he was currently making loan or lease payments on the vehicle.<sup>130</sup> Both the Ninth Circuit Bankruptcy Appellate Panel and the Ninth Circuit Court of Appeals affirmed the ruling of the bankruptcy court.<sup>131</sup>

The Supreme Court affirmed the decision of the court of appeals.<sup>132</sup> Noting that § 707(b)(2)(A)(ii)(I) states that "[t]he debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the National Standards and Local Standards," the Court applied the plain meaning of the statute and found that a debtor may claim a deduction "only if that deduction is appropriate for him."<sup>133</sup> A deduction is only appropriate "if the debtor will incur that kind of expense during the life of the plan."<sup>134</sup> The Court further found that this interpretation is supported by the language in § 1325(b) defining a debtor's disposable income as his "current monthly income . . . less amounts *reasona-*

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126. *Id.* at \_\_\_, 131 S. Ct. at 722 (quoting 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2006 & Supp. IV 2010)).

127. *Id.* at \_\_\_, 131 S. Ct. at 723 (citations omitted).

128. *Id.* at \_\_\_, 131 S. Ct. at 722 (citations omitted).

129. *See id.* at \_\_\_, 131 S. Ct. at 723 (citations omitted).

130. *Id.* at \_\_\_, 131 S. Ct. at 723 (citations omitted).

131. *Id.* at \_\_\_, 131 S. Ct. at 723 (citing *In re Ransom*, 380 B.R. 799, 808–09 (B.A.P. 9th Cir. 2007); *In re Ransom*, 577 F.3d 1026, 1027 (9th Cir. 2004)).

132. *Id.* at \_\_\_, 131 S. Ct. at 723.

133. *Id.* at \_\_\_, 131 S. Ct. at 724 (emphasis added) (quoting 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2006 & Supp. IV 2010)) (internal quotation marks and citations omitted).

134. *Id.* at \_\_\_, 131 S. Ct. at 724.

bly necessary to be expended.”<sup>135</sup> As Congress intended the means test to approximate a debtor’s actual and reasonable expenditures on essential items, “a debtor should be required to qualify for a deduction by actually incurring an expense in the relevant category.”<sup>136</sup> Finally, the Court found that denying deductions for expenses that the debtors do not actually incur furthers Congress’s intention to ensure that debtors repay creditors the maximum amount they can afford.<sup>137</sup> As the debtor did not actually incur any expenses for loan or lease payments on his vehicle, the Court held that the debtor could not properly claim an expense for such expenses on the means test.<sup>138</sup>

The Fourth Circuit in *Morris v. Quigley (In re Quigley)*<sup>139</sup> was presented with a variation of the fact pattern presented in *Hamilton v. Lanning*.<sup>140</sup> The debtor listed two all-terrain vehicles (“ATVs”) on her Schedule B and stated on her Schedule D that the ATVs were collateral for promissory notes that she had executed.<sup>141</sup> The debtor accordingly listed the payments on the ATVs as expense deductions when calculating her monthly disposable income.<sup>142</sup> In her Chapter 13 plan, however, she indicated that she would be surrendering both ATVs to the secured creditors and no longer would be required to make the payments.<sup>143</sup>

The Chapter 13 trustee objected to the debtor’s proposed plan, alleging that the debtor had understated her disposable income by improperly deducting, inter alia, the payments for the ATVs when the debtor would in fact no longer be responsible for such payments during the life of the plan.<sup>144</sup> Ruling prior to the decision in *Lanning*, the bankruptcy court overruled the trustee’s objection on the grounds that projected disposable income was based only on the expenses and income in the six months prior to the petition date and that it was statutorily prohibited from con-

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135. *Id.* at \_\_\_, 131 S. Ct. at 724 (quoting 11 U.S.C. § 1325(b)(2) (2006 & Supp. IV 2010)) (internal quotation marks omitted).

136. *Id.* at \_\_\_, 131 S. Ct. at 725.

137. *Id.* at \_\_\_, 131 S. Ct. at 725 (quoting H.R. REP. NO. 109-31, pt. 1, at 2 (2005)).

138. *Id.* at \_\_\_, 131 S. Ct. at 730.

139. 673 F.3d 269 (4th Cir. 2012).

140. 560 U.S. \_\_\_, 130 S. Ct. 2464 (2010).

141. *In re Quigley*, 673 F.3d at 270.

142. *Id.*

143. *Id.*

144. *Id.* at 271.

sidering even known changes in the debtor's future expenses.<sup>145</sup> The district court affirmed.<sup>146</sup>

Applying *Lanning*, which was released between the ruling in the district court and the consideration of the case by the Fourth Circuit, the Fourth Circuit reversed the decision of the district court on the same rationale articulated by the Supreme Court.<sup>147</sup> The Fourth Circuit held that a court may properly "account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation."<sup>148</sup> The court also specifically rejected the debtor's contention that the circumstances presented did not rise to the level of "exceptional" and that the bankruptcy court was therefore within its rights to not take them into account, as well as the contention that the sums involved were not sufficient to warrant the court's consideration.<sup>149</sup> As removing the ATV payments from the disposable income calculation would result in a two-thirds increase in the debtor's payments to creditors, the court found that failing to correct for these payments would result in the very type of "senseless result" that the Supreme Court sought to prevent in *Lanning*.<sup>150</sup>

In *Johnson v. Zimmer*, the Fourth Circuit considered how to determine a Chapter 13 debtor's household size for purposes of calculating the debtor's disposable income.<sup>151</sup> The debtor shared custody of her two children with her former husband, the children spending approximately 204 days per year at the debtor's residence.<sup>152</sup> The debtor's second husband, with whom she resided, shared custody of his three children, who resided in the debtor's residence approximately 180 days per year.<sup>153</sup> The debtor applied the "heads-on-beds" approach utilized by the United States Census Bureau, counting "all the people who occupy a housing unit" and listing a household size of seven.<sup>154</sup> The debtor's former hus-

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145. *Id.*

146. *Id.*

147. *Id.* at 274 (quoting *Hamilton v. Lanning*, 560 U.S. \_\_\_, \_\_\_, 130 S. Ct. 2464, 2475 (2012)).

148. *Id.* at 273 (quoting *Lanning*, 560 U.S. at \_\_\_, 130 S. Ct. at 2478) (internal quotation marks omitted).

149. *Id.* at 273-74 (quoting *Lanning*, 560 U.S. at \_\_\_, 130 S. Ct. at 2471).

150. *Id.* at 274 (quoting *Lanning*, 560 U.S. at \_\_\_, 130 S. Ct. at 2475).

151. 686 F.3d 224, 225 (4th Cir. 2012).

152. *Id.* at 226.

153. *Id.* (footnote omitted).

154. *Id.* (internal quotation marks and citation omitted).

band, who was also a creditor, subsequently objected to the debtor's Chapter 13 plan on the grounds that the debtor had miscalculated the household size and thus incorrectly calculated her monthly disposable income.<sup>155</sup>

The bankruptcy court rejected the "heads-on-beds" method applied by the debtor in favor of a variation of the "economic unit" approach, which assesses the number of individuals that act as a "single economic unit" in a household.<sup>156</sup> In addition to full-time residents, the court included part-time residents according to the percentage of the year in which they reside in the household.<sup>157</sup> Under this calculation, the debtor's two children who resided in the household 204 days per year each constituted 0.56 members of the household, while the debtor's three stepchildren who resided in the household 180 days per year each constituted 0.49 members.<sup>158</sup> This "fractional economic unit approach" resulted in the debtor having 2.59 children in the household, which the court rounded up to three.<sup>159</sup> The court found that, as the debtor's correct household size was five persons, the plan could not be confirmed as proposed.<sup>160</sup>

The Fourth Circuit affirmed the decision of the bankruptcy court, finding that, as the Bankruptcy Code does not mandate a particular method, the economic unit approach best effectuates the intent and purpose of the code.<sup>161</sup> The court first expressly rejected the heads-on-beds test, finding that it is "wholly unrelated to any bankruptcy purpose."<sup>162</sup> The court stated that, as the test was developed simply to permit the Census Bureau to determine the number of people in a geographic region, it does not "serve the Code's objective of identifying a debtor's deductible monthly expenses and, ultimately, his or her disposable income."<sup>163</sup> The economic unit approach, in contrast, is "consistent with § 1325(b), the BAPCPA, and the Code as a whole."<sup>164</sup> The court specifically

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155. *Id.*

156. *Id.* at 226–27 (citations omitted).

157. *Id.* at 227.

158. *Id.* (footnote omitted) (citing *In re Johnson*, No. 10-072448-JRL, 2011 WL 5902883, at \*3 (Bankr. E.D.N.C. July 21, 2011)).

159. *Id.*

160. *Id.*

161. *Id.* at 227–28.

162. *Id.* at 236.

163. *Id.*

164. *Id.* at 237.

noted the test's utility in examining the "financial interdependence of individuals to determine whether someone is an economic part of the debtor's household," which the court defined as "those the debtor financially supports and those who financially support the debtor."<sup>165</sup> The court further held that the economic unit approach is most consistent with the Supreme Court's decision in *Hamilton v. Lanning*, as it recognizes that bankruptcy courts should possess the flexibility to avoid a mechanical application of the code in favor of an approach that permits courts to most accurately approximate a debtor's household size, given the nuances of a debtor's particular family situation.<sup>166</sup>

## VII. CLAIMS

A company in financial distress often is compelled to lay off various parts of its workforce both before and after filing a bankruptcy petition. Many companies implement severance benefit plans for all or a portion of their employees in good times, and they even do so in bad times in an attempt to prevent a mass exodus of talented, operationally important employees at a time when the company is struggling to keep the lights on. Unsurprisingly, then, issues relating to employees' claims for severance benefits occur frequently in corporate bankruptcy cases.

In bankruptcy, creditors receive distributions on their claims according to the statutory order of priority set forth in § 507(a) of the Bankruptcy Code.<sup>167</sup> Fourth in priority are employee claims (up to a capped amount for each employee) for "wages, salaries, or commissions, including vacation, severance, and sick leave pay," that are earned within 180 days before the petition date.<sup>168</sup> In a direct appeal arising out of LandAmerica's bankruptcy case, the Fourth Circuit addressed whether, and to what extent, an employee's claim for severance benefits is entitled to priority under § 507(a)(4).<sup>169</sup>

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165. *Id.*

166. *Id.* at 242 (footnote omitted) (citing *Hamilton v. Lanning*, 560 U.S. \_\_\_, \_\_\_, 130 S. Ct. 2464, 2471-78 (2010)).

167. See 11 U.S.C. § 507(a) (2006 & Supp. IV 2010).

168. See *id.* § 507(a)(4).

169. *Matson v. Alarcon*, 651 F.3d 404, 406 (4th Cir. 2011).

The liquidating trustee in LandAmerica objected to more than one hundred priority claims filed by employees for severance benefits, arguing that the severance benefits were “earned” over the entire course of the employees’ employment because the severance plan at issue provided for different amounts of severance pay based on the length of a given employee’s employment and that the amount eligible for priority should be prorated.<sup>170</sup> The bankruptcy court rejected this argument and held that the severance benefits were earned on the date of termination, which in this case occurred within 180 days before the petition date.<sup>171</sup> The liquidating trustee, with authorization from the bankruptcy court, appealed directly to the Fourth Circuit.<sup>172</sup>

In resolving just when severance benefits are “earned” within the meaning of § 507(a)(4), the Fourth Circuit was compelled to draw on dictionary definitions of “severance pay” and “earned” because such terms are undefined in the Bankruptcy Code.<sup>173</sup> The Fourth Circuit also highlighted the unique nature and purpose of severance pay, as opposed to other forms of employee compensation:

The triggering events permitting employees to receive wages, salaries, and commissions generally lie within the employees’ control upon performance of their work, subject to the terms of the employment agreement. . . .

In contrast to wages, salaries, and commissions, the triggering events allowing employees to receive “severance pay” lie within the employer’s control and its decision both to provide severance compensation and to terminate the employment relationship. Thus, employees do not “earn” “severance pay” in exchange for services rendered as they do when they “earn” wages, salaries, and commissions. Rather, employees receive “severance pay” as compensation for the injury and losses resulting from the employer’s decision to terminate the employment relationship. This ordinary understanding of the term “severance pay” is consistent with the stated purpose of the plan in the present case, namely, to assist employees upon termination.<sup>174</sup>

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170. *See id.* at 407.

171. *See id.* at 407–08.

172. *See id.* at 406.

173. *See id.* at 408, 409 (quoting WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 714 (2002); *id.* at 2081) (citing *Scrimgeour v. Internal Revenue*, 149 F.3d 318, 327 (4th Cir. 1989)).

174. *See id.*

On that basis, the Fourth Circuit then concluded that “to become entitled, represents the ordinary meaning of the manner in which employees ‘earn’ ‘severance pay,’ within the intendment of Congress . . . . [A]n employee ‘earns’ the full amount of ‘severance pay’ on the date the employee becomes entitled to receive such compensation . . . .”<sup>175</sup> This date typically will be the date on which an employee is terminated, which in this case was within the 180-day period before the bankruptcy petition was filed, and the Fourth Circuit therefore affirmed the bankruptcy court’s decision.<sup>176</sup>

### VIII. CLASS ACTIONS

In *Gentry v. Siegel*, the Fourth Circuit addressed the means by which a putative class of claimants may seek certification in a bankruptcy court.<sup>177</sup> Four former employees of Circuit City Stores, Inc., filed proofs of claim asserting that each claim was filed for the named claimant, and on behalf of other former employees similarly situated.<sup>178</sup> The bankruptcy court rejected these attempts to certify classes of claimants, ruling that the claimants were not authorized to file class proofs of claim; that the motion under Federal Rules of Bankruptcy Procedure, Rule 9014, to incorporate Rule 7023, regarding class actions, was untimely; that the already-established bankruptcy claims resolution process would be superior to the class action process for handling the claims of potential class members; and that potential claimants had received constitutionally adequate notice of the bankruptcy proceedings and the applicable proof of claim deadlines.<sup>179</sup>

The Fourth Circuit affirmed in part and reversed in part, but ultimately agreed with the bankruptcy and district courts that class certification was not warranted in this case.<sup>180</sup> The court first held that claimants seeking class certification in a bankruptcy proceeding may file a claim on behalf of themselves and other similarly situated claimants, as the claimants did here.<sup>181</sup> Howev-

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175. *See id.* at 409 (footnote omitted).

176. *Id.* at 410.

177. *See* 668 F.3d 83, 86, 90 (4th Cir. 2012).

178. *Id.* at 85.

179. *Id.*

180. *See id.* at 86.

181. *Id.* at 90.

er, this claim only constitutes a proposal to represent the class, which must then be approved by the bankruptcy court.<sup>182</sup> If approval subsequently is received, such approval relates back to the time of filing.<sup>183</sup> Should approval be denied, the court required that putative class members be given reasonable time to file individual proofs of claim following such rejection.<sup>184</sup>

The court then held that the claimants' motion under Rule 9014 to apply Rule 7023 was not untimely.<sup>185</sup> The court stated that Rule 9014 applies only to contested matters, which do not arise from a proof of claim until an objection to the claim has been filed.<sup>186</sup> Here, the court found that the motion under Rule 9014 was filed shortly after the objection to the class proofs of claim was filed and was therefore timely.<sup>187</sup>

Having reversed the prior courts on these points, the court then found that the bankruptcy court did not abuse its discretion in ruling that the bankruptcy claims resolution process was superior to the class action process in resolving the claims of putative class members.<sup>188</sup> The court noted that the bankruptcy court previously had established an effective process for resolving large numbers of claims and thus had determined that the addition of several hundred potential class claims would not negatively impact the claims resolution process.<sup>189</sup> The court finally held that as no class had been certified, putative class members were not entitled to the notice provisions contained in Rule 7023.<sup>190</sup> The only required notice was that giving notice of the bankruptcy procedures and the claims bar date.<sup>191</sup> Accordingly, as the bankruptcy court had considered the claimants' motion on the merits, the court affirmed the ultimate decision of the lower courts.<sup>192</sup>

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182. *Id.*

183. *Id.*

184. *Id.* The court also noted that the requirement that putative class members be given the opportunity to file individual claims was not at issue because no unnamed claimant had attempted, nor indicated any intent, to file an individual proof of claim. *Id.* at 91.

185. *Id.* at 92.

186. *Id.* (quoting *Certified Class in Charter Sec. Litig. v. Charter Co. (In re Charter Co.)*, 876 F.2d 866, 874-75 (11th Cir. 1989)).

187. *Id.*

188. *See id.* at 92-94 (internal citations omitted).

189. *See id.* at 93.

190. *See id.* at 94.

191. *Id.*

192. *See id.* at 95.

Shortly after the Fourth Circuit's decision was released in *Gentry v. Siegel*, the Bankruptcy Court for the Eastern District of Virginia again was confronted with a substantially similar fact pattern in *In re Movie Gallery, Inc.*<sup>193</sup> The claimant timely filed an unsecured priority claim in the amount of "\$10,950/class member" for "wages, salaries, and compensation."<sup>194</sup> The claim did not contain a clear statement that it was being filed on behalf of a class, but the claimant did attach a copy of a complaint filed in California state court seeking to pursue a class action against the debtor.<sup>195</sup> Due to the vague nature of the claim, the liquidating trustee did not become aware that the claimant considered his claim to be on behalf of a class until approximately six months after the debtor's Chapter 11 plan had been confirmed.<sup>196</sup> The claimant filed a motion for an order applying Rule 7023 to his proof of claim approximately two weeks prior to the scheduled hearing on the trustee's objection to his claim.<sup>197</sup>

The court noted that, while *Gentry* held that class claims may be allowed in a bankruptcy case, such claims only should be allowed "if doing so would produce 'a more practical and efficient process for the adjudication of claims.'"<sup>198</sup> The court then found that—given the advanced stage of the case, the fact that few claims remained unresolved, and the fact that substantially all of the debtor's hard assets had been liquidated—certification of a class action would "serve only to throw the entire administration of the case into chaos."<sup>199</sup> The claimants' motion therefore was denied.<sup>200</sup>

## IX. DISCHARGEABILITY

There are some debts a debtor cannot discharge in bankruptcy. An example is a "debt . . . for a tax . . . with respect to which a return, or equivalent report or notice, if required[,] was not filed or

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193. See *In re Movie Gallery, Inc.*, No. 10-30696-DOT, 2012 WL 909501, at \*1 & nn.3–4 (Bankr. E.D. Va. 2012) (footnotes omitted).

194. *Id.* at \*2 (internal quotation marks omitted).

195. *Id.* (footnote omitted).

196. *Id.* at \*3.

197. *Id.*

198. *Id.* at \*4 (quoting *Gentry v. Siegel*, 668 F.3d 83, 90 (4th Cir. 2012)).

199. *Id.* at \*5.

200. *Id.*

given.”<sup>201</sup> This reflects a legislative policy concern that the debtor’s fresh start in bankruptcy should not be obtained at the expense of “the tax collector, who . . . has not had reasonable time to collect” and that the discharge should not apply to tax claims “to whose staleness the debtor contributed by some wrong-doing or serious fault.”<sup>202</sup>

In *Maryland v. Ciotti (In re Ciotti)*, the Fourth Circuit held that a state’s pre-petition tax claims were not discharged because the debtor failed to file a required report with state taxing authorities, the purpose of which was to notify state taxing authorities that the IRS had adjusted the debtor’s federal income.<sup>203</sup> Although the debtor failed to file the report, the IRS separately notified the state of the adjustment to the debtor’s income, and the state, in turn, made adjustments to the debtor’s state returns, adding more than \$500,000 in taxes, penalties, and interest for the tax years at issue.<sup>204</sup>

The Fourth Circuit held that the state’s claims for these taxes were not discharged because the 2005 BAPCPA amendments to the Bankruptcy Code specifically added the failure to file an “equivalent” . . . “report or notice” as a circumstance that will cause a tax debt to be nondischargeable, and the report at issue in *Ciotti* was the equivalent to a tax return.<sup>205</sup> For instance, the report was found to be similar to a tax return because submitting false or misleading information in the report could lead to criminal liability under applicable state law, and one element of a tax return is that it is submitted under penalty of perjury.<sup>206</sup> In addition, the report satisfied the element of a tax return that it contain sufficient data to compute tax liability because the report required the taxpayer to submit as an attachment to the report a complete copy of the federal audit, including all exhibits.<sup>207</sup> The

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201. 11 U.S.C. § 523(a)(1)(B)(i) (2006 & Supp. IV 2010).

202. Compare *id.*, with S. REP. NO. 95-989, at 14 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5800.

203. See 638 F.3d 276, 278 (4th Cir. 2011).

204. *Id.*

205. *Id.* at 279, 280 (citing Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. 109-85, § 714, 119 Stat. 23 (2005) (codified as amended at 11 U.S.C. § 523(a)(1)(B) (2006))).

206. See *id.* at 280 (citing MD. CODE ANN., TAX-GEN. § 13-1204(a) (LexisNexis Repl. Vol. 2010)).

207. See *id.* at 280–81 (quoting *Maroney v. United States (In re Moroney)*, 352 F.2d 902, 905 (4th Cir. 2003); MD. CODE REGS. 03.04.02.11 (2012)).

Fourth Circuit rejected the argument that the report was “given” because the IRS separately informed state taxing authorities of the adjustment to the debtor’s income because the applicable state statute provided that “*the person shall submit to the tax collector a report of federal adjustment . . .*”<sup>208</sup> For all of these reasons, the Fourth Circuit concluded that the tax debt was not discharged.<sup>209</sup>

Another type of debt not generally capable of being discharged in a bankruptcy case is student loan debt. In order to discharge student loan debt of a Chapter 13 debtor, the bankruptcy court must find that failure to discharge the student loan debt would impose an “undue hardship” on the debtor.<sup>210</sup> In *United Student Aid Funds, Inc. v. Espinosa*, the Supreme Court granted certiorari to resolve a circuit split regarding whether a bankruptcy court order entered in contravention of these rules is void.<sup>211</sup>

In *Espinosa*, a Chapter 13 debtor filed a proposed plan listing only his student loan debt and proposing to repay the principal of such debt, but providing for the discharge of all accrued interest once the principal was repaid.<sup>212</sup> The debtor did not comply with the procedural requirement of initiating an adversary proceeding to determine the dischargeability of a debt as set forth under Federal Rules of Bankruptcy Procedure, Rule 7001(6).<sup>213</sup> However, the creditor, United Student Aid Funds, Inc. (“United”), received actual notice of the proposed plan and failed to object to the proposed plan or appeal the bankruptcy court’s order confirming the plan.<sup>214</sup> The bankruptcy court did not make any findings regarding whether the student loan debt posed an undue hardship if it were not discharged. Several years after the debtor completed his plan payments and the bankruptcy court entered an order discharging the debtor, United filed a motion under Federal Rules of Civil Procedure, Rule 60(b)(4), requesting that the bankruptcy

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208. *Id.* at 281 (quoting MD. CODE ANN., TAX-GEN. § 13-409(b)).

209. *Id.*

210. 11 U.S.C. §§ 523(a)(8), 1328(a)(2) (2006 & Supp. IV. 2010).

211. 559 U.S. \_\_\_, \_\_\_, 130 S. Ct. 1367, 1373 (2010).

212. *Id.* at \_\_\_, 130 S. Ct. at 1373, 1374 (citations omitted).

213. *Id.* at \_\_\_, 130 S. Ct. at 1373 (citing FED. R. BANKR. P. 7001(6), 7003, 7004, 7008).

214. *Id.* at \_\_\_, 130 S. Ct. at 1373.

court set aside its order confirming the debtor's plan as a void judgment.<sup>215</sup>

United argued that the confirmation order was void for two reasons: first, the order was inconsistent with §§ 523(a)(8) and 1328(a) of the Bankruptcy Code and Rule 7001(6) of the Federal Rules of Bankruptcy Procedure; second, United's due process rights had been violated because the debtor did not initiate an adversary proceeding by filing and serving a summons and complaint as required by Federal Rules of Bankruptcy Procedure, rules 7003, 7004, and 7008.<sup>216</sup> The bankruptcy court rejected both of these arguments and denied United's Rule 60 motion.<sup>217</sup>

On United's appeal, the district court reversed and held that "United was denied due process because the confirmation order was issued without service of the summons and complaint the Bankruptcy Rules require."<sup>218</sup> Espinosa, the debtor, then appealed to the Ninth Circuit and won.<sup>219</sup> The Ninth Circuit ultimately

concluded that by confirming Espinosa's plan without first finding undue hardship in an adversary proceeding, the Bankruptcy Court at most committed a legal error that United might have successfully appealed, but that any such legal error was not a basis for setting aside the confirmation order as void under Rule 60(b).<sup>220</sup>

United then appealed to the Supreme Court,<sup>221</sup> which ruled against United and upheld (for the most part) the Ninth Circuit's decision.<sup>222</sup>

The Supreme Court first explained "that a void judgment is one so affected by a fundamental infirmity that the infirmity may be raised even after the judgment becomes final."<sup>223</sup> A judgment is not void "simply because it is or may have been erroneous,"<sup>224</sup> and

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215. *Id.* at \_\_\_, 130 S. Ct. at 1374.

216. *Id.* at \_\_\_, 130 S. Ct. at 1374-75 (citations omitted).

217. *Id.* at \_\_\_, 130 S. Ct. at 1375.

218. *Id.* at \_\_\_, 130 S. Ct. at 1375.

219. *Id.* at \_\_\_, 130 S. Ct. at 1375.

220. *Id.* at \_\_\_, 130 S. Ct. at 1375 (citing *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193, 1198-1202 (9th Cir. 2008)) (footnote omitted).

221. *Id.* at \_\_\_, 130 S. Ct. at 1376 (citing *United Student Aid Funds, Inc. v. Espinosa*, 557 U.S. \_\_\_, 129 S. Ct. 2791 (2009)).

222. *See id.* at \_\_\_, 130 S. Ct. at 1378, 1382.

223. *Id.* at \_\_\_, 130 S. Ct. at 1377 (citations omitted).

224. *Id.* at \_\_\_, 130 S. Ct. at 1377 (quoting *Hault v. Hault*, 57 F.3d 1, 6 (1st Cir. 1995)) (internal quotation marks omitted) (citing 12 J. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* § 60.44[1][a], at 60-150 to 60-151 (3d ed. 2007)).

“a motion under Rule 60(b)(4) is not a substitute for a timely appeal.”<sup>225</sup> Rather, Rule 60(b)(4) provides relief from a judgment that is “premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard.”<sup>226</sup>

In this case, the Supreme Court noted that United did not assert that the confirmation order suffered from a jurisdictional defect and explained that any such assertion would have failed in any event because § 523(a)(8) (requiring a finding of undue hardship before discharging student loan debt) and the applicable bankruptcy rules (requiring the initiation of an adversary proceeding to determine the dischargeability of student loan debt) are not jurisdictional.<sup>227</sup> The Supreme Court rejected the notion that United’s due process rights were violated because “United received *actual* notice of the filing and contents of Espinosa’s plan. This more than satisfied United’s due process rights. . . . Espinosa’s failure to serve a summons and complaint does not entitle United to relief under Rule 60(b)(4).”<sup>228</sup>

The Supreme Court also rejected United’s argument that the confirmation order was void because it was entered in violation of the Bankruptcy Code.<sup>229</sup> First, the Court held that

a failure to find undue hardship in accordance with § 523(a)(8) is [not] on par with the jurisdictional and notice failings that define void judgments . . . . Instead, § 523(a)(8) requires a court to make a certain finding before confirming the discharge of a student loan debt . . . . [This] does not mean that a bankruptcy court’s failure to make the finding renders its subsequent confirmation order void . . . .<sup>230</sup>

The Court concluded that the bankruptcy court’s failure to make the required factual findings regarding undue hardship before confirming Espinosa’s plan “was a legal error . . . [b]ut the order remains enforceable and binding on United because United had

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225. *Id.* at \_\_\_, 130 S. Ct. at 1377 (citing *Kocher v. Dow Chem. Co.*, 132 F.3d 1225, 1229 (8th Cir. 1997); *MOORE ET AL.*, *supra* note 224, § 60.44[1][a], at 60-150).

226. *Id.* at \_\_\_, 130 S. Ct. at 1377 (citations omitted).

227. *Id.* at \_\_\_, 130 S. Ct. at 1377–78 (citing *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 515–16 (2006); *Kontrick v. Ryan*, 540 U.S. 443, 454 (2004)).

228. *Id.* at \_\_\_, 130 S. Ct. at 1378.

229. *Id.* at \_\_\_, 130 S. Ct. at 1380.

230. *Id.* at \_\_\_, 130 S. Ct. at 1379 (footnote omitted).

notice of the error and failed to object or timely appeal.”<sup>231</sup> To this extent, the Supreme Court agreed with the Ninth Circuit’s decision.<sup>232</sup>

However, the Supreme Court specifically disagreed with the Ninth Circuit’s holding that “bankruptcy courts *must* confirm a plan proposing the discharge of a student loan debt without a determination of undue hardship in an adversary proceeding unless the creditor timely raises a specific objection.”<sup>233</sup> This was, according to the Supreme Court, “a step too far.”<sup>234</sup> Instead, the Court held that it is “plain that bankruptcy courts have the authority—indeed, the obligation—to direct a debtor to confirm his plan to the requirements of §§ 1328(a)(2) and 523(a)(8) . . . [E]ven if the creditor fails to object or appear in the adversary proceeding.”<sup>235</sup>

## X. ETHICAL ISSUES

Legal ethics require particular attention in the bankruptcy realm, as the Bankruptcy Code imposes heightened ethical duties and conflict of interest rules in addition to any regulations enacted by state bar organizations. In *In re Pinebrook, LLC*, the Bankruptcy Court for the Eastern District of Virginia analyzed whether counsel for a debtor limited liability company was disinterested under § 327(a) of the Bankruptcy Code when counsel had received retainers from members of the debtor who were also creditors as a result of loans made to the corporation.<sup>236</sup> Pinebrook LLC was a limited liability company whose members were also limited liability companies.<sup>237</sup> Counsel for the debtor received retainers from several of these member limited liability companies, none of whom were in control of the debtor.<sup>238</sup> Several of the companies that provided the retainers to counsel were also creditors by virtue of loans made to the debtor prior to bankruptcy when no other source of funding was available.<sup>239</sup> The United States trustee

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231. *Id.* at \_\_\_, 130 S. Ct. at 1380.

232. *Id.* at \_\_\_, 130 S. Ct. at 1380.

233. *Id.* at \_\_\_, 130 S. Ct. at 1380 (citing *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193, 1205 (9th Cir. 2008)).

234. *Id.* at \_\_\_, 130 S. Ct. at 1380.

235. *Id.* at \_\_\_, 130 S. Ct. at 1381 (footnote and citation omitted).

236. 441 B.R. 67, 68 (Bankr. E.D. Va. 2009).

237. *Id.*

238. *Id.*

239. *Id.*

sought to deny counsel's application for compensation on the grounds that counsel was not disinterested under §§ 101(14) and 327(a) as a result of these retainers.<sup>240</sup>

The court held that counsel is not per se prohibited from receiving compensation from a creditor of the debtor.<sup>241</sup> Under § 101(14) of the Bankruptcy Code, which defines a disinterested person, a party cannot hold an interest "materially adverse" to the estate or any class of creditors or equity security holders.<sup>242</sup> In setting this "materially adverse" standard, the court explained that Congress implicitly contemplated that some level of adversity may exist without requiring disqualification.<sup>243</sup> Accordingly, a court should examine the "nexus between the creditor/guarantor making the payment and the debtor itself."<sup>244</sup> Where the creditor paying the fees also is controlling the debtor, and where the personal interests of the creditor likely are to be at odds with the debtor, courts likely will find that counsel is not disinterested.<sup>245</sup> The court noted that the parties that provided the retainers at issue had no means by which they could control the debtor or the debtor's counsel and, therefore, found that the limited adversity that existed did not require the denial of compensation to the debtor's counsel.<sup>246</sup>

In *In re Lewis Road, LLC*, however, the court was not so forgiving of such a conflict.<sup>247</sup> The sole assets of the debtor were two adjoining pieces of property that were encumbered by two liens held by a bank and a limited liability company, respectively.<sup>248</sup> After the tenant leasing the property from the debtor elected not to renew its lease, the tenant and the debtor entered into a settlement agreement to address damage and structural changes to the property.<sup>249</sup> Pursuant to this agreement, \$74,549.18 was to be paid to the junior lienholder to reimburse it for its attorneys' fees

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240. *Id.*

241. *Id.* at 69.

242. 11 U.S.C. § 101(14) (2006).

243. *In re Pinebrook, LLC*, 441 B.R. at 69.

244. *Id.*

245. *See id.*

246. *Id.*

247. No. 09-37672, 2011 WL 6140747, at \*14 (Bankr. E.D. Va. Dec. 9, 2011).

248. *Id.* at \*1.

249. *Id.* at \*2 (footnote omitted).

and costs incurred in connection with the settlement.<sup>250</sup> The court approved this settlement agreement pursuant to Federal Rules of Bankruptcy Procedure, Rule 9019.<sup>251</sup>

Several months after the settlement agreement was approved, the United States trustee informed the court of a conflict between counsel for the debtor and counsel for the junior lienholder.<sup>252</sup> Not only were respective counsel father and son, but they were also members of the same law firm.<sup>253</sup> Counsel for the debtor argued that the conflict was disclosed to the court in its application for employment, that it had received a waiver of any potential conflict from both the debtor and the junior lienholder, and that he did not feel that the conflict was problematic because “everyone was working together to achieve a positive resolution to [the] matter.”<sup>254</sup> The United States trustee then filed a motion under Federal Rules of Civil Procedure, Rule 60(b), as made applicable by Federal Rules of Bankruptcy Procedure, Rule 9024, to amend the settlement agreement to rescind approval of the junior lienholder’s attorneys fees and to require the disgorgement of these funds to the estate.<sup>255</sup>

The court found the disclosure of the potential conflict in counsel’s application for employment to be grossly insufficient.<sup>256</sup> Pursuant to Federal Rules of Bankruptcy Procedure, Rule 2014, counsel was required to disclose any connections with the debtor, creditors, or any other parties in interest.<sup>257</sup> Counsel’s disclosure simply stated that it had “connections with a creditor” and did not elaborate further.<sup>258</sup> The court further found that any purported waiver of the conflict was ineffective without the approval of the court, as counsel must independently satisfy the requirements of § 327.<sup>259</sup> “Any waiver of the conflict required written notice to all parties in interest in the case and the approval of the bankruptcy

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250. *Id.* (citation omitted).

251. *Id.* (footnote omitted).

252. *Id.*

253. *Id.* at \*2–3.

254. *Id.* at \*3 (citations omitted).

255. *Id.* at \*1, \*5.

256. *Id.* at \*9.

257. *Id.* at \*6; FED. R. BANKR. P. 2014(a).

258. *In re Lewis Road, LLC*, 2011 WL 6140742, at \*9.

259. *Id.* at \*10 (citing *In re Wynne Residential Asset Mgmt., LLC*, 62 Collier Bankr. Cas. 2d (MB) 1937, 1944 (Bankr. W.D.N.C. Dec. 18, 2009)).

court.”<sup>260</sup> Having rejected the arguments of debtor’s counsel, the court granted the trustee’s motion under Rule 60(b), found that counsel’s representation of the debtor violated the requirements of § 327(a) and Rule 2014, and required that all moneys received by counsel’s firm in connection with the case be disgorged.<sup>261</sup>

## XI. EXEMPTIONS

When a bankruptcy petition is filed, all of a debtor’s assets become “property of the estate” and subject to creditors’ claims, administration by the trustee, if one is appointed, and oversight by the bankruptcy court.<sup>262</sup> Section 522 of the Bankruptcy Code authorizes a debtor to exempt certain property from the estate within statutorily defined limits.<sup>263</sup> The Federal Rules of Bankruptcy Procedure require a debtor to file a schedule of assets on the Official Form titled “Schedule B” and a list of claimed exemptions on the Official Form titled “Schedule C.”<sup>264</sup> Under Federal Rules of Bankruptcy Procedure, Rule 4003(b), interested parties generally must object to a debtor’s claimed exemptions within thirty days after conclusion of the meeting of creditors that must be held under 11 U.S.C. § 341(a) and Federal Rules of Bankruptcy Procedure, Rule 2003(a).<sup>265</sup> Section 522(l) provides that “[u]nless a party in interest objects, the property claimed as exempt on such list is exempt.”<sup>266</sup>

In *Schwab v. Reilly*, the Supreme Court granted certiorari in an appeal arising from a bankruptcy court decision in Pennsylvania (within the Third Circuit) to resolve a circuit split regarding an interested party’s duty to object to a debtor’s claimed exemption when a debtor lists the value of the exemption on Schedule C

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260. *Id.* (citing *In re Wynne Residential Asset Mgmt., LLC*, 62 Collier Bankr. Cas. 2d (MB) at 1944).

261. *Id.* at \*14 (citations omitted).

262. See 11 U.S.C. § 541(a)(1) (2006) (“[The] estate is comprised of all the following property, wherever located and by whomever held . . . all legal or equitable interests of the debtor in property as of the commencement of the case.”).

263. See generally 11 U.S.C. § 522 (2006).

264. See FED. R. BANKR. P. 1007(b)(1)(A); FED. R. BANKR. P. 4003(a); 11 U.S.C. app. Official Bankr. Form 6B (2006 & Supp. IV 2010); *id.* app. Official Bankr. Form 6C (2006 & Supp. IV 2010).

265. See FED. R. BANKR. P. 4003(b)); FED. R. BANKR. P. 2003(a).

266. 11 U.S.C. § 522(l) (2006).

in an amount equivalent to the amount the debtor listed as the asset's value on Schedule B.<sup>267</sup>

Reilly in *Schwab v. Reilly* was a caterer who filed a Chapter 7 bankruptcy petition and claimed an exemption in cooking and other kitchen equipment that was worth \$10,718, according to her estimate of fair market value as of the petition date.<sup>268</sup> Schwab, the Chapter 7 trustee in Reilly's bankruptcy case charged with liquidating the debtor's assets for the benefit of creditors, did not object to the claimed exemption within the deadline because the amount Reilly claimed as exempt was within the statutory limits.<sup>269</sup> However, an appraisal of the equipment—performed before the objection deadline expired—revealed that it was worth as much as \$17,200.<sup>270</sup> After the deadline to object passed, Schwab moved for authority to auction the equipment and distribute \$10,718 to Reilly on account of her exemption but distribute the remainder to Reilly's creditors.<sup>271</sup> Reilly objected and argued that

by equating on Schedule C the total value of the exemptions she claimed in the equipment with the equipment's estimated market value [i.e., the value Reilly had scheduled on Schedule B as the value of the equipment], she had put Schwab and her creditors on notice that she intended to exempt the equipment's full value, even if that amount turned out to be more than the dollar amount she declared, and more than the Code allowed.<sup>272</sup>

Thus, according to Reilly, Schwab should have, but did not, object to her exemption in time, and the full value of the equipment was exempt.<sup>273</sup> Reilly asserted that her sentimental attachment to the equipment, which was purchased for Reilly by her parents, was so great that she would dismiss her bankruptcy case before allowing the equipment to be sold at auction.<sup>274</sup> The bankruptcy court agreed with Reilly and denied Schwab's motion to auction

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267. See 560 U.S. \_\_\_, 130 S. Ct. 2652, 2659 (2010).

268. *Id.* at \_\_\_, 130 S. Ct. at 2657 (citations omitted).

269. *Id.* at \_\_\_, 130 S. Ct. at 2658 (citations omitted).

270. *Id.* at \_\_\_, 130 S. Ct. at 2658 (footnote omitted).

271. *Id.* at \_\_\_, 130 S. Ct. at 2658 (citation omitted).

272. *Id.* at \_\_\_, 130 S. Ct. at 2658 (citation omitted).

273. *Id.* at \_\_\_, 130 S. Ct. at 2658 (citation omitted).

274. *Id.* at \_\_\_, 130 S. Ct. at 2658. Reilly, in fact, filed a conditional motion to dismiss her case in the event the bankruptcy court granted Schwab's motion to auction the equipment. See *id.* at \_\_\_, 130 S. Ct. at 2659 (citing *In re Reilly*, 403 B.R. 336 (Bankr. M.D. Pa. 2006)).

the equipment, and thereafter, both the district court and the Third Circuit affirmed the bankruptcy court's ruling against Schwab on appeal.<sup>275</sup>

In ruling against Schwab, the Third Circuit construed the Supreme Court's prior decision in *Taylor v. Freeland & Kronz*<sup>276</sup> to stand for the "unstated premise . . . that a debtor who exempts the entire reported value of an asset is claiming the full amount, whatever it turns out to be."<sup>277</sup> The result of the Third Circuit's decision was that Reilly was granted "the equivalent of an in-kind interest in her business equipment, even though the value of that exemption exceeded the amount that Reilly declared on Schedule C and the amount that the Code allowed her to withdraw from the bankruptcy estate."<sup>278</sup>

Reilly argued on appeal that "where, as here, a debtor equates the total value of her claimed exemptions in a certain asset . . . with her estimate of the asset's market value . . . she establishes the 'property claimed as exempt' as the full value of the asset, whatever that turns out to be."<sup>279</sup> Schwab did not dispute that the way Reilly filled out schedules B and C put him on notice that Reilly "equated the total value of her claimed exemptions in the equipment . . . with the equipment's market value."<sup>280</sup> Schwab's essential argument on appeal was that such "identical

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275. See *id.* at \_\_\_, 130 S. Ct. at 2659 (citing *In re Reilly*, 403 B.R. 336; *In re Reilly*, 534 F.3d 173 (3d Cir. 2008)).

276. 503 U.S. 638, 644 (1992) (finding important that the debtor had listed "unknown" for both the value of the asset and the value of the claimed exemption with respect to whether interested parties were on notice for objection purposes of the debtor's intent to exempt the full value of the property).

277. *In re Reilly*, 534 F.3d at 179 (quoting *Allen v. Green* (*In re Green*), 31 F.3d 1098, 1100 (11th Cir. 1994) (internal quotation marks omitted). The Supreme Court repudiated such an interpretation of *Taylor*, explaining first that "[i]n *Taylor*, the question concerned a trustee's obligation to object to the debtor's entry of a 'value claimed exempt' that was not plainly within the limits the Code allows. In this case, the opposite is true." *Schwaab*, 560 U.S. at \_\_\_, 130 S. Ct. at 2666. The Supreme Court then clarified that *Taylor* does not rest on what the Third Circuit described as an "unstated premise:"

*Taylor* does not rest on this premise. It establishes and applies the straightforward proposition that an interested party must object to a claimed exemption if the amount the debtor lists as the "value claimed exempt" is not within statutory limits, a test the value (\$ *unknown*) in *Taylor* failed, and the values (\$8,868 and \$1,850) in this case pass.

*Id.* at \_\_\_, 130 S. Ct. at 2666.

278. *Schwaab*, 560 U.S. at \_\_\_, 130 S. Ct. at 2659 (citing *In re Reilly*, 534 F.3d at 178–79).

279. *Id.* at \_\_\_, 130 S. Ct. at 2661 (citation omitted).

280. *Id.* at \_\_\_, 130 S. Ct. at 2661.

listing [did not] put [him] on notice that Reilly intended to exempt the property fully,' regardless whether its value exceeded the exemption limits the code prescribes."<sup>281</sup> Schwab premised his argument on his contention that "the Code defines the 'property' Reilly claimed as exempt under § 522(l) as an 'interest' whose value cannot exceed a certain dollar amount."<sup>282</sup> Viewing Reilly's schedules in light of these Code provisions, Schwab asserted "that Reilly's claimed exemption was facially unobjectionable because the 'property claimed as exempt' (i.e., two interests in her business equipment worth \$8,868 and \$1,850, respectively) is property Reilly was clearly entitled to exclude from her estate under the Code provisions she referenced [in Schedule C]."<sup>283</sup>

The Supreme Court agreed with Schwab's statutory interpretation and, in a passage that reveals how the Supreme Court approaches statutory construction issues under the Bankruptcy Code, carefully paraded through § 522 to explain its reasoning:

The portion of § 522(l) that resolves this case is not, as Reilly asserts, the provision stating that the "property claimed as exempt on [Schedule C] is exempt" unless an interested party objects. Rather, it is the portion of § 522(l) that defines the target of the objection, namely, the portion that says Schwab has a duty to object to the "list of property that the debtor claims as exempt *under subsection (b)*." That subsection, § 522(b), does *not* define the "property claimed as exempt" by reference to the estimated market value on which Reilly and the Court of Appeals rely. Section 522(b) refers only to property defined in § 522(d), which in turn lists 12 categories of property that a debtor may claim as exempt. As we have recognized, most of these categories (and all of the categories applicable to Reilly's exemptions) define the "property" a debtor may "clai[m] as exempt" as the debtor's "interest"—up to a specified dollar amount—in the assets described in the category, *not* as the assets themselves. Viewing Reilly's form entries in light of this definition, we agree . . . that Schwab had no duty to object to the property Reilly claimed as exempt (two interests in her business equipment worth \$1,850 and \$8,868) because the stated value of each interest, and thus of the "property claimed as exempt," was within the limits the Code allows. . . . The Court of Appeals' contrary holding not only fails to account for the Code's definition of the "property claimed as exempt." It also fails to account for the provisions in § 522(d) that permit debtors to exempt certain property in kind or in full regardless of value. We decline to

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281. *Id.* at \_\_\_, 130 S. Ct. at 2661 (quoting *In re Reilly*, 534 F.3d at 178) (second alteration in original).

282. *Id.* at \_\_\_, 130 S. Ct. at 2661 (citations omitted).

283. *Id.* at \_\_\_, 130 S. Ct. at 2661 (citations omitted).

construe Reilly's claimed exemptions in a manner that elides the distinction between these provisions and provisions such as [those that govern Reilly's exemptions in the equipment], particularly based upon an entry on Schedule C—Reilly's estimate of her equipment's market value—to which the Code does not refer in defining the "property claimed as exempt."<sup>284</sup>

The Supreme Court sided with Schwab and rejected Reilly's arguments because such arguments defined "the target of a trustee's objection—the 'property claimed as exempt'—based on language in Schedule C and dictionary definitions of 'property,' that the definition in the Code itself overrides."<sup>285</sup> The Court also sided with Schwab on policy grounds:

We agree that "exemptions in bankruptcy cases are part and parcel of the fundamental bankruptcy concept of a 'fresh start.'" We disagree that this policy required Schwab to object to a facially valid claim of exemption on pain of forfeiting his ability to preserve for the estate any value in Reilly's business equipment beyond the value of the interest she declared exempt. This approach threatens to convert a fresh start into a free pass.<sup>286</sup>

The majority opinion ended with an instruction guide for debtors who wish to exempt the full fair market value of an asset:

Where, as here, it is important to the debtor to exempt the full market value of the asset or the asset itself, our decision will encourage the debtor to declare the value of her claimed exemption in a manner that makes the scope of the exemption clear, for example, by listing the exempt value as "full fair market value (FMV)" or "100% of FMV." Such a declaration will encourage the trustee to object promptly to the exemption if he wishes to challenge it and preserve for the estate any value in the asset beyond relevant statutory limits. If the trustee fails to object, or if the trustee objects and the objection is overruled, the debtor will be entitled to exclude the full value of the asset. If the trustee objects and the objection is sustained, the debtor will be required either to forfeit the portion of the exemption that exceeds the statutory allowance, or to revise other exemptions or arrangements with her creditors to permit the exemption.<sup>287</sup>

The ultimate outcome in *Schwab*—that an interested party need not object to facially valid exemptions—is consistent with the dissent's admonishment that "forms, rules, treatise excerpts,

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284. *Id.* at \_\_\_, 130 S. Ct. at 2661–63 (internal footnotes and citations omitted).

285. *Id.* at \_\_\_, 130 S. Ct. at 2662 (internal footnote and citation omitted).

286. *Id.* at \_\_\_, 130 S. Ct. at 2667 (internal citations omitted).

287. *Id.* at \_\_\_, 130 S. Ct. at 2668 (internal footnotes and citation omitted).

and policy considerations . . . must be read in light of the Bankruptcy Code provisions that govern this case, and must yield to those provisions in the event of conflict.”<sup>288</sup>

## XII. FINAL ORDERS

In *McDow v. Dudley*, the Fourth Circuit held that an order denying a motion to dismiss a debtor’s Chapter 7 bankruptcy case as abusive under § 707(b) of the Bankruptcy Code is a final and appealable order under 28 U.S.C. § 158(a).<sup>289</sup> In *Dudley*, the debtors filed a petition under Chapter 13 of the Bankruptcy Code, which they subsequently converted to a case under Chapter 7.<sup>290</sup> The United States trustee then filed a motion to dismiss the Chapter 7 case under § 707(b), asserting that the debtors failed to meet the requirements of the means test under § 707(b)(2) and that the debtors’ financial circumstances indicated that they had the ability to repay their creditors under § 707(b)(3).<sup>291</sup> The bankruptcy court denied the trustee’s motion to dismiss the case.<sup>292</sup> The trustee appealed the bankruptcy court’s ruling to the district court, which dismissed the appeal for lack of subject matter jurisdiction holding that the order was not “final” within the meaning of 28 U.S.C. § 158(a)(1).<sup>293</sup>

The Fourth Circuit vacated the district court’s dismissal of the appeal.<sup>294</sup> The court noted that “the concept of finality in bankruptcy cases has traditionally been applied in a more pragmatic and less technical way . . . than in other situations.”<sup>295</sup> The court explained that, “because of the special nature of bankruptcy proceedings, which often involve multiple parties, claims, and procedures,” postponing the review of rulings on discrete issues could waste significant time and judicial resources.<sup>296</sup> Therefore, “or-

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288. *Id.* at \_\_\_, 130 S. Ct. at 2660 n.5 (internal citation omitted).

289. 662 F.3d 284, 289 (4th Cir. 2011).

290. *Id.* at 285.

291. *Id.* at 285–86.

292. *Id.* at 286 (citing *McDow v. Dudley (In re Dudley)*, 405 B.R. 790, 801 (W.D. Va. 2009)).

293. *Id.* (citing *McDow v. Dudley*, 428 B.R. 686, 688–89 (W.D. Va. 2010)).

294. *Id.* at 285.

295. *Id.* at 287 (quoting *Gold v. Guberman (In re Computer Learning Ctrs. Inc.)*, 407 F.3d 656, 660 (4th Cir. 2005) (internal quotation marks and additional citations omitted)).

296. *Id.* at 287 (citing *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir. 1986); *Bourns v. Northwood Props., LLC*, 509 F.3d 15, 21 (1st Cir. 2007)).

ders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case.<sup>297</sup>

The court then held that orders denying motions to dismiss under § 707(b) constitute orders disposing of just such a discrete issue.<sup>298</sup> The court distinguished motions to dismiss under § 707(b) from motions to dismiss under other provisions in the Bankruptcy Code, noting the relatively short time frame within which a motion to dismiss under this section must be filed.<sup>299</sup> Under § 704(b), the United States trustee must review whether a Chapter 7 case is abusive as a mandatory threshold question in every case filed under Chapter 7 and must then file a statement regarding his conclusion within ten days of the meeting of creditors.<sup>300</sup> Other motions to dismiss, in contrast, such as certain motions under § 1112(b) or Federal Rules of Civil Procedure, Rule 12(b), may be brought throughout the bankruptcy case.<sup>301</sup> Given these timelines, the court found that a trustee's motion to dismiss under § 707(b) constitutes a discrete dispute that is finally resolved when a bankruptcy court denies the trustee's motion, thus rendering the court's order appealable under 28 U.S.C. § 158(a)(1).<sup>302</sup>

### XIII. *STERN V. MARSHALL*—POWERS OF THE COURT

By far, the Supreme Court's 2011 decision in *Stern v. Marshall*<sup>303</sup> (authored by Chief Justice Roberts) has garnered more attention from the bankruptcy bench and bar than any other decision from any court in recent years.<sup>304</sup> This is because *Stern* marks the first time in the past thirty years that the Supreme Court has addressed the constitutionality of the bankruptcy judicial system in the United States, and the Supreme Court's *Stern* decision, some might argue, drastically limits a bankruptcy

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297. *Id.* (citing *In re Computer Learning Ctrs. Inc.*, 407 F.3d at 660).

298. *Id.* at 290.

299. *Id.* at 289.

300. *Id.* at 288 (citing 11 U.S.C. § 704(b)(1)(A) (2006 & Supp. IV 2010)).

301. *See id.* at 289.

302. *Id.*

303. 564 U.S. \_\_\_, 131 S. Ct. 2594 (2011).

304. *See* Katie Drell Grissel, *Stern v. Marshall—Digging for Gold and Shaking the Foundation of Bankruptcy Courts (or Not)*, 72 LA. L. REV. 647, 648 (2012).

judge's constitutional authority to adjudicate causes of action the debtor may have against creditors or other parties.<sup>305</sup>

The procedural history of *Stern*, which arose from the bankruptcy case of Anna Nicole Smith, is quite complicated—in fact, the Supreme Court likened it to the Jarndyce suit in Charles Dickens's *Bleak House*.<sup>306</sup> It suffices to understand that Anna Nicole filed a bankruptcy petition in California; the son of Anna Nicole's late husband filed a complaint and proof of claim in Anna Nicole's bankruptcy case asserting that Anna Nicole and her lawyers had defamed him; and Anna Nicole filed a counterclaim against the son for tortious interference, alleging that the son fraudulently induced Anna Nicole's late husband (one of the richest men in Texas) to exclude Anna Nicole from his living trust and will.<sup>307</sup> Though *Stern* involves other interesting issues, the most noteworthy issue in *Stern* was whether the bankruptcy court had statutory and constitutional authority to enter a final judgment on Anna Nicole's counterclaim.<sup>308</sup>

With regard to the bankruptcy court's statutory authority, the Supreme Court had to decide whether Anna Nicole's counterclaim was a "core" matter under 28 U.S.C. § 157, which authorizes district courts to refer bankruptcy matters to bankruptcy courts and authorizes a bankruptcy court to enter final judgments on "core" matters and to submit proposed findings and conclusions to the district court on non-core matters.<sup>309</sup> Because Anna Nicole's counterclaim was a "counterclaim[] by the estate against persons filing claims against the estate," it was a "core" proceeding under 28 U.S.C. § 157(b)(2)(C).<sup>310</sup> The son argued that the bankruptcy court nonetheless was not statutorily authorized to enter a final judgment on Anna Nicole's counterclaim because 28 U.S.C. § 157 could be read to allow "a bankruptcy judge [to] enter a final judgment on a core proceeding only if that proceeding also

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305. See *Med. Educ. & Health Servs., Inc. v. Indep. Mayaguez (In re Med. Educ. & Health Servs., Inc.)*, 459 B.R. 527, 548 (Bankr. D.P.R. 2011).

306. *Stern*, 564 U.S. at \_\_\_, 131 S. Ct. at 2600 (citing Charles Dickens, *Bleak House*, in 1 WORKS OF CHARLES DICKENS 4–5 (1891)).

307. *Id.* at \_\_\_, 131 S. Ct. at 2601 (citations omitted).

308. See *id.* at \_\_\_, 131 S. Ct. at 2604–05, 2608.

309. *Id.* at \_\_\_, 131 S. Ct. at 2603, 2604 (quoting 11 U.S.C. §§ 157(b)(1), (2)(C), (2006)) (footnote omitted).

310. *Id.* at \_\_\_, 131 S. Ct. at 2604 (quoting 28 U.S.C. § 157(b)(2)(C)) (internal quotation marks omitted).

'aris[es] in' a Title 11 case or 'aris[es] under' Title 11 itself."<sup>311</sup> The Supreme Court rejected that argument and held that there is no such thing as a core matter that neither arises under Title 11 nor arises in a case under a Title 11 of the United States Code, which was the erroneous assumption underpinning the son's interpretation of 28 U.S.C. § 157.<sup>312</sup> Rather, the Supreme Court explained that a core matter must be an "arising" proceeding.<sup>313</sup>

Although the Supreme Court held that the bankruptcy court had statutory authority over Anna Nicole's counterclaim, it nonetheless held that the bankruptcy court lacked constitutional authority over the counterclaim under separation of powers principles.<sup>314</sup> The Supreme Court started its constitutional analysis by explaining that Article III, Section 1 of the United States Constitution provides that the "judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish."<sup>315</sup> The judges of Article III courts "shall hold their Offices during good Behavior' and 'receive for their Services[] a Compensation[] [that] shall not be diminished' during their tenure."<sup>316</sup> The Supreme Court further explained that

[U]nder "the basic concept of separation of powers . . . that flow[s] from the scheme of a tripartite government" adopted in the Constitution, "the 'judicial power of the United States' . . . can no more be shared" with another branch than "the Chief Executive, for example, can share with the Judiciary the veto power, or the Congress share with the Judiciary the power to override a Presidential veto."<sup>317</sup>

Applying separation of powers principles, the Supreme Court held that the bankruptcy court's exercise of "judicial power" over Anna Nicole's counterclaim was unconstitutional because, among other reasons, a bankruptcy judge is not an Article III judge—

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311. *Id.* at \_\_\_, 131 S. Ct. at 2604 (second and third alterations in original).

312. *See id.* at \_\_\_, 131 S. Ct. at 2604–05.

313. *Id.* at \_\_\_, 131 S. Ct. at 2605 ("[C]ore proceedings are those that arise in a bankruptcy case or under Title 11.").

314. *See id.* at \_\_\_, 131 S. Ct. at 2608 (quoting *N. Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 58 (1982) (plurality opinion); U.S. Const. art. III).

315. *See id.* at \_\_\_, 131 S. Ct. at 2608 (citation omitted).

316. *See id.* at \_\_\_, 131 S. Ct. at 2608 (alterations in original) (citation omitted).

317. *Id.* at \_\_\_, 131 S. Ct. at 2608 (quoting *United States v. Nixon*, 418 U.S. 683, 704 (1974)) (alterations in original).

bankruptcy judges “enjoy neither tenure during good behavior nor salary protection.”<sup>318</sup> The Supreme Court ultimately held that

Article III of the Constitution provides that the judicial power of the United States may be vested only in courts whose judges enjoy the protections set forth in that Article. We conclude today that Congress, in one isolated respect, exceeded that limitation in the Bankruptcy Act of 1984. The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim.<sup>319</sup>

Bankruptcy, district, and circuit courts continue to grapple with *Stern*’s impact, and clear consensus on *Stern*’s reach has not yet emerged.

#### XIV. LIENS AND SECURITY INTERESTS

In *SunTrust Bank, N.A. v. Macky (In re McCormick)*, the Fourth Circuit addressed the strong arm powers of a bankruptcy trustee under § 544.<sup>320</sup> The debtors owned two contiguous tracts of land (“Tract I” and “Tract II”), on which SunTrust held deeds of trust.<sup>321</sup> While SunTrust properly recorded its lien on Tract II in the Parcel Identifier Number (“PIN”) Index used as the official real property recording index in Orange County, North Carolina, it failed to properly record its lien on Tract I.<sup>322</sup> The bankruptcy trustee sought to avoid the lien held by SunTrust on Tract I under § 544(a)(3) because a search of the index on the petition date would not have disclosed the existence of SunTrust’s lien as the lien had not been properly recorded on the PIN Index.<sup>323</sup> SunTrust argued that the trustee had constructive knowledge of the lien because a competent title searcher would have reviewed the deed of trust on Tract II and found reference to SunTrust’s lien on Tract I and would have found reference to the lien on Tract I in the unofficial grantor/grantee index also maintained by Orange County.<sup>324</sup>

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318. *See id.* at \_\_\_, 131 S. Ct. at 2601, 2608.

319. *See id.* at \_\_\_, 131 S. Ct. at 2620.

320. *See* 669 F.3d 177, 178 (4th Cir. 2012).

321. *Id.*

322. *Id.* at 179.

323. *Id.*

324. *Id.*

The court held that, under § 544(a)(3), the trustee's ability to avoid the lien is determined by whether "a bona fide purchaser of the property would have taken the property subject to the lien" under state law.<sup>325</sup> A trustee, therefore, is imputed only with the knowledge of a bona fide purchaser under state law without regard to any actual knowledge of the trustee.<sup>326</sup> Analyzing North Carolina's recording system, the court concluded that under North Carolina law, if a prior lien is not recorded properly, a subsequent purchaser can take the property as if no lien exists even if the purchaser has actual knowledge that an earlier lien has been created.<sup>327</sup> The Court thus held that any constructive knowledge held by the trustee was irrelevant.<sup>328</sup> As the lien was not properly recorded on the PIN Index, under North Carolina law the trustee's status as a hypothetical bona fide purchaser permitted him to avoid SunTrust's lien.<sup>329</sup>

In *Botkin v. DuPont Community Credit Union*, the debtor owned residential property with a market value of \$22,500 subject to a purchase money deed of trust in the amount of \$24,124 and a judicial lien in the amount of \$9800.<sup>330</sup> Although the debtor had \$2777 in remaining homestead exemptions under Virginia Code section 34-14, she did not claim a homestead exemption for any portion of her real property.<sup>331</sup> The debtor filed a motion to avoid the judicial lien under § 522(f).<sup>332</sup> The bankruptcy court denied the debtor's motion on the ground that the debtor must actually claim an exemption to avoid a judicial lien under § 522(f).<sup>333</sup> On appeal, the district court reversed the decision of the bankruptcy court, holding that the debtor need not actually claim an exemption to utilize § 522(f).<sup>334</sup> The judicial lien creditor, DuPont Community Credit Union, appealed the district court's reversal to the Fourth Circuit.<sup>335</sup>

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325. *Id.* at 180 (quoting 11 U.S.C. § 544(a)(3) (2006)).

326. *Id.*

327. *Id.* at 181, 182 (quoting *Hill v. Pinelawn Mem'l Park, Inc.*, 282 S.E.2d 779, 782 (N.C. 1981); *Turner v. Glenn*, 18 S.E.2d 197, 201 (N.C. 1942)).

328. *See id.* at 183.

329. *Id.* at 184.

330. 650 F.3d 396, 397 (4th Cir. 2011).

331. *Id.*

332. *Id.*

333. *Id.* at 398.

334. *Id.*

335. *Id.*

Section 522 provides that a “debtor may avoid the fixing of a [judicial] lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled.”<sup>336</sup> A lien impairs an exemption

to the extent that the sum of (i) the lien; (ii) all other liens on the property; and (iii) the amount of the exemption that the debtor could claim if there were no liens on the property; exceeds the value that the debtor’s interest in the property would have in the absence of any liens.<sup>337</sup>

Dupont conceded that this mathematical test set forth in § 522(f)(2) was satisfied.<sup>338</sup>

Analyzing the plain language of the statute, the court affirmed the ruling of the district court that a debtor need not actually claim an exemption to avail itself of § 522(f).<sup>339</sup> The court noted that the language of § 522(f)(2) refers to “the amount of the exemption that the debtor *could claim* if there were no liens on the property . . . [thus reflecting] § 522’s focus not on any actual claim of exemption, but rather on the hypothetical exemption that the debtor would have been entitled to in the absence of the lien.”<sup>340</sup> Accordingly, debtors do not need to claim an exemption as a precondition of avoiding a lien under § 522(f).<sup>341</sup>

The court in *Pierce v. New Generations Federal Credit Union* (*In re Pierce*) addressed whether Chapter 13 debtors may strip off a lien that had been treated as fully secured in the debtors confirmed plan.<sup>342</sup> The debtors’ real property was encumbered by two liens held by Bank of America and New Generations Federal Credit Union, respectively.<sup>343</sup> The debtors’ confirmed plan elected to treat both liens as fully secured.<sup>344</sup> After confirmation, however, the debtors filed an adversary proceeding seeking to strip off the second priority lien held by New Generations.<sup>345</sup>

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336. *Id.* at 397–98 (quoting 11 U.S.C.A. § 522(f)(1) (West 2004 & Supp. 2010)).

337. *Id.* at 399 (citing 11 U.S.C.A. § 522(f)(2)(A) (West 2004 & Supp. 2010)).

338. *Id.*

339. *Id.* at 400.

340. *Id.* (internal citation and footnote omitted).

341. *Id.*

342. Nos. 10-35404-KRH, APN 11-03288-KRH, 2012 WL 1903263, at \*1 (Bankr. E.D. Va., May 24, 2012).

343. *Id.*

344. *Id.* at \*3.

345. *Id.* at \*1.

While finding that the amount of the first lien exceeded the value of the debtors' property and that New Generations' lien therefore was completely unsecured, the court nevertheless dismissed the debtors' adversary proceeding because the confirmed Chapter 13 plan did not propose to modify New Generations' lien.<sup>346</sup> The court held that while § 506(d) provides that a lien is void to the extent that it does not secure a claim against a debtor that is an allowed secured claim, this section is not self-executing.<sup>347</sup> Rather, the authority to avoid a lien comes through § 1322(b)(2) and the plan confirmation process.<sup>348</sup> The court thus found that a debtor only may pursue an adversary proceeding to avoid a lien after confirmation of a Chapter 13 plan allowing for the modification.<sup>349</sup> Additionally, the court held that the Chapter 13 plan's treatment of New Generations' claim as fully secured had *res judicata* effect that prevented the modification of the lien.<sup>350</sup> Finding that plan confirmation was a final judgment binding both the debtors and New Generations to the terms of the plan, the court concluded that the debtors could not initiate an adversary proceeding to strip the lien unless the debtors first proposed to do so in a modified plan.<sup>351</sup>

In *In re Nguyen*, a creditor opposed the debtor's attempts to avoid a judgment lien pursuant to § 522(f) on the ground that the debtor did not have equity in the property, citing the case of *In re Sheaffer*.<sup>352</sup> The court rejected this argument, holding that the 1994 amendment to § 522(f), which added the mathematical formula for calculating whether a lien would impair an exemption to which the debtor would be entitled, was specifically enacted to permit a debtor to avoid a judicial lien on property in which the

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346. *Id.* at \*1, \*3, \*4 (citing *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992); *Ryan v. Homecomings Fin. Network*, 253 F.3d 778, 779 (4th Cir. 2001)).

347. *Id.* at \*3.

348. *Id.*

349. *Id.*

350. *Id.* (citations omitted).

351. *Id.*

352. No. 11-15308-BFK, 2011 WL 4915884, at \*1 (Bankr. E.D. Va. Oct. 17, 2011) (citing *Sheaffer v. Marshall Nat'l Bank & Trust Co.* (*In re Sheaffer*), 159 B.R. 758, 760 (Bankr. E.D. Va. 1993), *superseded by statute*, Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 22).

debtor lacks equity.<sup>353</sup> The earlier decision in *In re Sheaffer* was thus overruled and is no longer applicable.<sup>354</sup>

In *Peterson v. United BankShares, Inc. (In re Peterson)*, the Chapter 13 debtor sought to strip off a second priority lien on the debtor's primary residence held by United Bank, alleging that there was no equity in the property to which the lien could attach.<sup>355</sup> While the parties agreed that the balance of the first lien was \$864,395.35, they disagreed with respect to the value of the property.<sup>356</sup> After weighing the valuation evidence presented by both parties, the court determined that the property had a value of \$880,000 and, thus, that the debtor had approximately \$15,600 equity in the property.<sup>357</sup>

The court noted that while a debtor may avoid a lien on property that is not supported by any equity, § 1322(b)(2) prohibits a court from modifying the rights of a creditor secured by a security interest in the debtor's principal residence.<sup>358</sup> This prohibition includes bifurcating a partially secured claim into secured and unsecured components.<sup>359</sup> Accordingly, the court held that "a deed of trust that is supported by even \$1.00 of equity cannot be modified."<sup>360</sup>

In *Radlax Gateway Hotel, LLC v. Amalgamated Bank*, the Supreme Court was called upon to determine whether a debtor may cram down a Chapter 11 plan that proposes to sell free and clear the encumbered assets of a secured creditor without giving the creditor a right to credit bid.<sup>361</sup> The debtors, owner of the Radisson Hotel at the Los Angeles International Airport, filed a Chapter 11 plan proposing to dissolve and to sell substantially all of its assets through an auction.<sup>362</sup> The plan also provided that the secured creditor could not use its debt to offset the purchase price and

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353. *Id.* at \*1–2 (quoting H.R. REP. NO. 103-835, at 52–54 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3361–62).

354. *See id.* at \*2–5.

355. 64 Collier Bankr. Cas. 2d (MB) 1667, 1667 (Bankr. E.D. Va. 2011).

356. *Id.* at 1668.

357. *Id.* at 1670–71.

358. *Id.* (citing 11 U.S.C. § 1322(b)(2) (2006); *Nobleman v. Am. Sav. Bank*, 508 U.S. 324 (1993)).

359. *Id.* at 1670 (citing 11 U.S.C. § 1322(b)(2); *Nobleman*, 508 U.S. 432).

360. *Id.* at 1671.

361. 566 U.S. \_\_\_, \_\_\_, 132 S. Ct. 2065, 2068 (2012).

362. *Id.* at \_\_\_, 132 S. Ct. at 2068, 2069.

must pay cash should it wish to bid on its assets.<sup>363</sup> The debtors sought to confirm this plan over the secured creditor's objection under § 1129(b)(2)(A).<sup>364</sup>

Under § 1129(b)(2)(A), a plan is "fair and equitable" with respect to a dissenting secured creditor if the plan provides that: (i) the creditor either retains its lien and receives deferred cash payments totaling at least the allowed amount of its claim; (ii) the property is sold free and clear of the creditor's lien with the creditor to receive a replacement lien on the proceeds of the sale, subject to the creditor's right to credit bid set forth in § 363(k); or (iii) the creditor will realize the "indubitable equivalent" of its claim.<sup>365</sup> The debtors sought to confirm the plan under § 1129(b)(2)(A)(iii), asserting that the creditor would receive the "indubitable equivalent" of its claim in the form of cash generated by the auction.<sup>366</sup>

The Court held that the debtors' plan must permit the creditor the right to credit bid at the sale of its encumbered assets.<sup>367</sup> The Court stated that well-established principles of statutory interpretation hold "that the specific governs the general," particularly where "Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions."<sup>368</sup> Looking at the statute in question, the court found that "clause (ii) is a detailed provision that spells out the requirements for selling collateral free of liens, while clause (iii) is a broadly worded provision that says nothing about such a sale."<sup>369</sup> Although clause (iii) may be broad enough to include the issue at hand, clause (iii) "will not be held to apply to a matter specifically dealt with' in clause (ii)."<sup>370</sup> Accordingly, as clause (ii) squarely addresses plans under which the property is sold free and clear of a credi-

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363. *Id.* at \_\_\_, 132 S. Ct. at 2069. Offsetting one's debt against the purchase price of such property is known as "credit bidding." *Id.* at \_\_\_, 132 S. Ct. at 2069.

364. *Id.* at \_\_\_, 132 S. Ct. at 2069.

365. *Id.* at \_\_\_, 132 S. Ct. at 2070 (citing 11 U.S.C. § 1329(b)(2)(A) (2006)).

366. *Id.* at \_\_\_, 132 S. Ct. at 2070 (internal quotation marks omitted).

367. *Id.* at \_\_\_, 132 S. Ct. at 2073.

368. *Id.* at \_\_\_, 132 S. Ct. at 2070–71 (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992)) (internal quotation marks omitted) (citing *Varity Corp. v. Howe*, 516 U.S. 489, 519 (1996) (Thomas, J., dissenting)).

369. *Id.* at \_\_\_, 132 S. Ct. at 2071.

370. *Id.* at \_\_\_, 132 S. Ct. at 2071–72 (quoting *D. Ginsburg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208 (1932)).

tor's lien, the debtor may not apply the catchall provision in clause (iii) to deny the creditor the right to credit bid.<sup>371</sup>

The debtors in *In re Martin* owned residential real property with a value of \$62,052.60 subject to a claim in the amount of \$132,429.97 secured by a deed of trust on both the real property and the debtor's interest in an escrow account.<sup>372</sup> Asserting that the anti-modification provisions of § 1322(b)(2) did not apply because the debtors' property was secured by an interest in both their primary residence and the escrow account, the debtors filed a Chapter 13 plan seeking to bifurcate the secured loan, to reamortize \$2527.17 in pre-petition mortgage arrears, and to reamortize the secured portion of the loan over a term of 108 months at 3.5 percent interest.<sup>373</sup>

The court found that the secured creditor's lien on the debtors' interest in the escrow account caused the claim to not be "secured only by a security interest in real property that is the debtor's principal residence," and that the anti-modification provision of § 1322(b)(2) did not apply.<sup>374</sup> The court nevertheless denied confirmation of the debtors' plan.<sup>375</sup> While the debtors could bifurcate the secured creditor's claim, the debtors only could extend payments on the secured portion of the claim beyond the life of the plan if the plan provided for the curing of any default within a reasonable time and the maintenance of payments while the case was pending.<sup>376</sup> The debtors' proposed plan sought to cure the default by reamortizing the pre-petition arrearage over 108 months, which the court concluded was not within a reasonable time.<sup>377</sup> The court further held that if the debtors sought to modify the terms of the loan with the secured creditor, the full amount of the secured portion of the loan must be paid over the life of the plan.<sup>378</sup> Should the debtors seek to extend payments of the se-

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371. *Id.* at \_\_\_, 132 S. Ct. at 2072.

372. 444 B.R. 538, 541-42 (Bankr. M.D.N.C. 2011).

373. *Id.*

374. *Id.* at 543 (quoting 11 U.S.C. § 1322(b)(2) (2006)) (internal quotation marks omitted).

375. *See id.*

376. *Id.* at 543-44 (citing *In re Plourde*, 402 B.R. 488, 491 (Bankr. D.N.H. 2009); *In re Veliz*, No. 08-13292, 2009 WL 3418638, at \*1 (Bankr. D.R.I. Oct. 16, 2009)).

377. *Id.* at 542, 543.

378. *Id.* (citing *In re Hayes*, No. 10-81248C-13D, 2011 WL 249450 (Bankr. M.D.N.C. Jan. 24, 2011); *In re Valdes*, No. 09-26712-BKC-AJC, 2010 WL 3956814, at \*4 (Bankr. S.D. Fla. Oct. 4, 2010); *In re Plourde*, 402 B.R. at 491; *In re McGregor*, 172 B.R. 718, 721

cured debt past the conclusion of the plan, the debtors would have to do so with the terms and interest rate set forth in the original mortgage agreement.<sup>379</sup>

## XV. NON-DEBTOR RELEASES

Chapter 11 debtors and their professionals, officers, directors, and affiliates often seek a release of liability in any proposed Chapter 11 plan—these releases are referred to as “non-debtor releases.” The Fourth Circuit had occasion in *Behrmann v. National Heritage Foundation, Inc.*, to confirm that non-debtor releases are not per se impermissible under the Bankruptcy Code (although such releases “should be granted cautiously and infrequently”) and to provide guidance to bankruptcy and district courts regarding the standards for approval of such non-debtor releases.<sup>380</sup>

The Fourth Circuit first reaffirmed its prior decision arising out of the A.H. Robins bankruptcy case (which resulted from A.H. Robins’s mass tort liability for the Dalkon Shield contraception device) approving non-debtor releases under § 524(e) of the Bankruptcy Code: “[W]e have rejected the notion that 11 U.S.C. § 524(e) forecloses bankruptcy courts from releasing and enjoining causes of action against nondebtors. . . . [In *A.H. Robins*,] we permitted the bankruptcy court to enjoin [suits against nondebtors] on grounds of equity.”<sup>381</sup> Next, the court explained that

a bankruptcy court need not find a precise fit between the circumstances found in *A.H. Robins* and the case before it as a precondition to granting equitable relief. Rather, whether a court should lend its aid in equity to a Chapter 11 debtor will turn on the particular facts and circumstances of the case . . . .<sup>382</sup>

To aid bankruptcy and district courts in evaluating whether the facts and circumstances of a given case supported approval of non-debtor releases, the Fourth Circuit endorsed the standards

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(Bankr. D. Mass. Oct. 21, 1994) (footnote omitted).

379. *Id.* (citing *In re Veliz*, 2009 WL 3418638, at \*1).

380. 663 F.3d 704, 712 (4th Cir. 2011) (citing *Deutsche Bank AG v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 142 (2d Cir. 2005); *Lacy v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 657–58 (6th Cir. 2002); *Gillman v. Cont’l Airlines* (*In re Cont’l Airlines*), 203 F.3d 203, 212–13 (3d Cir. 2000)).

381. *Id.* at 710 (citing *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 850 F.2d 694, 701 (4th Cir 1989) (conferring equitable powers on court)).

382. *Id.* at 711.

set forth in two other decisions: the Sixth Circuit's decision in *In re Dow Corning Corp.*<sup>383</sup> and the Bankruptcy Court for the District of Maryland's decision in *In re Railworks Corp.*<sup>384</sup> The Fourth Circuit explained that "we are satisfied to leave to a bankruptcy court the determination of which factors may be relevant in a specific case . . . ."<sup>385</sup> However, the Fourth Circuit admonished bankruptcy and district courts that they must "make specific factual findings in support of [the] decision to grant equitable relief."<sup>386</sup> In *National Heritage*, the bankruptcy court had not made sufficient factual findings, and the Fourth Circuit remanded for the bankruptcy court to make additional findings.<sup>387</sup>

## XVI. PROPERTY OF THE ESTATE

A big issue for consumer debtors is what will happen to their vehicles if they file bankruptcy. The Fourth Circuit in *DaimlerChrysler Financial Services Americas, LLC v. Jones (In re Jones)*,<sup>388</sup> clarified this issue, at least with respect to the proce-

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383. *Id.* at 711–12 (quoting *In re Dow Corning Corp.*, 280 F.3d at 658). The *Dow Corning* factors are:

- (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;
- (2) The non-debtor has contributed substantial assets to the reorganization;
- (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;
- (4) The impacted class, or classes, has overwhelmingly voted to accept the plan;
- (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
- (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and;
- (7) The bankruptcy court made a record of specific factual findings that support its conclusions.

*In re Dow Corning Corp.*, 280 F.3d at 658 (citing *In re A.H. Robins*, 880 F.2d at 7901–02; *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 92–94 (2d Cir. 1988); *In re Conti'l Airlines*, 203 F.3d at 214).

384. *Nat'l Heritage Found. Inc.*, 663 F.3d at 712 (citing *Hoge v. Moore (In re Railworks Corp.)*, 345 B.R. 529, 536 (Bankr. D. Md. 2006)). The *Railworks Corp.* factors are:

- (1) overwhelming approval for the plan;
- (2) a close connection between the causes of action against the third party and the causes of action against the debtor;
- (3) that the injunction is essential to the reorganization; and
- (4) that the plan of reorganization provides for payment of substantially all of the claims affected by the injunction.

*See id.* (citing *In re Railworks Corp.*, 345 B.R. at 536).

385. *Id.*

386. *Id.*

387. *See id.* at 713.

388. 591 F.3d 308 (4th Cir. 2010).

dural hurdles a debtor must meet to retain his car in bankruptcy. If a debtor intends to retain the car, §§ 362(h) and 521(a)(6) of the Bankruptcy Code require a debtor to file a statement of intention setting forth either the intent to reaffirm the debt in a reaffirmation agreement under 11 U.S.C. § 524(c) or the intent to redeem the property by paying off the full amount of the lien under 11 U.S.C. § 722.<sup>389</sup> Before BAPCPA was enacted in 2005, the Fourth Circuit had recognized a third, so-called “ride-through” option: even if a debtor did not reaffirm or redeem, the “ride-through option permitted Chapter 7 debtors who were current on their installment payments to continue making payments and retain collateral after discharge . . . .”<sup>390</sup>

In *Jones*, the debtor, Mr. Jones, filed a statement indicating that he would continue making his car payments but did not indicate whether or not he intended to reaffirm or redeem the debt.<sup>391</sup> Jones also did not timely redeem the car or execute a reaffirmation agreement, and the bankruptcy court entered an order at the lender’s request confirming that the automatic stay had terminated so that the lender could repossess the vehicle based on the default caused by the debtor’s bankruptcy filing (i.e., a default under an ipso facto provision).<sup>392</sup> After entry of that order, the lender repossessed the vehicle.<sup>393</sup>

Jones and his wife (who was not a joint debtor but was a co-owner of the vehicle with Jones) filed a lawsuit against the lender in the bankruptcy court and obtained an injunction against the sale of the vehicle and providing for the return of the vehicle to the Joneses.<sup>394</sup> The bankruptcy court, relying on the “ride-through” option under which a Chapter 7 debtor like Jones may keep the vehicle so long as payments remain current, held that the lender had no right to repossess the vehicle even though Jones did not timely reaffirm the debt or redeem the vehicle by paying off the liens in full.<sup>395</sup> The lender appealed to the district court and won: the district court held that BAPCPA eliminated

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389. *Id.* at 309 & n.1 (citing 11 U.S.C. §§ 362(h), 521(a)(2), 524(c), 722 (2006)).

390. *Id.* at 310 (citing *Home Owners Funding Corp. of Am. v. Belanger (In re Belanger)*, 962 F.2d 345, 347–49 (4th Cir. 1992)).

391. *Id.* at 309.

392. *Id.* at 310.

393. *Id.*

394. *Id.*

395. *Id.* (citing *In re Belanger*, 962 F.2d at 347–49).

the ride-through option.<sup>396</sup> The lender won again at the Fourth Circuit; the Fourth Circuit agreed that BAPCPA abrogated the Fourth Circuit's prior ruling in *Belanger* that endorsed the ride-through option.<sup>397</sup>

The Fourth Circuit's analysis is straightforward and based on the plain language of the applicable Bankruptcy Code sections as they exist after BAPCPA. First, the court explained why it had endorsed the ride-through option before BAPCPA:

*In re Belanger* analyzed the language of former § 521(2)(A), which required a debtor to file a statement of intention which, "if applicable," indicated the debtor's intent to either redeem the collateral or reaffirm the debt secured by the collateral. We interpreted the language "if applicable" to mean that the options of redeeming or reaffirming were not exclusive and, therefore, the property could ride through the bankruptcy unaffected if the debtor chose to retain the property and continue making payments.<sup>398</sup>

Next, the court explained that, while BAPCPA did not effect material changes to former § 521(2)(A), BAPCPA did introduce changes in other sections with a significant impact on the analysis: "[F]ormer § 521(2)(C) has been amended as follows: 'nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title, *except as provided in section 362(h)*.'"<sup>399</sup> Section 362(h) in turn provides in relevant part that the debtor must, "if retaining such personal property [e.g., a vehicle], either redeem such personal property . . . [or] enter into [a reaffirmation] agreement . . . ."<sup>400</sup> Section 362(h) also provides that if a debtor fails to file the required statement of intention, the stay terminates, and the property is no longer property of the estate.<sup>401</sup>

In addition, the Fourth Circuit pointed out an entirely new section added by BAPCPA that impacts the analysis:

Section 521(a)(6), added by BAPCPA, also evidences that the ride-through option has been eliminated. That section provides that a

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396. *Id.* (citing Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23; Daimler Chrysler Fin. Servs., Ams. LLC v. Jones (*In re Jones*), 397 B.R. 775, 787 (Bankr. S.D. W. Va. 2008).

397. *Id.* at 311-12 (citing *Santos v. United States*, 461 F.3d 886, 891 (7th Cir. 2006)).

398. *Id.* at 311 (citing *In re Belanger*, 962 F.2d at 345-47).

399. *Id.* (quoting 11 U.S.C. § 521(a)(2)(C) (2006)).

400. 11 U.S.C. § 362(h)(1)(A) (2006).

401. *Id.*

debtor may not retain possession of personal property which is subject to a secured claim unless the debtor either reaffirms the debt or redeems the property, according to the debtor's statement of intention required by §§ 521(a)(2) and 362(h), within 45 days of the first meeting of creditors. This section further provides that if the debtor fails to so act within the 45-day period, the stay is terminated, the property is no longer considered part of the estate, and "the creditor may take whatever action as to such property as is permitted by applicable nonbankruptcy law."<sup>402</sup>

Thus, after BAPCPA and the Fourth Circuit's decision in *Jones*, an individual debtor in the Fourth Circuit has three options when it comes to a vehicle: (i) surrender it; (ii) keep it by paying off the liens in full; or (iii) enter into a reaffirmation agreement with the secured creditor.

## XVII. PRO SE ACTIONS

It is widely accepted that courts will afford pro se parties considerable leeway when enforcing pleading and other procedural requirements. As recognized by the United States District Court for the Eastern District of Virginia in *Stewart v. HSBC Bank, USA*, however, this deference is not unlimited.<sup>403</sup> In *Stewart*, the pro se plaintiff filed a seventy-nine page complaint containing full copies of court documents, generally incomprehensible allegations, and very few facts.<sup>404</sup> Noting the Supreme Court's requirements in *Bell Atlantic Corp. v. Twombly* that a pleading contain "a short and plain statement of the claim showing that the pleader is entitled to relief" and more than "unadorned accusation[s],"<sup>405</sup> the court found the plaintiff's complaint to be woefully inadequate and dismissed the case.<sup>406</sup> "While *pro se* actions are to be generously construed," the court stated, "federal courts are not required to 'conjure up questions never squarely presented to them.'"<sup>407</sup>

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402. *In re Jones*, 591 F.3d at 311 (quoting 11 U.S.C. § 521(a)(7) (2006)).

403. No. 3:10CV586, 2010 WL 3522087, at \*1 (E.D. Va. Sept. 3, 2010).

404. *Id.*

405. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (citing FED. R. CIV. P. 8(a)(2)).

406. *Stewart*, 2010 WL 3522087, at \*1, \*3 (citations omitted).

407. *Id.* at \*1 (quoting *Beaudett v. Hampton*, 775 F.2d 1274, 1278 (4th Cir. 1985)).

## XVIII. SINGLE ASSET REAL ESTATE

In *In re Light Foot Group LLC*, the Bankruptcy Court for the District of Maryland held that a debtor that owned several contiguous parcels of property containing seventeen housing units of varying types was a single asset real estate entity as defined by § 101(51B) of the Bankruptcy Code.<sup>408</sup> Section 101(51B) states:

The term "single asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.<sup>409</sup>

The debtor argued that the property did not qualify as single asset real estate because it had differing intended future uses for each parcel of property, because none of the buildings on the property contained more than four units, and because the debtor also operated an affiliate company on the property that performed repair work on the buildings.<sup>410</sup>

The court rejected each of the debtor's arguments.<sup>411</sup> First, the court found that the only discussion of the various parcels in the debtor's plan of reorganization and cash flow projections attached to the disclosure statement regarded rental income derived from the property and did not indicate any other current or future intended uses for the parcels.<sup>412</sup> The court concluded that the only business of the debtor was the generation of rental income from a single property.<sup>413</sup> Next, the court disagreed with the debtor's interpretation of § 101(51B), finding that the phrase "real property constituting a single property or project," other than residential real property with fewer than four residential units, requires only that the property as a whole contain four or more residential units.<sup>414</sup> Finally, the court dismissed the debtor's argument that the presence of its affiliated company on the property removes the

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408. 66 Collier Bankr. Cas. 2d (MB) 1626, 1630-31 (Bankr. D. Md. 2011).

409. 11 U.S.C. § 101(51B) (2006 & Supp. IV 2010).

410. *In re Light Foot Group LLC*, 66 Collier Bankr. Cas. 2d (MB) at 1629-30.

411. *Id.*

412. *Id.* at 1629.

413. *Id.*

414. *Id.* at 1629-30 (quoting 11 U.S.C. § 101(51B)) (internal quotation marks omitted).

debtor from single asset real estate status.<sup>415</sup> The court found that this affiliate, which was engaged in the repair and installation of HVAC systems, performed work for the debtor that was required to meet the debtor's obligations as a landlord and, therefore, was incidental to the business.<sup>416</sup> Accordingly, the court concluded that the debtor was a single asset real estate under § 101(51B).<sup>417</sup>

## XIX. TAX ISSUES

A decision involving both the Internal Revenue Code *and* the Bankruptcy Code probably would rank on most lawyers' top ten list of un-sexiest decisions. But the Supreme Court's five-to-four decision on those statutory regimes in *Hall v. United States*, sexy or not, likely will have a significant impact on tax and bankruptcy planning for family farmers seeking relief in bankruptcy court under Chapter 12 of the Bankruptcy Code.<sup>418</sup>

In general, a Chapter 12 plan of reorganization must provide for payment in full of all priority claims,<sup>419</sup> but as a result of a change wrought by BAPCPA, a Chapter 12 debtor may treat certain governmental claims resulting from the disposition of farm assets as unsecured, nonpriority claims that are dischargeable.<sup>420</sup> This exception, however, applies only to claims that are "entitled to priority under section 507" of the Bankruptcy Code.<sup>421</sup> At issue in *Hall* were post-petition taxes resulting from the Chapter 12 debtors' (the Halls') sale of their farm shortly after filing a bankruptcy petition.<sup>422</sup> The question was whether the IRS's tax claim was entitled to priority under § 507 as an administrative expense on account of "tax[es] . . . incurred by the estate" under § 503(b) of the Bankruptcy Code.<sup>423</sup>

The Halls filed a proposed plan in which the tax claim would be paid as a general unsecured claim to the extent funds were available to pay unsecured creditors, and any unpaid excess would be

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415. *Id.* at 1630.

416. *Id.*

417. *Id.* at 1630–31.

418. *See* 566 U.S. \_\_\_, \_\_\_, 132 S. Ct. 1882, 1885–86 (2012).

419. *Id.* at \_\_\_, 132 S. Ct. at 1885 (citing 11 U.S.C. § 1222(a)(2) (2006)).

420. *See id.* at \_\_\_, 132 S. Ct. at 1885 (quoting 11 U.S.C. § 1222(a)(2)(A)).

421. *Id.* at \_\_\_, 132 S. Ct. at 1885 (quoting 11 U.S.C. § 1222(a)(2)(A)).

422. *Id.* at \_\_\_, 132 S. Ct. at 1885, 1886.

423. *Id.* at \_\_\_, 132 S. Ct. at 1886 (quoting 11 U.S.C. § 503(b)(1)(B)(i) (2006)).

discharged.<sup>424</sup> The IRS objected and argued that the tax claim was not “incurred by the estate” and was neither collectible nor dischargeable in the Halls’ bankruptcy case.<sup>425</sup> The bankruptcy court agreed with the IRS and sustained the IRS’s objection to the Halls’ proposed plan because a Chapter 12 estate is not a separate taxable entity under the Internal Revenue Code.<sup>426</sup> On appeal to the district court, the district court reversed in favor of the Halls because the district court disagreed with the bankruptcy court’s reliance on Internal Revenue Code provisions to construe § 503(b) of the Bankruptcy Code and because the district court concluded that the legislative history of § 1222(a)(2)(A) was intended to apply to post-petition taxes incurred by Chapter 12 debtors.<sup>427</sup> On further appeal by the IRS to the Ninth Circuit, the Ninth Circuit reversed the district court and affirmed the bankruptcy court’s initial decision.<sup>428</sup> The Halls then appealed to the Supreme Court but were unsuccessful.<sup>429</sup>

First, the Supreme Court gave the phrase “incurred by the estate” a “plain and natural reading” and held that the phrase refers to “a tax for which the estate itself is liable.”<sup>430</sup> The Supreme Court then referred to provisions of the Internal Revenue Code providing that a separate taxable estate is created when an individual debtor files a Chapter 7 or Chapter 11 bankruptcy petition but not when an individual debtor files a Chapter 12 or Chapter 13 bankruptcy petition.<sup>431</sup> For the Supreme Court, these Internal Revenue Code provisions

suffice to resolve this case: Chapter 12 estates are not taxable entities. [The Halls], not the estate itself, are required to file the tax return and are liable for the taxes resulting from their postpetition farm sale. The postpetition federal income tax liability is not “incurred by the estate” and thus is neither collectible nor dischargeable in the Chapter 12 plan.<sup>432</sup>

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424. *See id.* at \_\_\_, 132 S. Ct. at 1886.

425. *Id.* at \_\_\_, 132 S. Ct. at 1886.

426. *See id.* at \_\_\_, 132 S. Ct. at 1886 (citing 26 U.S.C. §§ 1398, 1399 (2006)).

427. *See id.* at \_\_\_, 132 S. Ct. at 1886.

428. *Id.* (citing *Hall v. United States*, 617 F.3d 1161 (9th Cir. 2010)).

429. *See id.* at \_\_\_, 132 S. Ct. at 1893.

430. *Id.* at \_\_\_, 132 S. Ct. at 1887 (citing *FCC v. AT&T Inc.*, 562 U.S. \_\_\_, \_\_\_, 131 S. Ct. 1177, 1182 (2011)).

431. *Id.* at \_\_\_, 132 S. Ct. at 1887 (citing 26 U.S.C. §§ 1398(1), 1399, 6012(b)(4) (2006)).

432. *Id.* at \_\_\_, 132 S. Ct. at 1887 (footnote omitted).

Interestingly, only *after* construing the Internal Revenue Code did the Court address whether its holding on the meaning of the phrase “incurred by the estate” as used in the Bankruptcy Code comported with other provisions of the Bankruptcy Code.<sup>433</sup> The Court examined § 346 from its inception in the 1978 enactment of the Bankruptcy Code through its most recent amendment in BAPCPA.<sup>434</sup> The Court declared that § 346 “crystallized the connection between the Bankruptcy Code and the IRC” because § 346 sets forth (and always has set forth) “a chapter-specific division of tax liabilities between the estate and the debtor,” and, after BAPCPA, even includes an express reference to the Internal Revenue Code provisions discussed above.<sup>435</sup> After a foray into analogous Chapter 13 provisions and case law, the court summarized: “We hold that the federal income tax liability resulting from [the Halls’] postpetition farm sale is not ‘incurred by the estate’ under § 503(b) and thus is neither collectible nor dischargeable in the Chapter 12 plan.”<sup>436</sup>

The result in *Hall* would have been entirely different if only the Halls had sold their farm *before* they filed their Chapter 12 petition, because pre-petition taxes *would* have been subject to the exception enacted by BAPCPA in § 1222(a)(2).<sup>437</sup> Thus, after *Hall*, a family farmer (and his tax and bankruptcy professionals) will need to carefully consider the timing of any sales of farm assets in connection with the filing of a Chapter 12 petition.

## XX. TRUSTEES

In *Spain v. Williams (In re Williams)*, the Bankruptcy Court for the Eastern District of Virginia was asked to determine the membership as well as to appoint a member to wind up the affairs of a Virginia limited liability company (“LLC”) engaged in contracting and construction projects.<sup>438</sup> The adversary proceeding in *Spain* originated in a Virginia circuit court when Sandra

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433. *Id.* at \_\_\_, 132 S. Ct. at 1887.

434. *See id.* at \_\_\_, 132 S. Ct. at 1887–89 (citations omitted).

435. *See id.* at \_\_\_, 132 S. Ct. at 1888–89 (quoting Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2565; Bankruptcy Prevention and Consumer Protection Act, Pub. L. 109-8, 119 Stat. 23 (2005)).

436. *Id.* at \_\_\_, 132 S. Ct. at 1893.

437. *See id.* at \_\_\_, 132 S. Ct. at 1893.

438. 455 B.R. 485, 494 (Bankr. E.D. Va. 2011).

Spain, a purported member of the LLC, initiated an action against another purported member, Thaddeus Williams, as well as a general contractor of a project on which the LLC had been a subcontractor, seeking money owed on a construction project and damages from a multitude of additional claims.<sup>439</sup> After Spain, Williams, and John Sprouse, a third potential member of the LLC, separately all sought relief under the Bankruptcy Code, the case was removed to the bankruptcy court.<sup>440</sup> Spain later amended her complaint to ask the court to either disregard the LLC as a legal entity or to appoint her as liquidating trustee.<sup>441</sup>

After reviewing the organizational documents of the LLC, the court found that although the LLC had been properly constituted under Virginia law, it had not properly named any members under the statutory procedures set forth in Virginia Code section 13.1.<sup>442</sup> The court thus looked to extrinsic evidence to determine the membership of the corporation.<sup>443</sup> The court found that although Williams and Sprouse had been the original members of the LLC, Sprouse had transferred his interest to Spain in exchange for personal guarantees and capital contributions.<sup>444</sup> Under Virginia law, however, an assignment of a membership interest does not automatically entitle the transferee to participate in the management of an LLC or to exercise any rights of a member; rather, such an assignment only transfers the right to receive any share of profits and losses and distributions to which the assignor would be entitled.<sup>445</sup> The court held that while Williams and Spain each owned fifty percent of the LLC, only Williams was a full member.<sup>446</sup>

The court then addressed the proper method for winding up the affairs of the LLC. Generally, the members of an LLC may wind up the company's affairs.<sup>447</sup> However, under Virginia Code section 13.1-1040.1(6)(a), "[A] member is dissociated from a limited liabil-

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439. *Id.* at 487–88.

440. *Id.* at 488.

441. *Id.* at 489 (footnote omitted).

442. *Id.* at 494–95 (quoting VA. CODE ANN. § 13.1-1039(A) (Repl. Vol. 2006 & Cum. Supp. 2010)).

443. *Id.* at 495.

444. *Id.* at 497–98.

445. *Id.* at 498 (quoting VA. CODE ANN. § 13.1-1039(A)).

446. *Id.*

447. *See* VA. CODE ANN. § 13.1-1048(B) (Repl. Vol. 2011).

ity company upon . . . [t]he member's [b]ecoming a debtor in bankruptcy."<sup>448</sup> While dissociated members retain their rights to any profits, losses, or distributions from the company, they no longer possess full membership entitling them to participate in the management of the company's affairs.<sup>449</sup> As all potential members of the LLC were in bankruptcy, the court concluded that, by operation of the Virginia Code, no member of the LLC was capable of winding up the company's affairs.<sup>450</sup>

The court thus elected to appoint a liquidating trustee pursuant to Virginia Code section 13.1-1048(B), which permits "the circuit court of the locality in which the registered office of the limited liability company is located . . . [to] appoint one or more liquidating trustees."<sup>451</sup> The bankruptcy court found that it stood in the stead of the circuit court by virtue of the notice of removal and therefore had assumed the powers of the circuit court to administer the affairs of the company.<sup>452</sup>

## XXI. VALUATION

The court in *Gray v. Bank of America, N.A. (In re Gray)* considered motions for default judgment filed in two separate cases to strip off subordinate deeds from the debtors' respective homes.<sup>453</sup> Although the lenders did not defend the claims and were in default, the court refused to enter default judgment because of deficiencies in the evidence presented regarding the value of the properties.<sup>454</sup>

While the court accepted the amount stated in the proofs of claim filed by the senior lenders as the balance of the first deed of trust liens as of the petition date, it took issue with the methods by which the debtors derived their valuation of the properties.<sup>455</sup> One debtor based her valuation on a competitive market analysis

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448. *Id.* § 13.1-1040.1(6)(a) (Repl. Vol. 2011).

449. *See id.* §§ 13.1-1002, -1040.2 (Repl. Vol. 2011).

450. *In re Williams*, 455 B.R. at 502 (citing VA. CODE ANN. § 13.1-1048 (Repl. Vol. 2006 & Cum. Supp. 2010)).

451. *Id.* (quoting VA. CODE ANN. § 13.1-1048(B)).

452. *Id.* (citing 28 U.S.C. § 1447(a) (2006)).

453. Nos. 09-14445-RGM, 09-14004-RMG, 2010 WL 276179, at \*1 (Bankr. E.D. Va. Jan. 15, 2010).

454. *Id.*

455. *Id.*

conducted four months prior to the petition date that did not include any adjustments to the value based on the nuances of the debtor's property and simply listed eleven other properties with somewhat similar characteristics.<sup>456</sup> The second debtor submitted a printout of an Internet valuation that listed four properties that the valuation deemed to be "comparable."<sup>457</sup> The printout did not list any information except the sale price and the number of bedrooms and bathrooms and did not provide any indication as to how the website arrived at the valuation.<sup>458</sup> The second debtor also submitted a county tax assessment to bolster the Internet valuation.<sup>459</sup>

The court refused to accept any of the valuations provided by the debtors.<sup>460</sup> With respect to the comparative market analysis, the court held that it could not rely on the resulting valuation because of the failure to conduct an actual analysis of the peculiar features of the debtor's property.<sup>461</sup> The analysis looked at other purportedly similar properties but failed to make adjustments for lot size, renovations, condition, or proximity to the debtor's property.<sup>462</sup> The court similarly found the Internet valuation and tax assessments to be wanting because they provided no description of the methods by which the valuations were reached.<sup>463</sup> The court noted that these valuations generally are based on statistical models that often do not take into account the specific features of a property and are therefore unreliable.<sup>464</sup> Noting that granting default judgment is at the discretion of the trial court and is not an entitlement as a matter of right,<sup>465</sup> the court found that the valuations were insufficiently reliable to support the entry of default judgment and denied the motions.<sup>466</sup>

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456. *Id.*

457. *Id.* at \*2.

458. *Id.* at \*2-3.

459. *See id.* at \*3.

460. *Id.* at \*4.

461. *Id.* at \*2 (footnote omitted).

462. *Id.*

463. *Id.* at \*3.

464. *Id.* at \*4.

465. *Id.* (citing *Ganther v. Ingle* 75 F.3d 207, 212 (5th Cir. 1996); *Silva v. Madison*, 69 F.3d 1368, 1377 (7th Cir. 1995); *Enron Oil Corp. v. Diakuhara*, 10 F.3d 90, 95 (2d Cir. 1993)).

466. *Id.*

In *Mitchem v. Branch Banking & Trust Co. (In re Mitchem)*, the court was confronted with the question of how to value a property that, due to the completely unfinished state of the ground floor, had very few comparable properties from which a value could be derived.<sup>467</sup> The first floor of the debtors' property was in the process of being renovated and was, in the court's words, an "empty shell[]."<sup>468</sup> The traditional comparable market analysis valuation method, which uses recent sale prices of properties in a similar area and with similar attributes to determine a likely value of a particular property, was therefore impracticable.<sup>469</sup> The court therefore accepted a substitute methodology by which the property would be valued by estimating the value of the property after all repairs and renovations are completed and then subtracting the value of such renovations.<sup>470</sup>

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467. 455 B.R. 108, 109 (Bankr. W.D. Va. 2011).

468. *Id.*

469. *Id.*

470. *Id.* at 110.

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