

Concurrent Session

Espinosa and Beyond

Lynne F. Riley, Moderator | Riley Law Group LLC; Boston

Hon. Jeffery P. Hopkins | U.S. Bankruptcy Court (S.D. Ohio)
Cincinnati

Prof. Margaret Howard | Washington & Lee Law School
Lexington, Va.

ESPINOSA AND BEYOND
Recent Supreme Court and Circuit Court Decisions
Impacting Consumer Practitioners

Panelists:

Lynne F. Riley (moderator)
Honorable Jeffrey P. Hopkins
Professor Margaret Howard

Written Materials by: Lynne F. Riley and David Koha
Riley Law Group LLC, Boston, MA
www.rileylawgroup.com

I. RECENT SUPREME COURT AND RELATED CIRCUIT COURT DECISIONS

1. *Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S.Ct. 1324 (2010)

Argued: December 1, 2009

Decided: March 8, 2010

In *Milavetz*, the Supreme Court decided (1) whether law firms are debt relief agencies and (2) whether the restrictions on debt relief agencies in 11 U.S.C. §§526 and 528 violate the First Amendment rights of attorneys.

The plaintiffs, a bankruptcy law firm and others, sought declaratory relief, arguing that they were not bound by the requirements for debt relief agencies enacted under BAPCPA. Under 11 U.S.C. §526(a)(4) and §528, debt relief agencies must make certain disclosures in their advertisements and are prohibited from advising clients to incur additional debt in contemplation of filing bankruptcy. The plaintiffs argued that attorneys were not included in the term “debt relief agency” as defined by §101(12A) and in the alternative, that the restrictions imposed on debt relief agencies were unconstitutionally overbroad violations of the First Amendment.

The district court determined that attorneys were not debt relief agencies, and that the restrictions of §§526 and 528 were unconstitutionally overbroad. The Eighth Circuit affirmed in part and reversed in part, determining that attorneys were debt relief agencies and that the disclosure requirements of §528 were constitutional, but agreeing that the restriction imposed by §526(a)(4) was overbroad in prohibiting advice to incur any additional debt, even when the advice comprised prudent pre-bankruptcy planning.

The Supreme Court affirmed in part and reversed in part, determining that attorneys are debt relief agencies and that both §§526 and 528 are constitutional. The Court determined that the definition of debt relief agency is unambiguous and that attorneys are included as debt relief agencies. The Court stated that although reference to the legislative history was unnecessary because the text was clear, the legislative history nonetheless supported the holding.

The Supreme Court upheld the Eighth Circuit's ruling on the constitutionality of the disclosure requirements of §528. The Court reasoned that the prohibition is directed at misleading commercial speech; and inasmuch as it is not an affirmative limitation on speech but rather requires certain disclosures, less exacting scrutiny applies, relying on *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626 (1985). The Court further determined that the §528 disclosures are reasonably related to the government's interest in preventing consumer deception.

The Supreme Court reversed the Eighth Circuit regarding the constitutionality of §526(a)(4)'s prohibition against giving advice to incur debt in contemplation of filing bankruptcy. Applying a narrow reading of the provision, the Court determined that it only prohibits the type of situation where a debtor is advised to "load up" on debt, with the expectation that it will be discharged. Read in this way, the Supreme Court held that the provision is not overbroad, because it is intended to prohibit specific abusive conduct.

Justice Scalia concurred with the decision, but disagreed with the majority's use of the legislative history. Justice Thomas also concurred, but questioned application of the the relaxed scrutiny standard of *Zauderer*.

***Adams v. Zelotes*, 606 F.3d 34 (2nd Cir. 2010)**

Decided: May 18, 2010

In *Adams*, the Second Circuit held that 11 U.S.C. §526(a)(4) was not unconstitutionally overbroad, overturning the district court's ruling that the section was unconstitutional as applied to attorneys. The Second Circuit held that *Milavetz*, in narrowly construing the limitations of the provision, "directly foreclosed" a challenge to §526(a)(4) as it applied to attorneys.

***Connecticut Bar Association v. US*, 620 F.3d 81 (2nd Cir. 2010)**

Decided September 7, 2010

In *Connecticut Bar Association*, the Second Circuit rejected a constitutional challenge to portions of §§526, 527, and 528 of the Code. The Court relied on *Milavetz* to reject the challenges to §526(a)(4), regarding advice about incurring new debt, and §528(a)(3)-(4) regarding advertisements for “bankruptcy relief” by a “debt relief agency”. Although some of the plaintiff’s arguments involved provisions not at issue in *Milavetz*, the Second Circuit relied on *Milavetz* to reject those claims, holding that the contract requirements of §528(a)(1)-(2) and the disclosure requirements of §527(a)-(b) were not unconstitutional. Like the provisions at issue in *Milavetz*, these requirements constituted commercial speech that fell under the relaxed scrutiny standard of *Zauderer*. The requirement of disclosure of the services to be rendered, the amount of the fee for the services, and the terms of payment could be “reasonably viewed as the debt relief agency’s proposal of a commercial transaction” with the debtor. The disclosure requirements of §527(a)(1)-(2) were similarly commercial speech because they relate to the commercial transaction between a debtor and his attorney, and they are required in context of the “federal bankruptcy system, a creature of law pervaded by commerce... [which] allows debtors to refashion commercial transactions in order to discharge debt obligations.” Having found the provisions to be commercial speech, the Court followed *Milavetz* in determining that there was a rational basis for the requirements.

2. *United Student Aid Funds v. Espinosa*, 130 S.Ct. 1367 (2010)

Argued: December 1, 2009

Decided: March 23, 2010

In *Espinosa*, the Supreme Court decided whether an order confirming a chapter 13 plan that discharged a portion of the debtor’s student loans, without a finding of undue hardship, was void.

The debtor’s plan, as confirmed, provided for discharge of interest on his student loan debt and repayment of principal only. The student loan creditor received notice of the proposed plan and did not object. The bankruptcy court confirmed the plan, and the debtor received a discharge after completing the plan.

The student loan creditor subsequently sought to collect the unpaid portion of the loan, and the debtor filed a motion in the bankruptcy court to enforce the discharge. The creditor argued that the order confirming the plan was void, seeking relief from judgment under Fed. R. Civ. P. 60(b)(4). According to the creditor, the plan was void because it was contrary to the Bankruptcy Code and the Bankruptcy Rules, which make student loan debts nondischargeable unless a finding of undue hardship is made through an adversary proceeding (11 U.S.C. §523(a)(8) and §1328(a); Fed. R. Bankr. P. 7001(6)). The creditor also argued that it was denied due process because it was not served with a summons and complaint.

The Supreme Court affirmed the ruling of the Ninth Circuit that the order confirming the plan was not void. Justice Thomas, writing for the unanimous Court, determined that for a judgment or order to be void, it must be “so affected by a fundamental infirmity that the infirmity may be raised even after the judgment becomes final.” This occurs only in rare instances such as a jurisdictional error or a violation of due process. Here, that had not occurred. There was no due process violation because the right to be served with a summons and complaint in an adversary proceeding was not a constitutional right but rather was granted by a procedural rule. Indeed, the creditor had received actual notice of the contents of the plan prior to confirmation. The Court held that although the Bankruptcy Court’s ruling was a clear error, it only provided grounds for a timely appeal. The Court relied on *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), which holds that the requirements of due process are satisfied where a party receives notice “reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.”

The Supreme Court held that bankruptcy courts should conduct an independent determination of undue hardship even if a creditor fails to object, rejecting the Ninth Circuit’s holding that a bankruptcy court must confirm a plan absent an objection. The Court also suggested that sanctions under Rule 9011 might be appropriate against debtors who file plans in derogation of the Code and in bad faith. While these comments by the Court may temper the holding’s impact, creditors will undoubtedly now take a more active role in plan confirmation and claim issues.

***In re Kleibrink*, 621 F.3d 370 (5th Cir. 2010)**

Decided: September 21, 2010

In *Kleibrink*, the Fifth Circuit applied *Espinosa* in voiding a discharge order’s abrogation of a secured creditor’s lien, where the creditor did not receive notice satisfying due process. The debtor received a discharge in an earlier bankruptcy and a creditor subsequently attempted foreclosure of the debtor’s property. The debtor sought to avoid the attempt to foreclose, arguing that the claim objection he filed in the earlier proceeding had extinguished the lien. The bankruptcy court held that the creditor had not been afforded due process because (1) the claim objection did not provide clear notice that the debtor was challenging the validity, priority, or extent of the lien, and (2) the debtor did not file an adversary proceeding as required by the Bankruptcy Rules. The district court affirmed on substantially the same grounds.

On appeal, the Fifth Circuit noted that in the time since the lower courts ruled, the Supreme Court decided *Espinosa*, which dealt with the same dispositive issue: whether a creditor in a bankruptcy case received notice that satisfied due process requirements. The Court affirmed the lower courts, determining that under *Espinosa*, where a creditor did not receive notice satisfying due process, a judgment extinguishing the creditor’s interest in a bankruptcy proceeding was

void under Fed. R. Civ. P. 60(b)(4). The factual findings of the lower courts showed that the debtor’s “confusing claim objection filings” did not provide notice that was “reasonably calculated, under all the circumstances, to apprise [the creditor] of the pendency of the action and afford [it] an opportunity to [object].” Therefore, the discharge of the creditor’s security interest was void.

***Holsinger v. Hanrahan (In re Miell)*, 439 B.R. 704 (8th Cir. BAP 2010)**

Decided: December 9, 2010

In *Miell*, the Eighth Circuit Bankruptcy Appellate Panel (BAP) relied on *Espinosa* to uphold an order authorizing the sale of several parcels of real estate free and clear of all liens where the junior lienholders complained that they had received insufficient notice of the sale. The BAP granted the buyer’s motion to dismiss for failure to state a claim, determining that the junior lienholders received actual notice of the proposed sale, which stated that it was “free and clear of all liens and encumbrances.” Even though the trustee’s notice did not specifically identify the junior lienholders or their claims, and despite the trustee’s procedurally erroneous failure to serve them with a copy of her motion for proposed sale, the notice was constitutionally sufficient because “all liens and encumbrances” necessarily includes junior liens. Under *Espinosa* and *Mullane*, constitutionally sufficient notice involves notice “reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.” Wherever these conditions are met, “with due regard to the practicalities and peculiarities of the case,” an order will not be held void under Fed.R.Civ.P 60(b)(4). The trustee’s failure to serve the junior lienholders with a copy of the motion for proposed sale deprived the junior lienholders of a right granted by a procedural rule, but under *Espinosa*, such failure does not amount to a constitutional deprivation voiding the subsequent court order.

3. *Schwab v. Reilly*, 130 S.Ct. 2652 (2010)

Argued: November 3, 2009

Decided: June 17, 2010

In *Reilly*, the Supreme Court decided whether the bankruptcy estate forfeited its claim to the portion of a debtor’s property in excess of its scheduled value, where the trustee failed to object to a claimed exemption that was within the statutory limits, and that equaled the scheduled value of the property.

The debtor listed cooking and other kitchen equipment as an asset on Schedule B, claiming an estimated market value of \$10,718. On Schedule C, the debtor claimed an exemption of \$10,718

in the property. The trustee did not object to the exemption, even though an appraisal showed that the property may have been worth as much as \$17,200. The trustee moved to sell the equipment and realize for the estate the value in excess of the claimed exemption. The debtor objected, arguing that by equating the claimed exemption with the equipment's market value, she put the trustee on notice that she intended to exempt the equipment's full value. She argued that even though the property turned out to be worth more than the amount she scheduled, resulting in an exemption exceeding the amount allowed under the Code, the trustee's failure to object resulted in a forfeiture of any rights in the excess value.

The bankruptcy court denied the trustee's motion to sell. The district court affirmed, as did the Third Circuit. The Third Circuit relied on *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), in holding that Schwab was put on notice that the debtor intended to exempt the full market value of the property. In *Taylor*, the Supreme Court held that where a debtor claimed an estimated market value of property as "unknown" and a corresponding exemption amount of "unknown," the trustee was required to object to the exemption because it was not within the statutory limits. The Third Circuit determined that an "unstated premise" of *Taylor* was that a claimed exemption that equals the reported value is a claimed exemption in "the full amount, whatever it turns out to be."

The Supreme Court reversed. Justice Thomas, writing for the 6-3 majority, held that the trustee was not required to object because the claimed exemption was within the amounts allowed by the Code. The Court reasoned that exemptions under §522(d) apply to the debtor's *interest* in the property up to a specified value – they are not exemptions in the property itself. Thus, the debtor was not claiming an exemption in the property irrespective of its full market value, but only an interest in the property up to the claimed amount of the exemption – here, \$10,718. The remaining value was an estate asset. The Court distinguished *Taylor*, determining that in *Taylor*, a claimed exemption of "unknown" was not within the limits prescribed by the Code, and therefore the trustee was required to object. Here, the exemption of \$10,718 was within the proper limits.

***Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206 (9th Cir. 2010)**

Decided: September 14, 2010

In *Gebhart*, the Ninth Circuit considered two companion cases in which the debtors owned real property and claimed their equity in the properties as fully exempt. One case was under the federal exemption, §522(d)(1), and the other under the Arizona state homestead exemption. The properties increased in value after the filing such that there was value in excess of the homestead exemptions. The Ninth Circuit relied on *Reilly*, holding that the increased value over and above the claimed exemptions and secured claims was property of the estate. The Court determined

that under *Reilly*, an exemption is frozen as of the time of filing, while the value of the property is not. The Court stated, “what is removed from the estate is an ‘interest’ in the property equal to the value of the exemption claimed at filing.”

4. *Hamilton v. Lanning*, 130 S.Ct. 2464 (2010)

Argued: March 22, 2010

Decided: June 7, 2010

In *Hamilton v. Lanning*, the Supreme Court interpreted the phrase “projected disposable income” in 11 U.S.C. §1325(b)(1). The provision requires that an above-median-income chapter 13 debtor commit all “projected disposable income” to repay creditors, unless creditors are being repaid in full.

The debtor in *Lanning* received a one-time buyout from her employer prior to filing her chapter 13 petition, resulting in an inflation of her current monthly income during the six month look-back period. Incorporating this income number into the means test calculation resulted in disposable income of \$1,114.98 on Form B22C. However, the debtor proposed a chapter 13 plan with a monthly payment of \$144, contending that the term “projected disposable income” was forward-looking and should not include the one-time buyout. The chapter 13 trustee objected to confirmation of the plan, asserting that the debtor was required to use the mechanical calculation to determine her plan payment, because although “projected” was not defined, “disposable income” was defined and was based on a calculation of “current monthly income,” averaging all income earned over the six months before filing. Since a monthly payment of \$756 would repay her creditors in full, the trustee argued that this was the required plan payment. There was no dispute that the debtor was unable to make payments in that amount.

The bankruptcy court overruled the trustee’s objection, holding that the word “projected” required that a debtor’s actual income on Schedule I be considered in order to avoid the absurd result of denying chapter 13 relief to individuals whose finances worsened during the six-month look-back period. The Tenth Circuit BAP affirmed, alluding to pre-BAPCPA practice in which courts considered Schedules I and J in arriving at “projected disposable income” – a phrase left unchanged by BAPCPA. The Tenth Circuit affirmed, holding that a court should start with the presumption that the mechanical means test calculation represents the debtor’s disposable income, but this presumption could be rebutted by showing a substantial change in circumstances.

The Supreme Court affirmed the lower courts in an 8-1 decision. Justice Alito, writing for the majority, identified the split of authority, with some courts taking the “mechanical approach” favored by the trustee, and other courts taking the “forward-looking approach” followed by the

debtor. The Court adopted the forward looking approach applied by most lower courts. The Court discussed the ordinary meaning of the word “projected,” determining that it is generally understood to take into account future changes. The Court discussed examples from ordinary usage and other federal statutes, and determined that when Congress wanted to mandate simple multiplication, it did so explicitly. The Court also referred to pre-BAPCPA case law, under which courts had discretion to account for “known or virtually certain changes in the debtor’s income.” The Court held that pre-BAPCPA practice was relevant where it had not been clearly altered by Congress, and here, the term “projected disposable income” was not changed. The Court also looked at the context of the provision and found that a mechanical approach would clash with the terms of §1325, which speak of (1) projected disposable income “to be received” (a phrase that would be read out of the statute if the mechanical approach was followed), (2) income “as of the effective date of the plan” (suggesting an emphasis on post-filing circumstances), and (3) a requirement that projected disposable income “will be applied to make payments” (which would be a “hollow command” if the debtor lacks the means to do so).

The Court also discussed the main argument advanced on behalf of the mechanical approach: that because BAPCPA had redefined “disposable income,” “projected disposable income” should be interpreted in accordance with the new meaning. The Court determined that the forward-looking approach did incorporate the new meaning, because disposable income calculated under the means test would always be the starting point for arriving at a plan payment – only in unusual circumstances should a court “go further and take into account other known or virtually certain information about the debtor’s future income or expenses.” The Court also noted that in cases where the debtor’s income over the six-month look-back period was substantially different from the actual income, the mechanical approach would lead to “senseless results that we do not think Congress intended.”

Although changes in the debtor’s anticipated expenses were not directly at issue in *Lanning*, the Court also applied its holding to changes in the debtor’s expenses that are known or virtually certain at the time of confirmation. Several courts interpreting *Lanning* have followed the holding in regards to expenses, suggesting that even though expenses were not at issue in *Lanning*, the case is binding precedent, not dicta. The question remains how courts will apply the holding to the various expense categories, some of which are based on the standardized expense deductions set forth in the IRS guidelines, some of which are based on actual expenses, and some of which are based on expenses “scheduled as contractually due to secured creditors in each of the 60 months following the date of the petition.” 11 U.S.C. §707(b)(2)(A)(ii)-(iv); see discussion, *infra*, of *Darrohn v. Hildebrand*, 615 F.3d 470 (6th Cir. 2010) and *In re Liehr*, 439 B.R. 179 (10th Cir. BAP 2010).

Justice Scalia dissented, arguing that the mechanical approach was the only approach that was true to the statutory text. He contended that BAPCPA’s definition of “disposable income” was

controlling and courts have no discretion to change the debtor's plan payment based on changed circumstances. Justice Scalia agreed with the majority's definition of the word "projected" as a prediction or calculation of future events, but he argued that Congress had already determined the basis for the projection – the six months of prior income of the debtor. Justice Scalia complained that the Court had "utterly abandon[ed] the text" and inserted its own conception of how a plan payment should be calculated. Justice Scalia found no basis in the text for court-authorized changes where the change to the debtor's disposable income was both "significant" and "known or virtually certain" – he argued that if the statute allows for changes, then it must allow them in all instances.

Justice Scalia said that the mechanical approach was not "senseless" and suggested policy rationales that could have motivated Congress. He theorized that Congress could have determined that debtors whose finances had deteriorated after or near the end of the six-month period "do not yet need a reprieve from repaying their debts; perhaps they will recover." Likewise, he suggested that "perhaps the debtor who has received a one-time bonus will thereby be enabled to stay afloat." This reasoning reflects Justice Scalia's approach to the doctrine of absurdity, which is that an unambiguous statute should be followed unless the court can arrive at no possible, reasonable explanation for the supposedly absurd result. Thus, a court should use its imagination in conjecturing why Congress could have written a seemingly senseless provision. This argument is premised on the principle that it is not for a court to decide on the wisdom of a statutory provision.

It should also be noted that *Lanning* only applies to chapter 13 cases because the means test under chapter 7 does not involve "projected disposable income." Thus, for the purposes of determining whether a presumption of abuse arises under §707(b)(2), the mechanical approach may still be viable. See discussion *infra*, *In re Rudler*, 576 F.3d 37 (1st Cir. 2009).

***Darrohn v. Hildebrand (In re Darrohn)*, 615 F.3d 470 (6th Cir. 2010)**

Decided: July 22, 2010

In *Darrohn*, the Sixth Circuit was faced with the reverse of the situation in *Lanning* – the chapter 13 debtor's six-month look back period included a 90-day period of unemployment, after which the debtor found a new job. The debtor used the mechanical approach to his advantage, proposing a chapter 13 plan with an artificially low payment, and the bankruptcy court confirmed the plan. The Sixth Circuit reversed and remanded, holding that under *Lanning*, the significant, known change in circumstances required an adjustment to the debtor's projected disposable income.

The Sixth Circuit also applied *Lanning* to changes in the expense side of the disposable income calculation. Acknowledging that this “was not directly at issue in *Lanning*”, the Court nevertheless found that the question “fall[s] squarely within the Court’s decision in *Lanning*.” The debtors claimed expense deductions for the mortgages on two properties that they intended to surrender. The language at issue provides a deduction for “amounts scheduled as contractually due to secured creditors in each of the 60 months following the date of the petition.” The bankruptcy court, following a mechanical approach, held that the relevant question was simple: whether the mortgages were contractually scheduled as due at the time of filing. Answering the question in the affirmative, the court allowed the deductions. The Sixth Circuit reversed, applying *Lanning* and holding that the surrender of the properties was a “known or virtually certain” change at the time of confirmation of the plan, and therefore the debtor could not claim an expense deduction for the mortgages.

***Whaley v. Tennyson (In re Tennyson)*, 611 F.3d 873 (11th Cir. 2010)**

Decided: July 16, 2010

In *Tennyson*, the 11th Circuit interpreted the term “applicable commitment period” in 11 U.S.C. §1325. The debtor argued that the term “applicable commitment period” exists only for the purposes of the calculation in §1325(b)(1)(B), wherein a debtor must pay projected disposable income to be received in the applicable commitment period. The Court held that under a plain reading, §1325(b)(4) has independent meaning, imposing a minimum duration of five years on chapter 13 plans for above-median debtors. The Court found support in *Lanning*, reasoning that since “projected disposable income” was not a strict mechanical formula, “applicable commitment period” must have an independent significance. To leave “applicable commitment period” dependent on “projected disposable income” would make the term dependent on the various factors set forth in *Lanning*. In order to give “applicable commitment period” a definite meaning, the term must be understood as a temporal term determined in §1325(b)(4). The Court also cited legislative history in support of its conclusion, quoting a House of Representatives report: “The heart of [BAPCPA] consumer bankruptcy reforms... is intended to ensure that debtors repay creditors the maximum they can afford.” The Court also referred to statements indicating that §1325(b) was intended to require a five year plan for above-median income debtors.

***In re Liehr*, 439 B.R. 179 (10th Cir. BAP 2010)**

Decided: November 4, 2010

This case follows *Lanning* and *Darrohn* in determining that debtors who state an intention to surrender their property could not claim the mortgage as a deduction, stating, “all of the Supreme

Court’s reasoning in *Lanning* with respect to the debtor’s change in income is equally applicable to the expense side of the PDI equation.”

***In re Timothy*, --- B.R. --- 2010 WL 5383897 (10th Cir. BAP 2010)**

Decided: December 29, 2010

This case follows the Eighth and Eleventh Circuits' decisions in *Frederickson* and *Tennyson*, concluding that the applicable commitment period for an above-median income debtor is a minimum of five years, unless all unsecured creditors are paid in full.

5. *Ransom v. FIA Card Services, N.A., fka MBNA America Bank, N.A.* 131 S.Ct. 716 (2011)

Argued: October 4, 2010

Decided: January 11, 2011

In *Ransom*, the Supreme Court resolved a circuit split regarding whether a debtor can deduct the “ownership” expense for a vehicle he owns free and clear for the purposes of calculating “projected disposable income” under 11 U.S.C. §1325(b). In this case, the debtor proposed a chapter 13 plan payment of \$210.55, reflecting his projected disposable income as calculated under the statutory means test formula. §707(b)(2); §1325(b)(2). As required by the statute, he arrived at this amount by deducting from his current monthly income the expenses allowed under the statute, including the “applicable” monthly expenses specified by the National and Local Standards issued by the IRS. The National Standards allow a vehicle “Ownership Cost” of \$471 for the first car owned. The debtor took the position that the “Ownership Cost” was “applicable” because he owned a car. FIA objected to confirmation, arguing that the monthly expense was not “applicable” because the debtor did not have a car payment.

The bankruptcy court denied confirmation of the debtor’s plan, holding that he could only use the “Ownership Expense” deduction if he was making loan or lease payments. The Ninth Circuit BAP and Court of Appeals both affirmed. The Supreme Court granted certiorari to resolve the circuit split on this issue.

Justice Kagan, writing the 8-1 majority opinion, affirmed the lower court holdings, determining that a deduction for “Ownership Costs” only applies when the debtor actually has a monthly loan or lease payment. Interpreting the term “applicable,” Justice Kagan determined that an expense is applicable when “the debtor has costs corresponding to the category covered by the [IRS] table.” *Ransom* at *7. Otherwise, the word “applicable” would be mere surplusage. Justice Kagan also referenced two IRS publications, the Internal Revenue Manual and the IRS

Collection Financial Standards, to support her determination. The Collection Financial Standards explicitly provide that an individual with no car payment may not claim the “Ownership Costs” deduction. Justice Kagan noted that “although the statute does not incorporate the IRS’s guidelines, courts may consult this material in interpreting the National and Local Standards.” *Ransom* at *10.

The Court essentially disliked the notion that a debtor could utilize a “wholly fictional” expense. To demonstrate the anomalies of the debtor’s interpretation, Justice Kagan presented a hypothetical situation where a debtor “purchase[s] for a song a junkyard car – an old, rusted pile of scrap metal that would sit on cinder blocks in his backyard... in order to deduct the \$471...” *Ransom* at *17. The Court acknowledged the central purpose of BAPCPA and the means test – ensuring that debtors who can pay, do pay. Mere ownership of a car, with no associated car payment, should not permit a debtor to withhold substantial distributions from creditors, especially when a separate expense deduction exists for the costs of operating the car.

Justice Scalia, the lone dissenter, agreed with the position of the three circuits that had resolved the question differently (5th, 7th, and 8th). Justice Scalia challenged the majority’s use of the Internal Revenue Manual and the Collection Financial Standards, arguing that no reference should be made to such sources because they were not incorporated into the statute, and that a plain text interpretation was possible within the confines of the statute and the IRS tables. Using only these authorities, a vehicle “Ownership Expense” would simply apply to anyone who owned a car. Justice Scalia also disagreed with the majority’s emphasis on the word “applicable,” making the point that “the canon against superfluity is not a canon against verbosity,” and that courts should not “cast about for some additional meaning to [a] word or phrase that could have been dispensed with.” *Ransom*, dissenting opinion at *2. Finally, Justice Scalia criticized the “imagined horrible” of the majority, positing the equally horrible scenario in which a debtor “might purchase a junkyard car for a song plus a \$10 promissory note payable over several years.” *Ransom*, dissenting opinion at 4.

An issue left unresolved by the Court was whether the National and Local standards merely set caps on the deductions, or whether a debtor may claim the full deduction even if it exceeds his actual expense for that category. See *Ransom* at *13 n.8.

***Baud v. Carroll*, -- F.3d -- , 2011 WL 338001 (6th Cir. February 4, 2011).**

Decided February 4, 2011

In *Baud v. Carroll*, the Sixth Circuit relied heavily on *Ransom* and *Lanning* in deciding three issues in the chapter 13 context.

The Court first decided whether §1325 requires, upon objection by the trustee or a creditor, that a plan have a certain duration, or whether it simply establishes a minimum amount that must be paid to unsecured creditors. Noting a split of authority, the Court discerned “tenable arguments” on both sides of the issue. The Court began with the language of the statute and noted that the terms “applicable commitment period” have a temporal connotation, quoting at length from *Tennyson*, supra. However, the Court observed that the textual arguments for the opposing position were also compelling. To resolve this conundrum, the Court relied on the purposivist reasoning in *Lanning* and *Ransom* to determine that a set duration was required.

The Sixth Circuit noted that in *Lanning*, the Supreme Court observed the lack of explicit multiplier language in the phrase “projected disposable income” and determined that Congress generally uses terms like “multiply” when simple multiplication is intended. Thus the Supreme Court had found the absence of that term revealing. The Court applied this reasoning to the phrase “applicable commitment period,” stating that if Congress had intended this phrase to serve simply as a monetary multiplier in arriving at the total to be paid out through the plan, it would have done so.

The Court also relied on pre-BAPCPA precedent, quoting *Lanning*: “[Pre-BAPCPA precedent] is telling because we will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.” The Court observed that prior to BAPCPA, there was a specific plan length requirement.

Finally, the Court emphasized the Supreme Court’s purposivist approach in *Lanning* and, especially, in *Ransom*. The Court quoted four separate portions of the *Ransom* opinion that clearly demonstrate the Supreme Court’s heavy reliance on the statute’s purpose in that case. Since *Ransom* clearly instructs that BAPCPA’s purpose was to ensure that debtors repay creditors to the greatest extent that they can, the Sixth Circuit determined that a durational requirement was most aligned with that purpose.

The second issue resolved by the Court involved the calculation of projected disposable income. The two underlying issues presented were: (1) whether *Darrohn* and *Lanning* require that “projected disposable income” include Social Security benefits even though the definition of “disposable income” excludes them, and (2) whether above-median debtors can deduct the full amount of their mortgage payment by right, or whether courts should inquire whether the payments are “reasonably necessary.”

The Sixth Circuit held that Social Security benefits should not be included in “projected disposable income” because they were not included in “disposable income.” *Darrohn* and *Lanning* provide that “known or virtually certain information about the debtor’s future income or expenses” should be taken into account in “unusual cases,” but courts are not empowered to

simply disregard the Code's definition of "disposable income." The Court cited the Seventh Circuit's post-*Lanning* decision, *In re Johnson*, 382 Fed. App'x 503 (7th Cir. June 21, 2010), which stated that the projected disposable income calculation "employs the inclusions and exclusions from 'current monthly income' set forth in section 101(10A), but applies them not in the retrospective manner specified by that provision but rather in the forward-looking manner envisioned by section 1325(b)." 382 Fed. App'x 503 (7th Cir. 2010). The Court noted that most courts to decide the issue after *Lanning* came out this way, although one bankruptcy court case reached the opposite conclusion. *In re Cranmer*, 433 B.R. 391 (Bankr. D. Utah 2010) (applying *Lanning* in a much broader sense to determine that a debtor who had Social Security benefits was "the unusual case the Supreme Court meant in *Lanning* where there are other known sources of income that should be included in the calculation of projected disposable income"). The Court determined that the language of the statute unambiguously excluded Social Security benefits, even in chapter 13. The statute demonstrated a clear intention on the part of Congress to depart from the pre-BAPCPA practice of including Social Security benefits. The Court reached this conclusion despite the fact that this result seemingly contradicts BAPCPA's purpose of maximizing creditor recoveries.

Turning to the question of whether the debtors could deduct the full amount of their mortgage payments regardless of the reasonableness of the expense (the debtors had a \$1,699.93 mortgage payment, compared with an IRS Local Standard for housing of \$791), the Court determined that the text of the statute clearly permitted the deduction of the full amount. (The Court refused to consider whether an above-median debtor's decision to continue making payments on secured debt could be factored into the good-faith analysis of §1325(a)(3), noting a split of authority on that matter). The Court summed up its holdings regarding calculation of projected disposable income, perhaps illuminating how *Lanning* will be applied to the expense side of the means test calculation, as follows: "[I]t is appropriate to calculate a debtor's projected disposable income using the inclusions and exclusions from disposable income set forth in the Code and the deductions permitted by the Code, supplemented as of the date of confirmation and adjusted to take into account changes during the applicable commitment period that are known or virtually certain at the time of confirmation."

The final issue decided by the Court was whether there is an exception to the temporal requirement for chapter 13 plans where debtors have zero or negative disposable income. The Court noted that the two circuit courts to have decided the issue, the Eleventh Circuit (in *Tennyson*) and the Ninth Circuit (in *Kagenveama*, 541 F.3d 868 (9th Cir. 2008)) applied a plain-meaning approach, but came to contradictory conclusions. In its own analysis, the Court began with a plain meaning analysis and found the *Tennyson* approach slightly more compelling. However, the Court noted that the "plain language arguments supporting each approach are nearly in equipoise, and... the circuit-level decisions on the issue are entirely so." Thus confused, the Court turned to *Ransom* and *Lanning* for guidance. The Sixth Circuit considered

the only relevant guidepost in *Lanning* to be the Supreme Court's desire to avoid a "senseless result that we do not think Congress intended... [which] would deny creditors payments that the debtor could easily make." The Court stated that *Ransom*, consistent with *Lanning*, established the same guidepost: courts should implement "BAPCPA's purpose of ensuring that debtors repay creditors using their full disposable income." With these principles in place, the Court engaged in an extended analysis showing why a minimum plan length requirement, even for debtors with no disposable income, maximizes creditor recoveries.

The Court concluded its analysis, stating: "We believe it is now clear that, where each competing interpretation of a Code provision amended by BAPCPA is consistent with the plain language of the statute, we must, as the Supreme Court did in *Lanning* and *Ransom*, apply the interpretation that has the best chance of fulfilling BAPCPA's purpose of maximizing creditor recoveries."

***In re Rudler*, 576 F.3d 37 (1st Cir. 2009)**

Rudler, a chapter 7 case decided before *Lanning* and *Ransom*, applied a mechanical, plain text approach in determining that debtors who intended to surrender their residence but had mortgage payments that were "scheduled as contractually due to secured creditors" could deduct this monthly expense in their chapter 7 means test. 11 U.S.C. §707(b)(2)(A)(iii)(I). The United States Trustee had argued that "allowing debtors to deduct only payments they will actually make, rather than all payments scheduled at the time of the bankruptcy filing, better serves the purpose behind the means test..." The First Circuit acknowledged that "this argument has force," but determined that the text of the statute was unambiguous.

Lanning does not abrogate this result because the modifier "projected" appears only in §1325(b) and therefore does not apply in the context of chapter 7 case. *Ransom*, however, may abrogate, or at least call into serious doubt, the continuing viability of *Rudler*. As discussed above, the Sixth Circuit has already opined on this issue in the chapter 13 context. See discussion supra., *Baud v. Carroll*, 2011 WL 338001 (6th Cir. February 4, 2011)("it is now clear that, where each competing interpretation of a Code provision amended by BAPCPA is consistent with the plain language of the statute, we must, as the Supreme Court did in *Lanning* and *Ransom*, apply the interpretation that has the best chance of fulfilling BAPCPA's purpose of maximizing creditor recoveries").

Query: Does the plain statutory text "scheduled as contractually due to secured creditors," without the countervailing application of the chapter 13 "projected" income and expense rationale of *Lanning*, make the provision unambiguous, or otherwise establish clear congressional intent to include expenses on secured debts that remain contractually due as of the petition date in a chapter 7 context? Or, inasmuch as the overarching concern in *Ransom* was allowing debtors to deduct non-existent, "phantom" expenses, would the Supreme Court

undertake a purposivist analysis to arrive at a similar result? And in this analysis, would the Court consider the legislative intent of BAPCPA to encourage consumers to file for reorganization under chapter 13 rather than liquidation under chapter 7?

6. *Chase Bank USA, N. A. v. McCoy*, -- S.Ct. -- (2011), Slip Opinion, No. 09-329 (January 24, 2011)

Argued: December 8, 2010

Decided: January 24, 2011

In *McCoy*, the Supreme Court considered the question whether Regulation Z, prior to its August 2009 amendment, required a credit card issuer to provide notice of an interest rate increase pursuant to a contractual provision allowing rate increases up to a pre-set maximum in the event of default, where the initial disclosures had alerted the card-holder of the issuer's right to do so. The Court determined that the relevant language was ambiguous, and thus deferred to the interpretation advanced by the Federal Reserve Board, which had promulgated the regulation. The Federal Reserve Board, in its amicus brief, argued that the regulation did not require notice of the rate increase at issue. The Court concluded that this interpretation was not "plainly erroneous or inconsistent with the regulation," and was unlikely to be a "post-hoc rationalization" taken as a litigation position because the Federal Reserve Board was not a party in the case.

The Court noted that under the 2009 amendment to the Regulation, 45 days notice would have been required, but the agreement in question was governed by the prior regulation. Therefore, the holding's relevance is limited to credit card agreements entered into prior to August 20, 2009. The case highlights the broader proposition that the Court, following *Auer v. Robbins*, is willing to defer to an agency's interpretation of an ambiguous provision of its own regulation, advanced in a legal brief, where the agency is not a party to the litigation and the interpretation is not plainly erroneous or inconsistent. 519 U.S. 452 (1997).

II. OTHER RECENT CIRCUIT COURT DECISIONS

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

Decided August 16, 2010

In *Hall*, the Ninth Circuit decided whether a tax on the post-petition sale of a farm was "incurred by the estate" and dischargeable in a chapter 12 case.

The debtors moved to sell their farm shortly after commencing their case, and the bankruptcy court approved the sale. The debtors proposed a plan in which they would pay off their debts with proceeds from the sale. The IRS objected, asserting a capital gains tax of \$29,000 from the sale. The debtors amended the plan to include the tax as an unsecured claim that would be partially paid and partially discharged. The IRS objected again, asserting that the tax was not dischargeable. The bankruptcy court sustained the objection. On appeal, the district court reversed, determining that the tax was dischargeable.

The Ninth Circuit reversed, holding that a tax on a post-petition sale was not dischargeable in a chapter 12 case. The court began with the text of the statute, and found it unambiguous. Section 1222(a)(2)(A) allows certain tax claims to be treated as unsecured, dischargeable claims. But the threshold requirement is that the tax must be a priority claim under §507. The Court found that §507(a)(8) covered only prepetition taxes, not post-petition taxes like the one at issue. Moreover, §507(a)(2) also did not apply because the tax was not a §503(b) administrative expense. In order to qualify as an administrative expense, the tax had to be “incurred by the estate.” The Court determined that the Internal Revenue Code specifically provides that a chapter 12 estate cannot incur taxes (26 U.S.C. §§ 1398 and 1399).

In holding that the tax was not incurred by the estate, the Court disagreed with the holding of the Eighth Circuit in *Knudsen*. There, the Eighth Circuit had determined that in §503(b), the phrase “tax incurred by the estate” meant simply a tax incurred post-petition. The Eighth Circuit did not give weight to §§1398 and 1399 of the Internal Revenue Code. Relying on *Knudsen*, the debtors in *Hall* argued that the Court should not use the Internal Revenue Code to “frustrate” the Bankruptcy Code’s purpose, because “Congress was not aware of the relevance of the former when drafting the latter.” The Court disagreed, stating that the Bankruptcy Code contained nothing contrary to the Internal Revenue Code’s treatment of chapter 12 estates. Moreover, the Court stated, “we must read the United States Code as a whole,” stating that courts should assume that Congress knew of existing law when it drafted legislation.

The Court refused to give credence to the legislative history cited by the debtors, which included floor statements suggesting Congressional intent to allow a chapter 12 estate to incur taxes. The Court disputed that there was a clear indication of Congress’ intent on the matter and stated that, even if the legislative history showed such intent, “we cannot ignore clear statutory text because of legislative floor statements.”

***In re Zarnel*, 619 F.3d 156 (2nd Cir. 2010).**

Decided August 26, 2010

Bankruptcy cases “commence” when debtors file their bankruptcy petitions, triggering the bankruptcy court's jurisdiction and protections of the automatic stay, even when a debtor fails to complete pre-filing credit counseling as required by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). The credit counseling requirement is not jurisdictional. Thus, the automatic stay becomes effective immediately even if the debtor is later determined ineligible to proceed. The decision abrogates *In re BDC 56 LLC*, 330 F.3d 111. 11 U.S.C.A. §§ 109(h), 301, 303, 362(a), (c)(3, 4).

***Rea v. Federated Investors*, 627 F.3d 937 (3rd Cir. 2010).**

Decided December 15, 2010.

The Bankruptcy Code’s anti-discrimination provision does not prohibit a private employer from refusing to hire an individual solely because that individual has filed bankruptcy. The overwhelming weight of authority among bankruptcy courts and district courts agrees with this interpretation. Government employers are subject to stricter requirements in §525(a), which include a prohibition against “deny[ing] employment to” prospective employees solely on the basis of a bankruptcy filing. Omission of this language in §525(b) for private employers must be given effect. “Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusive or exclusion.”

***In re Rodriguez*, -- F.3d --, 2010 WL 5191428 (3rd Cir. 2010).**

Decided: December 23, 2010

The debtors owed arrears to their mortgage lender for tax and insurance escrow payments. Part of the arrearage was an amount in excess of the estimated future taxes and insurance, a “cushion” permitted by RESPA. The lender did not include the amount of the cushion in its proof of claim but instead included it in the post-petition escrow payments.

The Third Circuit ruled that the lender had a pre-petition claim for the escrow cushion, even though a right to payment did not exist under state law. The right to collect the escrow was contingent on a disbursement for taxes or insurance by Countrywide of its own funds. Because “claim” includes contingent rights to payment, the lender had a prepetition claim. The Court remanded for a determination of whether a willful stay violation had occurred by the lender’s inclusion of these pre-petition amount in its post-petition escrow requirements.

***In re Berman*, -- F.3d --, 2011 WL 181482 (7th Cir. 2011)**

Decided: January 21, 2011

An individual chapter 7 debtor's wholly owned corporation placed advertising with various media outlets for a client, receiving 110% of the cost of placing the advertising and keeping the extra 10% as a commission. The debtor's corporation did not pay certain advertising bills and the client was forced to pay the media outlets directly, without receiving reimbursement for fees paid to the debtor's corporation. The claimant filed an adversary proceeding in the debtor's individual bankruptcy case alleging the debt was nondischargeable under 11 U.S.C. §523(a)(4) because the debtor was a fiduciary and committed fraud or defalcation.

The claimant first alleged that because the debtor was an officer of the corporation, Illinois state law made him a fiduciary of the corporation's creditors once the corporation became insolvent. The Seventh Circuit rejected this argument. The Court stated that federal law determines whether a debtor is a fiduciary for purposes of §523(a)(4), not state law. Under federal law, the conventional view of a fiduciary is one "in whom confidence is reposed [who] is entrusted with another person's money for safekeeping." The state law definition of a fiduciary diverged from the conventional, federal view.

The claimant's second argument was that the debtor's wholly owned corporation owed claimant a fiduciary duty, and then sought to pierce the corporate veil to hold the debtor personally responsible. The Court rejected this argument as well, holding that the corporation did not owe the claimant a fiduciary duty. Quoting the 1844 Supreme Court case of *Chapman v. Forsyth*, dealing with the question of the fiduciary nondischargeability exception, the Court noted: "in almost all the commercial transactions of the country, confidence is reposed in the punctuality and integrity of the debtor, and a violation of these is, in a commercial sense, a disregard of a trust. But this is not the relation spoken of in... the act." The Court held that at one time, the fiduciary exception applied only to express trusts, and since then courts have extended its application to certain relationships, such as attorney-client or director-shareholder. The Court found that no express trust was created, and no implied fiduciary status existed either. Implied fiduciary status usually involves a relationship in which one person has "a position of ascendancy over the other" through greater knowledge or power, or where one party is incapable of monitoring the other's performance. Here, the parties were more or less equals, with no disparities in power or knowledge between them.

***In re Camp*, -- F.3d --, 2011 WL 184551 (5th Cir. 2011)**

Decided: January 21, 2011

A debtor who moved from Florida to Texas less than 730 days prior to his chapter 7 filing was not eligible for Texas exemptions. However, he could claim the federal exemptions because

Florida's opt-out statute only applies to Florida residents. The Fifth Circuit reasoned that the result is not absurd just because it may lead to limited forum shopping.

***In re Phegley*, --- B.R. ---, 2011 WL 207962 (8th Cir. BAP 2011).**

Decided: January 25, 2011

Crucial question in determining whether a debt should be characterized as support or property settlement was the function the award was intended to serve. The bankruptcy court held that the attorney's fee award was in the nature of support. It determined that "the disparities in the parties' education, training, employment history, and earning capacity all led the bankruptcy court to find that the attorney fee award was made to balance those disparities and was, therefore, intended as support."

III. PENDING BEFORE THE SUPREME COURT

***Stern v. Marshall* (U.S. Supreme Court, Docket No. 10-179)**

Argued: January 18, 2011

Lower Court Decision: *In Re Marshall (Marshall v. Stern)*, 600 F. 3d 1037 (9th Cir. 2010).

The outcome of this case is important to all bankruptcy professionals and those otherwise involved in bankruptcy proceedings inasmuch as it challenges the constitutionality of the present statutory scheme empowering bankruptcy judges to enter final judgments on compulsory counterclaims to proofs of claim as authorized under 11 U.S.C. §157(b)(2)(C).

The facts and prior proceedings are as follows: Vickie Lynn Marshall (Vickie) was the widow of J. Howard Marshall II (J. Howard). J. Howard died of heart failure at age 90 (8/4/95), without providing for Vickie in his will, although, according to Vickie, J. Howard intended to provide for her through a gift in the form of an inter-vivos trust. E. Pierce Marshall (Pierce), J. Howard's son, was the beneficiary of J. Howard's estate and offered J. Howard's will for probate in Texas (8/16/95). While J. Howard's estate was subject to ongoing Texas probate court proceedings, Vickie filed for bankruptcy in California (1/25/96). Pierce filed an adversary proceeding under Code § 523(a)(6) in Vickie's bankruptcy case (5/7/96), alleging that Vickie defamed him when, after J. Howard's death, her lawyers told the press that Pierce had engaged in forgery, fraud, and overreaching to gain control of his father's assets, and seeking a declaration that his defamation claim was non-dischargeable. Pierce also filed a proof of claim (6/12/96), attaching his non-dischargeability complaint as an exhibit. Vickie answered the complaint, asserting truth as a defense, objecting to Pierce's proof of claim, and filing counterclaims, including that Pierce had tortiously interfered with a gift she expected from J. Howard. Pierce moved to dismiss the

counterclaim based on jurisdiction and requested the bankruptcy court to abstain. The bankruptcy court denied his motions. The bankruptcy court granted summary judgment for Vickie on Pierce's non-dischargeability claim (11/5/99), and after a trial on the merits entered judgment for Vickie on her counterclaim for tortious interference with a gift (12/29/00). The bankruptcy court held that both Vickie's objection to Pierce's proof of claim and her counterclaim were "core proceedings" under 28 U.S.C. §157, and awarded Vickie compensatory and punitive damages of \$474 million. Pierce filed a post-trial motion to dismiss for lack of subject-matter jurisdiction, asserting that Vickie's tortious interference claim could be tried only in the Texas probate court. The bankruptcy court again court denied his motion to dismiss based on lack of jurisdiction.

Subsequently, the Texas probate court entered final judgment declaring that J. Howard's estate plan was valid (8/15/01). Meanwhile, back in the California federal forum, Pierce sought the district court's review of the bankruptcy court's judgment. The district court held that the probate exception did not reach Vickie's counterclaim. Citing *Markham*, the district court said that the exception bars federal jurisdiction only if it would "interfere" with the probate proceedings. The court concluded there was no such interference because (1) success on Vickie's counterclaim did not necessitate any declaration that J. Howard's will was invalid, and (2) under Texas law, probate courts do not have exclusive jurisdiction to entertain claims of the kind asserted in Vickie's counterclaim. The court further held that Vickie's claim did not qualify as a "core proceeding" over which a bankruptcy court could exercise plenary power. Accordingly, the district court treated the bankruptcy court's judgment as proposed, rather than final, and undertook *de novo* review (6/19/01). After *de novo* review, the district court adopted and supplemented the bankruptcy court's findings, and determined that Pierce had tortiously interfered with Vickie's expectancy by conspiring to suppress or destroy the *inter vivos* trust instrument J. Howard had directed his lawyers to prepare for Vickie, and to strip J. Howard of his assets by backdating, altering, and otherwise falsifying documents and presenting them to J. Howard under false pretenses. The district court entered final judgment and reduced Vickie's prior award to \$88.6 million in compensatory and punitive damages (3/7/02).

Pierce appealed and the Ninth Circuit reversed (2004). Although the Ninth Circuit recognized that Vickie's claim did not involve the administration of an estate, the probate of a will, or any other purely probate matter, it still held that the probate exception barred federal jurisdiction. It read the probate exception broadly to exclude from the federal courts' adjudicatory power not only direct challenges to a will or trust, but also questions ordinarily decided by a probate court in determining their validity, including claims alleging fraud, undue influence, or tortious interference with the testator's intent. The Ninth Circuit further held that a State's vesting of exclusive jurisdiction over probate matters in a special court stripped the federal courts of jurisdiction to entertain probate-related matters, including claims regarding tax liability, debt, gift, and tort. Noting that the Texas probate court had already ruled it had exclusive jurisdiction

over all of Vickie's claims, the Ninth Circuit held that the Texas court's ruling was binding on the district court.

Vickie appealed and the U.S. Supreme Court reversed. The Court held that the Ninth Circuit had no authority from Congress, or from the Court's prior decisions, for its sweeping extension of the probate exception to federal jurisdiction. It held that because this case did not fall within the probate exception, the district court properly asserted jurisdiction over Vickie's counterclaim against Pierce, and the probate court's ruling that it had exclusive jurisdiction over all of Vickie's claims against Pierce did not deprive the federal district court of jurisdiction over Vickie's tort claim against Pierce in her bankruptcy case. The Court further determined that the Ninth Circuit had failed to address the issue of whether Vickie's claim was "core" and Pierce's arguments concerning claim and issue preclusion. The Supreme Court remanded to the Ninth Circuit for consideration of these issues.

The Ninth Circuit issued its opinion in March 2010, holding that under *Marathon* and *Katchen*, core jurisdiction exists under §157(b)(2)(C) only for compulsory counterclaims¹ that are entirely encompassed within the allowance or disallowance of a creditor's claim against the estate, and that to be core, such counterclaim cannot raise issues beyond the creditor's proof of claim. The Ninth Circuit determined that Vickie's counterclaim, although compulsory, was non-core because in order for her to prevail she had to prove elements beyond those required to rule on Pierce's defamation claim.

Vickie's estate² petitioned for certiorari to the U.S. Supreme Court and Pierce's estate³ opposed the petition. Cert. was granted on September 28, 2010. The order stated three questions to be considered by the Supreme Court: (i) whether the Ninth Circuit's interpretation of §157(b)(2)(C) contravenes congressional intent; (ii) whether Congress may constitutionally authorize bankruptcy court core jurisdiction over debtors' compulsory counterclaims; and (iii) whether the Ninth Circuit misapplied the Supreme Court precedent of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) and *Katchen v. Landy*, 382 U.S. 323 (1966) by holding that Congress cannot constitutionally authorize non-Article III bankruptcy judges to enter final judgment on all compulsory counterclaims to proofs of claim.

Timeline

8/4/95: J Howard dies

¹ A compulsory counterclaim to a proof of claim is any counterclaim that, at the time of pleading, arises out of the same transaction or occurrence as the creditor's claim against the estate, does not require adding another party over whom the court cannot acquire jurisdiction, and is not already pending in another action. Fed. R. Bankr. P. 7013; Fed. R. Civ. P. 13(a).

² Vickie passed away in 2007 at age 39.

³ Pierce passed away in 2006 at age 67.

- 8/16/95: Pierce submits J Howard's will for probate in Texas
- 12/20/95: J Howard Marshall III (elder son) files will contest in Texas probate court
- 1/25/96: Vickie files chapter 11 petition
- 5/7/96: Pierce files AP
- 6/12/96: Pierce files proof of claim
- 6/14/96: Vickie files counterclaim and objection to claim
- 1/23/98: Vickie joins will contest
- 11/5/99: bankruptcy court enters SJ for Vickie on Pierce's non-dischargeability claim
- 12/29/00: bankruptcy court enters judgment for Vickie on counterclaim and objection to claim
- 6/19/01: district court holds Vickie's counterclaim non-core; undertakes de novo review
- 8/15/01: probate court enters final judgment declaring J Howard's will valid
- 3/7/02: district court enters final judgment for Vickie after de novo review
- 2004: 9th Circuit issues decision #1
- 2006: US Supreme Court issues decision #1
- 3/2010: 9th Circuit issues decision #2 in favor of Pierce estate
- 9/2010: US Supreme Court grants Vickie's cert. petition re: 9th Circuit's decision #2
- 1/18/11: US Supreme Court hears oral argument, includes Solicitor General, amicus curiae for petitioner

RELEVANT CONSTITUTION and U.S. CODE PROVISIONS

Article I - The Legislative Branch

Section 8 - Powers of Congress

The Congress shall have Power...

To constitute Tribunals inferior to the Supreme Court...

To establish ... uniform Laws on the subject of Bankruptcies throughout the United States...

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

Article III - The Judicial Branch

Section 1 - Judicial powers

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.* The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services a Compensation which shall not be diminished during their Continuance in Office.

28 U.S.C § 157. Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

(b)

(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section [158](#) of this title.

(2) Core proceedings include, but are not limited to—

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title [11](#) but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

QUESTIONS/COMMENTS FROM JUSTICES AT ARGUMENT:

Justice Sotomayor: “What’s the authority at all for a bankruptcy court to adjudicate proof of claims without violating Article III? I don’t think we have ever had a case that’s actually said that.

Justice Kagan: Are there any limits [to adjudication of common law claims]? Suppose that Congress had authorized bankruptcy courts to decide contract disputes between two creditors in a bankruptcy proceeding. Would that be alright?

Justice Sotomayor: Can the bankruptcy court adjudicate permissive counterclaims? And if you posit a no, what is the limiting principle?

Justice Alito: What do you make of the fact that [28 U.S.C. §157(b)(2)] say core proceedings include, but are not limited to, the matters that are listed after that? How would a court go about deciding whether something that is not specifically mentioned constitutes a core proceeding except to look back to (b)(1), which is what the court of appeals did?

Justice Alito: What do you think is the principle that defines a core proceeding? Some of these specifically enumerated items are potentially very broad. (A), “matters concerning the administration of the estate.”

Justice Scalia: But say you waive it when, in order to protect yourself for a debt that is owed to you, you make a claim in a bankruptcy proceeding. We do have a doctrine that you cannot condition a Federal right upon the waiver of constitutional protections, and that seems to me what you’re saying here; If you want to get paid by the bankrupt estate, you have to waive your right to a jury trial.

Justice Scalia: A State can do that (i.e., subject claimant to jurisdiction for all purposes as price paid for seeking affirmative judicial relief in its court), but can the Federal Government make it the price that you pay for going into a non-Article III tribunal?

Justice Sotomayor: [W]hat entitles you, outside of equity, and what stops either a ... State legislature or a congressional legislature, from saying when someone is in bankruptcy this is the res and these are the people entitled to it. It’s a separate claim. It’s not the State law claim. It may be measured by State law entitlement, but it’s a separate claim. Why isn’t it just a separate claim?

Justice Sotomayor: [L]ike with preferences, there is an unfairness that makes this inequitable. You’re asking the estate to give you something, but you’re not willing to submit in equity to deciding whether there’s something you should give the estate back [i.e. through adjudication of compulsory counterclaim].

Justice Breyer: So what is essential to the integrity of the judicial process that requires you to have de novo hearing before a district court rather than the kind of review that's given here?

Justice Ginsburg: [O]ne thing one can say about Marathon is that when the debtor has a claim against the creditor and the creditor hasn't made any claim in the bankruptcy, he can't drag that into the bankruptcy court. But once the bankruptcy court has authority over the [creditor's] claim ... then the court can clear up the whole matter.

Justice Sotomayor: [Y]ou're basically saying that Congress cannot delegate any State law-based claim to which a jury is entitled to a bankruptcy counterclaim at all. So if you have a claim by lawyers for their fees [and] a defense of malpractice, maybE they can adjudicate [the fee claim], but they can't adjudicate the malpractice claim. It would be a counterclaim, correct?

Justice Kagan: So one can look at a case like Marathon and say the problem there was that the president appointed the bankruptcy judges in a way that the president on longer does and that the district courts did not have the supervisory control over the bankruptcy judges in the way that they do now, and that that makes a constitutional difference.

Justice Breyer: Structurally it does injure... the integrity of the ... Federal judiciary to allow the bankruptcy judge to adjudicate a direct claim; why is a counterclaim different?

Who is impacted by outcome of Marshall #2 decision:

Debtors with counterclaims against mortgage servicers, debt collectors, payday lenders; need for cost-effective mechanism to litigate these counterclaims.

Trustees with counterclaims against creditors filing proofs of claim; need efficient single adjudication without district court de novo review, causing additional costs and delays in administration and distribution to creditors.

Bankruptcy judges, needing to know what matters they can and can't finally adjudicate; at what stage of litigation do non-core compulsory counterclaims move to the district court? Should whole claim objection be withdrawn to district court at inception?

District court judges would be burdened with additional adjudicatory function, adding to heavy caseloads.

Cost and delay to litigants and inefficient use of judicial resources.

Final Notes:

Regarding *Marshall*: In predicting outcome of *Marshall #2*, consider the Supreme Court's recent unanimous decision, written by Justice Breyer, wherein the Court addressed another jurisdictional objection. Here, the Court considered the jurisdictional statute in a 3-step analysis: (1) the statute's text, (2) administrative simplicity, and (3) legislative history. In considering step 2, the Court observed:

[A]dministrative simplicity is a major virtue in a jurisdictional statute. . . . Complex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but which court is the right court to decide those claims ... Complex tests produce appeals and reversals, encourage gamesmanship, and, again, diminish the likelihood that results and settlements will reflect a claim's legal and factual merits. Judicial resources too are at stake. ... We recognize that there may be no perfect test that satisfies all administrative and purposive criteria. *Hertz v. Friend*, ---U.S.---, 130 S. Ct. 1181, 1193-94 (2010).

Regarding *Milavatz, Espinosa and Lanning*: Consider article by Hon. Thomas Waldron, *Didn't See That Coming: Recent Supreme Court Decisions and Ethics*, 2011 Norton Bankruptcy Law Adviser No. 1 (January 2011), where Judge Waldron argues that it is unfortunate that lawyers' professional responsibility is being defined by lobbyists representing creditors' interests. He summarizes the Supreme Court's "trifecta of admonitions" to counsel for debtors:

It is also appropriate to recognize this decision completes the Supreme Court's trifecta of admonitions to debtor's counsel: *Milavetz*--advice which could be construed as approving "loading up" on debt potentially violates the "Federal Bankruptcy Code of Professional Conduct"; *Espinosa*--advice which could be construed as presenting plans with illegal provisions potentially violates the "Federal Bankruptcy Code of Professional Conduct," and, *Lanning*--advice which could be construed as manipulation of projected disposable income potentially violates the "Federal Bankruptcy Code of Professional Conduct."

Regarding *Lanning, Ransom, and multitude of conflicting plain meaning analyses on various BAPCPA provisions*: See Lynne F. Riley and Maria C. Furlong, *BAPCPA and the Plain Meaning Paradox*, 2009 Norton Annual Survey of Bankruptcy Law, Part II § 1