

**Basic Concepts:
Sources of Law,
Structure of Code,
Bankruptcy Courts,
Legal Ethics
and Estate Property**

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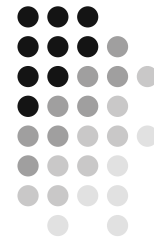
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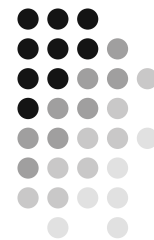
AN INTRODUCTION TO BANKRUPTCY

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A Short History of American Bankruptcy Law

. . . or, 450 years in 9 slides



Origins of American Bankruptcy Law



- **Early English antecedents**
 - Earliest English bankruptcy statutes enacted in 1542 and 1570
 - Creditors could petition Lord Chancellor to begin bankruptcy proceeding
 - Proceeding initiated upon showing of “act of bankruptcy” by debtor (e.g., “keeping house”)
 - Appointment of “commissioners” to seize and sell debtor’s assets
 - Pro rata distribution to creditors
 - Creditors permitted to continue collection actions against debtor

Origins of American Bankruptcy Law



- **Statute of Anne (1706):**
 - Limited to merchants
 - Granted discharge to “bankrupts”
 - Carrot-and-stick approach: cooperative debtors who turned over assets retained small amount of exempt property and received discharge
 - Discharge barred further actions by creditors to collect pre-bankruptcy debts
 - Death penalty for noncompliance or fraud

Origins of American Bankruptcy Law



- The Constitution
 - Article I, § 8:

“The Congress shall have the power . . . to establish . . . uniform laws on the subject of bankruptcies throughout the United States”

Early American Bankruptcy Law



- Statutes
 - Failed federal bankruptcy law experiments:
 - Bankruptcy Act of 1800 (repealed 1803)

Essentially copied English bankruptcy law
 - Bankruptcy Act of 1841 (repealed 1843)

Permitted voluntary bankruptcy for the first time
 - Bankruptcy Act of 1867 (repealed 1878)

Permitted debtor to propose “composition agreement” governing repayment of debts

Early American Bankruptcy Law



- The Equity Receivership
 - Non-statutory
 - Based on equitable power of federal courts
 - First used for railroads
 - Initiated by creditor's request to appoint receiver
 - Receiver seized assets but continued operation of firm
 - Foreclosure and "sale" of assets, usually to reorganization committee
 - Favored insiders

Modern American Bankruptcy Law



- Bankruptcy Act of 1898
 - First permanent federal bankruptcy law
 - Federal district courts sat as "courts of bankruptcy"
 - Voluntary and involuntary bankruptcy permitted
 - Voluntary bankruptcy open to "any person who owes debts, except a corporation" — no insolvency requirement
 - Permitted composition agreements instead of liquidation if approved by majority of creditors and by court
 - Liberal discharge provisions

Modern American Bankruptcy Law



- Chandler Act of 1938
 - Amended 1898 Act
 - Expanded 1898 Act to new classes of debtors:
 - Chapter X: reorganization of corporations; appointment of trustee (ousting incumbent managers); SEC role
 - Chapter XI: reorganization of corporations; no trustee
 - Chapter XII: adjustment of debt for non-corporate firms
 - Chapter XIII: adjustment of debt for wage earners
 - Displaced equity receiverships
 - Discouraged corporate reorganization

Bankruptcy Reform Act of 1978



- Comprehensive overhaul of bankruptcy law
- Enacted Bankruptcy Code (Title 11, U.S. Code)
 - Chapter 7: Liquidation (with discharge for individuals)
 - Chapter 11: Reorganization (combined Chapters X, XI, and XII of the 1898 Act)
 - Chapter 13: Readjustment of debts for debtors with regular income (expansion of former Chapter XIII)
- Encouraged reorganization
 - Permitted incumbent management to run firm in bankruptcy as “debtor-in-possession” (DIP) without trustee

Legislation Since 1978

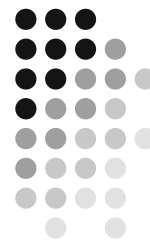


- Bankruptcy Amendments and Federal Judgeships Act of 1984 (“BAFJA”)
 - Revamped bankruptcy court jurisdiction after Marathon
- Bankruptcy Reform Act of 1994
 - Made large number of amendments to Code
- Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)
 - Major changes to consumer bankruptcy provisions
 - Also changes to corporate bankruptcy:
 - Shortened “exclusivity” period
 - Shortened period for assumption and rejection of leases
 - Restricted Key Employee Retention Plans (“KERPS”)
 - New Chapter 15

BANKRUPTCY JURISDICTION, PROCEDURE & PRACTICE

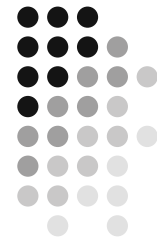
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A Short History of Bankruptcy Jurisdiction:

The Statute and Constitutional
Jurisprudence



Bankruptcy Jurisdiction Under the Former Bankruptcy Act of 1898

- Summary jurisdiction of the bankruptcy court:
 - Administration of bankruptcy case
 - Property in actual or constructive possession of estate
 - With implied or express consent of litigant (by failing to object; by filing proof of claim; by otherwise participating in bankruptcy case)
 - Limited matters over which jurisdiction expressly granted
- Plenary jurisdiction
 - Federal district court – if diversity or federal question or other grant of federal jurisdiction existed
 - State Court



Jurisdictional Reform in the 1978 Bankruptcy Code



- Abolished summary/plenary distinction
- Provided broad grant of bankruptcy jurisdiction to federal district courts – “arising under” title 11, “arising in” or “related to” title 11 case
- All of this jurisdiction was exercised by bankruptcy judges who were appointed for 14 year terms to bankruptcy courts separate from the district courts

Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982)



- Held unconstitutional the exercise by an untenured bankruptcy judge of “related to” jurisdiction over a cause of action arising purely under State contract and tort law and brought by DIP against entity that had not filed a proof of claim against the estate
- Splintered decision – four Justice plurality; two concurring Justices; multiple dissenting opinions

Plurality Opinion in Marathon



- **Public Rights**
 - Described Public Rights Doctrine as limited to matters arising “between the [US] Government and persons subject to its authority in connection with the performance of constitutional functions of the executive or legislative departments” and “which historically could have been determined exclusively by those departments.”
- **Adjunct Court**
 - Described Congress’s ability to vest judicial power in adjunct court as follows:
 - Congress possesses substantial discretion to prescribe the process under which substantive federal right may be adjudicated – including delegation to adjunct court –
 - So long as “essential attributes” of judicial power are retained in Article III court .

Plurality (cont.)



- **Public Rights**
 - Declined to uphold here – dispute between private parties concerning State law.
 - Noted that “restructuring of dr/cr relations” – at “the **core**” of bankruptcy power – “may well” involve a public right. 458 U.S. at 71.
- **Adjunct Court**
 - State, not federal, law implicated in Marathon’s suit
 - Bankruptcy courts exercise all ordinary powers of district courts:
 - Conduct jury trials
 - Issue declaratory judgments, writs of habeas corpus, and orders “necessary and appropriate to enforcement” of Code
 - Render findings of fact, subject only to ordinary appellate review

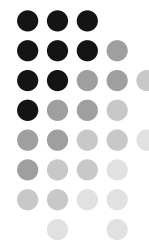


Concurrence

- Did not join in plurality's description of "public rights" and "adjunct court" jurisprudence
- But did agree that bankruptcy court's exercise of jurisdiction over state law cause of action brought against party that had not filed proof of claim was unconstitutional
- Both concurrence and plurality agreed that, because reference to "related to" jurisdiction was found in same statutory provision as remaining grant of jurisdiction, entire grant of jurisdiction to bankruptcy courts was invalid

Congress responded to Marathon by enacting the current bankruptcy jurisdictional provisions:

28 U.S.C. §§ 1334 and 157



The Broad Grant of Federal Bankruptcy Jurisdiction – 28 U.S.C. § 1334(a), (b) and (e)



- Section 1334(a) provides that federal district courts “shall have original and exclusive jurisdiction of all cases under title 11.”
- Section 1334(b) grants district courts “original but not exclusive” jurisdiction over “all civil proceedings arising under title 11, or arising in or related to cases under title 11.”
- Section 1334(e) further grants to district courts “exclusive jurisdiction” over
 - “all property, wherever located, of the debtor as of the commencement of such case, and of the property of the estate;” and
 - “over all claims or causes of action that involve construction of section 327 of title 11 ... rules relating to disclosure requirements under section 327.” (2005 Amendment)

Federal Bankruptcy Jurisdiction



“Arising under” jurisdiction



- Extends only to proceedings based solely on rights created under the federal bankruptcy laws found in title 11 of the United States Code
- Examples include:
 - Preference or fraudulent transfer actions--§§547 or 548
 - Proceedings to enforce or request relief from the automatic stay--§362
 - Actions to resolve the scope of property of the estate, or request authority to reject or assume an executory contract or unexpired lease--§§541 or 365

“Arising in” jurisdiction



- Courts apply a “but for” test, which asks if it is a proceeding “that by its nature, could arise only in the context of a bankruptcy case” – even though it is not based on any right created under federal bankruptcy law.
- Examples include:
 - Resolution of proofs of claim and counter-claims raised to the proof of claim;
 - Proceedings involving post-petition operation of estate.

“Related to” jurisdiction



- First, Second, Third, Seventh and Tenth Circuits require a showing that proceeding will affect administration of estate or distributions from estate
- Fifth, Sixth, Ninth and Eleventh Circuits have adopted a broader standard that requires only “that the activity have some conceivable impact on the bankruptcy reorganization or estate”

Dividing the Exercise of Jurisdiction Between District Courts and Bankruptcy Courts – 28 U.S.C. § 157





28 U.S.C. § 157(a)

- Federal district courts rarely exercise the bankruptcy jurisdiction granted to them in § 1334.
- Instead, § 157(a) permits each district court to provide that any or all proceedings may be “referred to the bankruptcy judge for the district.”
- Nearly without exception, district courts have referred their bankruptcy jurisdiction to the bankruptcy judges in their district.



Bankruptcy court exercise of jurisdiction depends upon nature of proceeding and party consent:

- Bankruptcy court can “hear and determine,” subject only to ordinary appellate review:
- Core proceedings that “arise under” title 11 or “arise in” title 11 case
- Non-core proceedings as to which parties have consented to exercise of jurisdiction by bankruptcy court
- Bankruptcy court can “hear,” but cannot enter final order:
- Non-core proceedings that are merely “related to” a title 11 bankruptcy case

28 U.S.C. § 157(b) – core proceedings



- Bankruptcy courts are empowered to hear and determine core proceedings that arise under title 11, or arise in a title 11 case, subject only to ordinary appellate review
- Core proceedings need not derive from federal law – § 157(b)(3)
- Non-exclusive laundry list of 17 matters that constitute core proceedings found in § 157(b)(2):
 - Resolution of proof of claim, including any counterclaims to such claim – § 157(b)(2)(B) & (C)
 - Matters concerning administration of estate – § 157(b)(2)(A)
 - Other proceedings affecting liquidation or assets of estate, or adjustment of creditor or shareholder relationship – § 157(b)(2)(O)

28 U.S.C. § 157(c)(2) – noncore proceedings with consent



- Bankruptcy courts can also “hear and determine” noncore proceedings that are “related to” a title 11 case, but only if all of the parties consent
- Upon consent, bankruptcy court authority over noncore proceeding is indistinguishable from that over core proceeding
- Nothing in statute defines consent
- Bankruptcy Rules require express consent
- But courts of appeals remain divided as to whether consent can be implied from parties’ conduct

28 U.S.C. § 157(c)(1) – noncore proceedings without consent



- In the absence of party consent, bankruptcy courts can exercise only limited jurisdiction over noncore proceedings “related to” a title 11 case
- Bankruptcy courts can hear these noncore proceedings and enter proposed findings of fact and law
- But district court enters final order after *de novo* review of recommendation

Courts remain divided on contours of core/noncore distinction:



- Courts of appeal disagree as to whether state law claims arising out of post-petition transaction with estate and brought against DIP or trustee constitute core proceedings
- Courts of appeal have divided as to whether actions to recover attorney’s fees under federal fee-shifting statutes constitute core proceedings
- They are also divided about whether contempt proceedings trigger core bankruptcy jurisdiction

Counterclaims as Core Proceedings

- Courts disagreed as to when counterclaims to proof of claims are core
- 28 USC § 157(b)(2)(C) appears to include all counterclaims as core proceedings, but few courts read the statute literally.
- Majority view was that counterclaims are core only when they arise out of the same transaction or occurrence as the proof of claim (i.e., compulsory counterclaims)
- Some courts required counterclaim to be bound up in the resolution of the underlying claim (e.g., Code § 502(d), which disallows claim by creditor withholding property of the estate)



Stern v. Marshall (2011)

- Compulsory counterclaim for tortious interference brought by estate against creditor who filed proof of claim for defamation
- Supreme Court adopts literal interpretation of 28 USC § 157(b)(2)(C) to find that the counterclaim was core proceeding
- But Court finds that the exercise of core jurisdiction in the case is unconstitutional





Stern v. Marshall (2011)

- Holding: A bankruptcy judge lacks constitutional power to hear and finally determine a state law counterclaim unless “the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process”
- Court stressed that its decision is “narrow”
 - But not entirely clear what role consent by parties to the entry of final judgment by bankruptcy judge plays
 - Also unclear how the terms “core” and “non-core” should be used in future bankruptcy cases

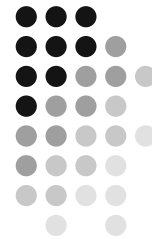
§ 157 (d) -- District courts retain the power to withdraw any reference



- Permissive withdrawal “for cause shown”
- District courts consider:
 - Uniformity in bankruptcy administration
 - Forum shopping
 - Economic use of judicial resources
 - Facilitate bankruptcy process
- Inability of bankruptcy court to conduct jury trial sufficient “cause” for withdrawal when trial-ready
- Mandatory withdrawal when “resolution of proceeding requires consideration of both title 11 and other laws of US regulating interstate commerce”
- Narrowly construed
- Withdrawal mandated only when substantial and material consideration of non-bankruptcy federal law is required to resolve proceeding

Dividing the Exercise of Bankruptcy Jurisdiction Between Federal and State Courts:

Abstention, Removal and Remand



Permissive Abstention -- § 1334(c)(1) (district court can abstain “in the interest of justice, or in the interest of comity with State courts or respect for State law”)



- Some courts of appeal read § 1334(c)(1) to codify judicially-created abstention doctrines applied in non-bankruptcy federal courts
- Others expressly reject this approach
- Most courts apply 12 factor test for permissive bankruptcy abstention

Mandatory Abstention -- §1334(c)(2)



- Requires district court to abstain from
 - “proceeding based upon State law”
 - that is “related to a case under title 11 but not arising under title 11 or arising in a title 11 case”
 - provided that there exists no federal question, diversity or other ground for federal jurisdiction
 - and that “an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction”
- Courts of appeal disagree as to whether mandatory abstention provision applies to state court proceedings removed to bankruptcy court

Limitation on Appellate Review of Abstention Orders



Section 1334(d) provides that “any decision to abstain or not to abstain . . . other than a decision not to abstain in a proceeding described in subsection (c)(2)” is “not reviewable by appeal or otherwise” to courts of appeal and U.S. Supreme Court.

Removal of Proceedings from State Court to Federal District or Bankruptcy Court:

28 U.S.C. §§ 1441(a) & 1452
(a)



Two Statutes Governing Bankruptcy Removal: §§ 1441 & 1452



- Section 1441(a) permits defendants “in any civil action brought in a State court” to remove to district court if district court “[would] have original jurisdiction”
- Section 1452 permits “any party” to remove a “claim or cause of action in a civil action” to district court if district court “has jurisdiction of such claim or cause of action under § 1334”

Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 129 (1995)



- Both § 1441 and § 1452 govern removal and remand in bankruptcy.
- “There is no express indication in § 1452 that Congress intended that statute to be the exclusive provision governing removals and remands in bankruptcy.”

Two Statutes Governing Bankruptcy Remand: §§1447(c) and 1452(b)



- Section 1447(c) permits remand of removed action if “district court lacks subject matter jurisdiction” or where procedural defect in removal process
- Section 1452(b) permits remand of action that was removed under §1452(a) “on any equitable ground”

Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 129 (1995) (“There is no reason §§1447 and 1452 cannot comfortably coexist in the bankruptcy context.”)

Supplemental Bankruptcy Jurisdiction— 28 U.S.C. § 1367



Courts are divided as to whether this provision enables federal district courts or bankruptcy courts to exercise jurisdiction supplemental to the federal bankruptcy jurisdiction conferred under § 1334(b)

Publicker Indus. v. U.S.
(In re Cuyahoga Equip. Corp.), 980 F.2d 110, 114-15 (2d. Cir. 1992) (upholding district court exercise of supplemental bankruptcy jurisdiction)

In re Walker, 51 F.3d 562 (5th Cir. 1995) (reversing bankruptcy court exercise of supplemental jurisdiction)

Jury Trials in Bankruptcy Courts



- 28 U.S.C. § 1411(a) provides that bankruptcy does “not affect any right to trial by jury that an individual has under applicable nonbankruptcy law with regard to a personal injury or wrongful death tort claim”
- 28 U.S.C. § 1411(b) provides that a district court may order the issues arising under § 303 (involuntary bankruptcy) “to be tried without a jury”

Pre-1994 Amendment Case Law Construing § 1411



- **Noncore proceedings** – courts uniformly agree that bankruptcy courts are constitutionally prohibited from conducted jury trials in noncore proceedings
- **Core proceedings** – courts of appeals divided as to whether bankruptcy courts were statutorily or constitutionally permitted to conduct jury trials in core proceedings
 - Only Second Circuit held that bankruptcy courts were so authorized
 - Supreme Court declined to resolve split

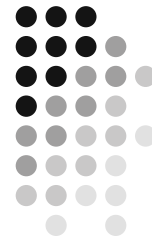
Jury Trials in Bankruptcy Courts – After 1994 Amendments



- 28 U.S.C. § 157(e) was added in 1994 to provide that bankruptcy courts are empowered to conduct jury trials “in core proceedings that are actions in law involving private and not public rights” if the bankruptcy court is “specially designated to exercise such jurisdiction by the district court” and the parties “have expressly consented to such an exercise of jurisdiction.”
- Does § 157(e) solve the problem?

Bankruptcy Appeals:

28 U.S.C. §§ 158, 1291 and 1292

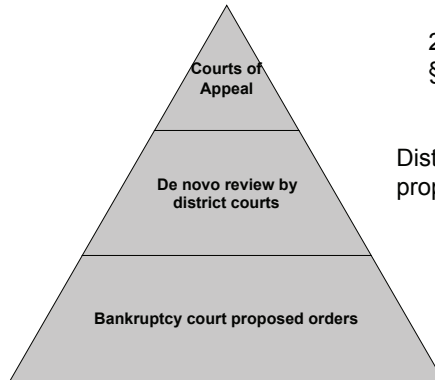


Review of bankruptcy court orders:



- **Noncore proceedings,** absent parties' consent:
- De novo review of district court – §157(c)(1)
- Appellate review of courts of appeals – §§1291 and 1292
- **Core proceedings,** and noncore proceedings with parties' consent:
- Intermediate appellate review by district court or BAP – §158(a)-(c)
- Secondary appellate review by courts of appeals – § 158(d)(1)
- Possibility of direct review by court of appeal – § 158(d)(2)

Review of bankruptcy court orders in non-core proceedings:



28 U.S.C.
§§1291, 1292

District court reviews
proposed order de novo

BCt proposes
findings of fact and
law in noncore
proceeding

Review of Final Bankruptcy Orders Entered in Noncore Proceeding



- District court enters final order, under §157 (c)(1), following de novo review
- Bankruptcy court's factual recommendations entitled to no deference under this standard
- Court of appeals reviews final district court orders under general appellate provision, 28 U.S.C. §1291

28 U.S.C. § 1291



The courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . .

Review of Interlocutory Bankruptcy Orders Entered in Noncore Proceeding?



- There is no express statutory direction for review of bankruptcy court interlocutory orders – by either district court or court of appeals.
- If the district court withdraws the reference, then interlocutory appeal to a court of appeals may be granted under 28 U.S.C. §1292(b) certification process
 - Requiring certification by district court
 - And leave to appeal by court of appeals



28 U.S.C. § 1292(b)

(b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: *Provided, however,* That application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

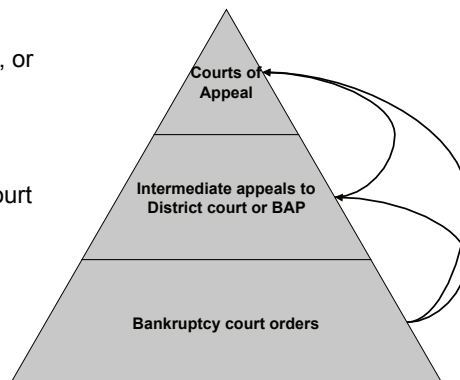
Review of bankruptcy court orders in core proceedings or noncore proceedings with consent:



Appeal from intermediate appeal, or direct appeal

Intermediate appeal brought to district court or BAP

BCt enters order in core proceeding



Intermediate Appellate Review in Core Proceedings—§ 158(a)-(c)



- District court review – §158(a)
 - Final judgments, orders, and decrees
 - Interlocutory orders under §1121(d) relating to exclusive period
 - With leave of the court, from other interlocutory orders
 - DCts have adopted §1292(b) standard, but do not require bankruptcy court certification for interlocutory review
- BAP – § 158 (b) and (c)
 - If designated by the judicial council for a circuit,
 - and district judges for district,
 - and if all parties consent,
 - panel of three bankruptcy judges can hear appeal
- Appellate jurisdiction defined under § 158(a)

Courts of Appeals' Jurisdiction to Review Final Orders Entered in Core Proceedings – §158(d)(1)



- “The courts of appeals shall have jurisdiction of appeals from all final decisions, judgment, orders, and decrees entered under subsection (a) and (b) of this section.”
 - Requires final order of bankruptcy court and final order entered in intermediate appeal (district court or BAP)
- Final order language closely tracks the language of 28 U.S.C. § 1291, which has been construed to preclude review until the order “ends all litigation on the merits and leaves nothing for the court to do but execute the judgment.”

Courts of Appeals' Jurisdiction to Review Final Orders Entered in Core Proceedings – §158(d)(1)



- Courts of appeals construe §158(d)(1)'s final order rule to preclude review of orders that would be viewed as “non-final” if they had been entered in the context of a general civil litigation
- But not all bankruptcy orders are comparable to orders entered in general civil litigation
- Interpretation of finality standard in bankruptcy appeals is complicated by
 - Case v. proceeding distinction
 - System of two tiered appellate review

Courts of Appeals' Jurisdiction to Review Interlocutory Orders Entered in Core Proceedings – 28 U.S.C. §1292



- **Connecticut National Bank v. Germain**, 503 U.S. 249 (1992)(concluding that 28 U.S.C. §1292(b) applies to bankruptcy appeals because nothing in plain language of §158(d)(1) indicated that it was intended to be exclusive route for bankruptcy appeals)
- Section 1292(b) permits courts of appeals to review certain interlocutory district court orders
- This provision may not be available to review interlocutory BAP decisions

Direct Appeals to Courts of Appeals – § 158(d)(2)



- Many view this two-step appellate process as too time consuming and complex.
- The 2005 Bankruptcy Amendments add new § 158(d)(2) to grant courts of appeals jurisdiction to hear a direct appeal if:
 - (A) the lower court certifies to the court of appeals that grounds for a direct appeal exist and the court of appeals grants leave to appeal; or
 - (B) all the parties to the appeal jointly certify that grounds for a direct appeal exist and the court of appeals grants leave to appeal.
- If a majority of the parties to the appeal request direct appeal, or if proper grounds exist, the lower court *shall* certify to the court of appeals that direct appeal is warranted.
- What are proper grounds warranting lower court certification?

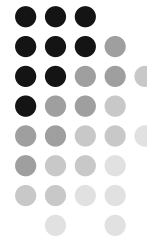
Direct Appeals to Courts of Appeals – § 158(d)(2)



- (i) The judgment, order or decree involves a question of law as to which there is no controlling decision, or involves a matter of public importance;
- (ii) The judgment, order or decree involves requires resolution of conflicting decisions; or
- (iii) An immediate appeal from the judgment, order or decree may materially advance the progress of the case or proceeding in which the appeal is taken.

The Federal Rules of Bankruptcy Procedure

28 U.S.C. §§ 158, 1291 and 1292



Basic Structure of Rules

- Grouped in nine parts from 1000s – 9000s
- 1000s: Commencement of the case
- 2000s: Appointment of trustees and committees; compensation
- 3000s: Proofs of claim, plans of reorganization
- 7000s: Adversary proceedings
- 9000s: Contested matters



Adversary Proceeding Rules



- 7000 rules generally incorporate analogous rules under the Federal Rules of Civil Procedure (e.g., FRBP 7023 makes FRCP 23 applicable in adversary proceedings).
- Rule 7004 modifies Rule 4 of the FRCP by authorizing nationwide service of process and personal jurisdiction to constitutional limits
- There is no Rule 7006
 - FRBP 9006 governs calculation of time

Contested Matter Rules



- 9000 rules contain general provisions for other litigation in bankruptcy proceedings.
- FRBP 9006 governs the counting of time
 - Formerly differed from FRCP
 - Amended to conform to changes in FRCP



Contested Matter Rules

- FRBP 9006 has been amended (effective Dec. 1, 2009).
 - New FRBP 9006: “count every day, including intermediate Saturdays, Sundays, and legal holidays”
 - Consistent with amendments to FRCP 6, also effective Dec. 1, 2009

NYU Basic Bankruptcy Program

Wednesday, September 21, 2011

Panel #1

**New York University School of Law
37th Annual Workshop on Bankruptcy & Business Reorganization
New York, New York
September 21-22, 2011**

History of the Bankruptcy Law

Scholars have traced laws providing for the treatment of debtors all the way back to the 451 B.C. Roman laws (the Law of the Twelve Tables) harshly provided for death to debtors, including dividing the debtor's body (pro-rata) among his creditors:

When a debt has been acknowledged or a judgment has been pronounced in court, 30 days must be the legitimate grace period. Thereafter, arrest of the debtor may be made by the laying on of hands. Bring him into court. If he does not satisfy the judgment (or no one in court offers himself as surety on his behalf) the creditor may take the debtor with him. He may bind him either in stocks or fetters, with a weight of no less than 15 lbs. (or more if he desires). . . .

If they do not come to another agreement, debtors are held in bonds for sixty days. During that time they are to be brought before court in the forum on three successive market days, and the amount for which they are liable shall be publicly announced. . . .

On the third market-day, [any multiple] creditors shall cut [the debtor] into pieces. If they cut more or less than their due, it shall be with impunity. . . .

The Bible provided for a "fresh start" for debtors every seven years in Deuteronomy 15:1-2: "At the end of every seven years you shall grant a release. And this is the manner of the release: every creditor shall release what he has lent to his neighbor, his brother, because the Lord's release has been proclaimed".

In the Middle Ages in Italy and Scotland, "bankrupts" were ostracized and forced to wear distinguishable, degrading clothing and apparel.

As far as back the Statute of Merchants in 1285, 13 Edw. 1 Stat. 3, English bankruptcy laws called for the imprisonment of debtors as “offenders.” This pro-creditor stance flourished in early England and in America until the end of the 20th century. These laws have been described as “viciously punitive from the perspective of the debtor.”¹

The Statute of Anne (1705).

For the first time in Anglo-American history, “bankrupts” were afforded relief under the bankruptcy laws with the introduction of the discharge. “Bankrupts” were granted a discharge if they turned over all of their assets, save exempted wearing apparel. Literally, “bankrupts” only got to keep the shirts on their backs.

Like most of early American law, early bankruptcy law was based on these English antecedents:

Bankruptcy laws as enacted in America:

The Adoption of the Bankruptcy Clause in the Constitution:

For the Supreme Court’s historical description of the inclusion of the Bankruptcy Clause in art. I, §8, cl. 4, see *U.S. v. Katz*, 126 S. Ct. 990; 163 L. Ed. 2d 945 (2006) (holding that the states waived their sovereign immunity in preference actions due to, *inter alia*, the states’ ratification of the Bankruptcy Clause in the Constitution).

¹ Douglas Baird & Thomas Jackson, *CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY* 27–28 (2d ed. 1990) (cited by Tabb in his *History of the Bankruptcy Laws in America*).

Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

This early law, although intended to only be temporary, was largely unsuccessful, having been repealed only three years after enactment. The Act of 1800 was modeled very closely after the British laws, which only provided for involuntary proceedings against merchants. Some discharge of debts was provided where distribution met certain requirements. Debtors were also discharged from prison if they made full disclosure of their property and assets, but were subject to harsh penalties if found guilty of hiding assets or not providing information to their creditors.

Prior to the Act of 1800, the non-payment of debt was considered immoral and debtors often languished in jail unless freed by generous benefactors willing to pay off the debtor's creditors.

Notwithstanding the change in tides regarding the imprisonment of debtors, in 1827 the Supreme Court upheld the imprisonment of debtors as constitutional in *Mason v. Hale*, 12 Wheat. 370 (1827).

The United States Bankruptcy Act of 1841, Act of Aug. 9, 1841, ch. 9, 5 Stat. 440 (repealed 1843).

1841 saw the introduction of the voluntary bankruptcy proceeding and bankruptcies by non-merchants. In addition, this law provided for more extensive exemptions, including "necessaries" up to \$300 in value. Discharges were granted unless objected to by a majority of claimants (in number and amount).

The world was apparently not yet ready for small distributions and for fairly liberal discharge as the Act was repealed after less than two years.

The Bankruptcy Act of 1867.

Another short-lived Act, The Bankruptcy Act of 1867 also suffered from the similar maladies as the Act of 1841 and had the same fate. The Act of 1867 did, however, provide for both voluntary and involuntary bankruptcy and corporations were also allowed to file for protection under the Act. The Act also extended involuntary bankruptcy proceedings to non-merchant debtors.

The Bankruptcy Act of 1898 (The “Act”).

The Bankruptcy Act of 1898 ushered in a new era in bankruptcy history: continuous and permanent coverage. While earlier acts were enacted and repealed, the Act of 1898 provided for the comprehensive treatment that formed the foundation of modern bankruptcy law in America. Since 1898, the Act largely stood unchanged until the Bankruptcy Reform Act of 1978 (“the Code”). For this reason, many practitioners still cite to pre-Code caselaw as persuasive authority for interpreting certain provisions of the Code.

The 1898 Act provided for both voluntary and involuntary bankruptcy for several classes of debtors. The Act also provided for the early analog of the Automatic Stay, which was upheld by the Supreme Court in *Continental Illinois National Bank & Trust Co. v. Chicago Rock Island & Pacific Railway Co.*, 294 U.S. 647 (1935), as not violative of the Fifth Amendment Due Process provision.

Under the Act, bankruptcy “referees” (the precursors to bankruptcy judges) presided over bankruptcy cases as adjuncts of the federal district courts. Also for the first time, debtors were allowed to elect generous exemptions as provided by state law.

Discharge was also more widely available, although there still remained a number of exceptions and limitations. Overall, the Act will be remembered as the beginning of the liberal treatment of debtors under the laws.

The Chandler Act of 1938.

The Chandler Act provided for the reorganization of new classes of debtors:

- Chapter X provided for the reorganization of corporations and modification of secured debt and required the appointment of a Trustee to replace the corporation's management.
- Chapter XI provided for the reorganization of corporations and modification of unsecured debt incurred in business. Chapter XI did not require the appointment of a Trustee.
- Chapter XII provided for the adjustment of debt for non-corporate entities (called "Arrangements").
- Chapter XIII provided for the adjustment of debt for wage earners.

The Bankruptcy Reform Act of 1978 (The "Code").

The major reform of the Code for business bankruptcy was the consolidation of Chapters X, XI and XII into Chapter 11. In addition, no Trustee was automatically appointed as in former Chapter X. Under the Code, a Trustee could be appointed for cause (such as in cases of fraud or corporate waste), otherwise a corporation's management kept control after the filing of a petition as the debtor-in-possession (DIP). The Code also provided for a state's election to opt-out of the federal exemption scheme.

Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA").

BAFJA was passed in the wake of the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 102 S.Ct. 285 (1982), which declared the jurisdictional scheme of the bankruptcy courts unconstitutional. The Code granted broad jurisdiction to bankruptcy judges, including the judicial power reserved to Article III district courts by the Constitution. The holding of the plurality decision in *Marathon* essentially stated that Congress impermissibly vested the Article III judicial power in the Article I bankruptcy courts. BAFJA saved the system from collapse by providing for jurisdiction of bankruptcy matters to vest in the federal district courts, with standing orders of reference to the bankruptcy courts. BAFJA provided that in "non-core" matters, the bankruptcy court is to produce findings of fact and conclusions of law, which the district court reviews *de novo*.

The Bankruptcy Abuse Prevention & Consumer Protection Act of 2005 (BAPCPA).

While the 2005 Act received most of its attention for its consumer bankruptcy provisions, there are several provisions which have the potential to have wide-ranging effects for business bankruptcy: (1) For small business debtors: the Act created a number of additional reporting requirements, enhanced oversight by the U.S. Trustee's office, and modified solicitation and disclosure requirements; (2) Shortened exclusivity periods (the time in which a debtor is allowed the exclusive right to propose a plan of reorganization) and bars for extension of time for both small and large business debtors; (3) Shortened periods for the assumption and rejection of leases in real estate; and (4) Restrictions on Key Employee Retention Plans (KERPs).

Sources of Law

The Bankruptcy Clause: Congress is authorized by Art. 1, § 8, cl. 4 to “establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.”

While the **Bankruptcy Code** is federal law, Congress, in the Bankruptcy Code, leaves certain provisions subject to other applicable law, such as state contracts law.

The jurisdiction of the courts of bankruptcy is provided for in **Title 28** (to be discussed more in depth in Panel #2).

Title 18, Crimes and Criminal Procedure, provides for, *inter alia*, criminal sanctions for crimes in bankruptcy, such as the concealment of assets by debtors.

Title 26, the Internal Revenue Code, provides for, *inter alia*, tax liens, property exempt from tax liens, penalties for willful violation of the tax laws and discharge of liens.

Practice in the courts of bankruptcy is governed by the **Federal Rules of Bankruptcy Procedure** and, in addition, the **Federal Rules of Civil Procedure** and **Federal Rules of Evidence**, where specifically applied by the Federal Rules of Bankruptcy Procedure.

Structure of the Bankruptcy Code

Generally:

The Bankruptcy Code is codified in Title 11 and is divided into 9 Chapters.

- Chapters 1, 3 and 5 apply to all Chapters (unless specifically made inapplicable).
- Chapter 7 provides for a specific kind of relief: Liquidation of an entity and distribution to creditors.
- Chapters 9, 11, 12 and 13 provide for the reorganization or adjustment of debts of a specific kind of Debtor.
- Chapter 15 (added by BAPCPA in 2005) provides for the treatment of Ancillary and other Cross-Border Cases.

Organization of Title 11:

CHAPTER 1—GENERAL PROVISIONS

Includes: Definitions, Rules of Construction, Power of the Court & Who May Be a Debtor

CHAPTER 3—CASE ADMINISTRATION

Includes: Commencement of a Case (Voluntary & Involuntary), Officers, Administration & Administrative Powers

CHAPTER 5—CREDITORS, THE DEBTOR, AND THE ESTATE

Includes: Creditors and Claims, Debtor's Duties and Benefits, and The Estate

CHAPTER 7—LIQUIDATION

Includes: Officers and Administration; Collection, Liquidation, and Distribution of the Estate; and Stockbroker Liquidation

CHAPTER 11—REORGANIZATION

Includes: Officers and Administration; The Plan; Postconfirmation Matters and Railroad Organization

CHAPTER 13—ADJUSTMENT OF DEBTS OF AN INDIVIDUAL WITH REGULAR INCOME

Includes: Officers, Administration, and The Estate and The Plan

CHAPTER 15—ANCILLARY AND OTHER CROSS-BORDER CASES

Includes: Access of Foreign Representatives and Creditors to the Court,
Recognition of a Foreign Proceeding and Relief; Cooperation with Foreign Courts and
Foreign Representatives and Concurrent Proceedings

For More Information:

The History of Bankruptcy:

John D. Ayer and Michael Bernstein, *Bankruptcy in Practice*, (ABI 4th ed. 2007).

Vern Countryman, *A History of American Bankruptcy*, 81 COM. L. J. 226 (1976).

Bruce Mann, *A REPUBLIC OF DEBTORS* (Harv. Univ. Press 2003).

David A. Skeel, *DEBTS DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* (U. of Princeton Press 2001).

Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, AM. BANKR. INST. L. REV. (Spring 1995).

United States v. Katz, 126 S. Ct. 990; 163 L. Ed. 2d 945 (2006) (detailing the adoption of the Bankruptcy Clause in the Constitution).

United States v. Krass, 409 U.S. 434 (1973) (describing the vivid history of bankruptcy).

Charles Warren, *BANKRUPTCY IN UNITED STATES HISTORY* (1935).

Basic Concepts in Bankruptcy

I. The Big Picture

A. Five Essential elements

Essential elements in a bankruptcy case include: The case's filing or *commencement*, the creation of the debtor's *estate* and the delineation of estate *property* (i.e., "property of the estate"), the filing of *claims* of creditors against the debtor's estate, the *automatic stay* of actions against estate property, and the debtor's *retention of professionals* to handle the case. These elements exist under all chapters of the Bankruptcy Code.

B. Eligibility and Commencement/Filing

§ 109 of the Bankruptcy Code defines which persons or entities may be a debtor under the different Chapters. Railroads and banks, for example, are excluded from Chapter 7 liquidations, but in some cases can file to reorganize their debts under Chapter 11. A case is commenced under § 301 by filing a petition with the bankruptcy court under the Chapter under which the debtor seeks relief. Alternatively, a debtor can be forced into bankruptcy involuntarily under § 303 if the requisite number of creditors (usually three) join in a petition and they are owed the requisite amount of unsecured, non-contingent, undisputed debt (\$14,425 in 2010).

C. Retention of Professionals and Ethical Obligations

§327 permits the debtor to retain and compensate disinterested professionals, including attorneys, that do not hold interests adverse to those of the estate.

These professionals owe fiduciary duties to *the estate as whole* rather than to the

individuals who hire them or to particular estate constituencies. The fees that they charge should be reasonable, § 328, and must be reviewed and approved by the bankruptcy court, § 329.

D. Automatic Stay

On the date the debtor first files the bankruptcy petition all creditors are stayed from commencing or proceeding with actions to collect against the debtor. This includes halting any civil litigation pending against the debtor, any efforts to collect upon or enforce a judgment obtained prior to the filing and any efforts to repossess property of the debtor. Creditors are stayed automatically, even if they are unaware of the bankruptcy filing. Creditors can seek relief from the automatic stay under § 362(d)(1) if they are able to show “cause.” “Cause” can include a lack of adequate protection of an interest in property. For example, if a secured creditor establishes that its collateral is declining in value, the court may either lift the stay or require the debtor to provide adequate protection against the decline.

E. Conceptual Distinctions Between Chapters 7 and 11.

Chapter 7 is designed for liquidation. For a corporation, no discharge will be granted because there will be no on-going post-bankruptcy business operations. Upon filing, the debtor’s assets become an estate managed by the bankruptcy court and the court appointed trustee. The goal of the estate in bankruptcy is to maximize returns for creditors during the asset liquidation process.

Chapter 11 is principally for business and corporate debtors, although non-business individual debtors may use it. Corporations can use this Chapter to

restructure pre-petition debt while at the same time overhauling and revitalizing the company's business operations. The corporation's management is permitted to remain in its leadership role, unlike the requirement of trustee control in Chapter 7. When management retains control during the bankruptcy it is called a debtor in possession. Chapter 11 requires the debtor and its creditors to formulate an acceptable repayment plan for prepetition debts. In Chapter 11 the debtor will propose a plan to repay debt. The plan may, among other things, extend the time to repay debts or reduce the amount to be paid. In Chapter 11 cases the creditors vote on the plan. The plan must meet specified confirmation standards in order to be approved by the court. In general, the plan must pay each creditor at least as much as it would have received in a Chapter 7 liquidation and must honor distributional priorities (e.g., creditors must be paid in full before shareholders may receive or retain any property). For individual debtors, the plan must also commit all of the debtor's disposable income to the repayment of debt. In addition, the court must determine that the plan is feasible.

II. Claims.

A. Definition of a Claim: § 101(5):

1. **Language of the Statute:** The term “claim” means—(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.

2. **Types of Claims and Priority:**
 - a. **Secured Claims under § 506(a).** Whether a claim is secured is a question of non-bankruptcy law, such as the state law of mortgages for real property and Art. 9 of the U.C.C. for personal property. A creditor is secured to the extent of the value of the collateral securing the claim. *See* § 506(a)(1). Thus, as a practical matter, valuation is key for both creditors and debtors. § 506(a) sets out how valuation is to be determined, but valuation methodology remains hotly debated. An issue to keep in mind: only over-secured claims are granted post-petition interest.

 - b. **Priority Claims under § 507 (Cf. Administrative Expenses).** Certain unsecured claims are given priority as enumerated in § 507. These include a first priority for domestic support obligations under § 507(1) (new as of the 2005 amendments); second priority for administrative expenses under § 507(2); third priority for involuntary gap

claims under § 507(3); fourth and fifth priority for different types of employee wage claims under § 507(4)-(5), among others. Each rung of priority must be paid in full before any payment is allowed for a lower ranked creditor.

Administrative “Expenses” arising under § 503(b) (but given a second priority under § 507(2)) are technically not “Claims” because, by definition, Administrative Expenses are those costs of administering the estate which arise during the pendency of the bankruptcy case (such as the fees for the professionals). “Claims” generally arise pre-petition. Holders of Administrative Expenses are “Administrative Claimants,” however and not “Creditors” (defined by § 101(1) as the holder of a claim).

c. **General Unsecured Claims (“GUCs”).** GUCs are those claims which are not secured and do not have a priority. GUCs share pro-rata in the pool of assets available to GUCs after the secured and priority claims receive their distribution.

B. **Claim or Interest?** Holders of “Interests” have an equity interest in the debtor. Equity equals an ownership interest (similar to an investor), whereas a “Claim” is a debt owed by the debtor. Shareholders in corporations have an equity interest equal to the value of their ownership of shares. Partners, both general and limited, have an “interest” in a Partnership. Holders of “interests” are paid last in the distribution under the absolute priority rule (to be discussed in more detail in a later session). Equitable subordination of claims under § 510(c), discussed *infra*, relegates a “claim” to the level of

an “interest” where, for example, the claim was a *de facto* disguised equity security interest.

C. Filing a Proof of Claim (“POC”)/Proof of Interest (“POI”):

1. Under Federal Rule of Bankruptcy Procedure 3003(c)(3), the bankruptcy court will set the deadline for the filing of a POC/POI (the “bar date”) in chapter 11 cases. In chapter 7 cases, the date is set according to Rule 3002(c).
2. The filing of the POC/POI is governed by the Code, § 501(a) and Rule 3001(a) (for POC).
3. The format of the POC should follow Official Form 10.
4. The POC is deemed allowed, unless the Debtor or another party-in-interest objects.

D. Effect of Filing a Claim

1. The filing of a POC allows a creditor to participate in the bankruptcy case of the debtor. Generally creditors must file a POC in order to receive a distribution in the bankruptcy or, in the case of a Chapter 11 case, vote on a proposed Plan of Reorganization. One exception in Chapter 11 is that section 1111(a) deems a claim filed if the claim is listed in the schedules filed by the debtor, unless it is listed as disputed, contingent or unliquidated.
2. The filing of a POC submits the creditor to the equitable jurisdiction of the court of bankruptcy. This is so because the proof of claim represents the creditor’s interest in an equitable distribution of the estate.

3. Because proceedings in equity do not give rise to a right to jury trial under the Seventh Amendment or under Title 28, the filing of a proof of claim in a bankruptcy proceeding effects a waiver of the right to jury trial for counterclaims that may be asserted by the estate against the creditor.

Cases:

Langenkamp v. Culp, 111 S.Ct. 330 (1990) (holding creditor who filed proof of claim waived right to jury trial).

Granfinanciera, S.A. v. Nordberg, 109 S.Ct. 2782 (1989) (upholding a creditor's right to jury trial where it had not filed a claim in the bankruptcy case).

Katchen v. Landy, 382 U.S. 323 (1966) (holding the claims process in bankruptcy as a proceeding in equity and a creditor's participation in the claims process precluded the right to jury trial on a preference action).

E. Objecting to Claims/Interests (Allowance/Disallowance of Claims):

1. The vast majority of chapter 7 cases are “no asset” cases, and few creditors bother filing a POC. In such cases, creditors should file claims as soon as either: (1) the case is noticed as an asset case or, (2) based on information obtained, such as at the § 341 meeting of creditors, there is a belief that funds will be available for distribution.

2. The Debtor and other parties-in-interest may raise substantive or procedural objections to claims. Claims objections are generally governed by § 502, however there are exceptions: (1) Objections to a POC arising from an ownership of stock is not a “claim” and therefore would not be brought under § 502, and (2) objections

to a POC that was filed without any supporting documentation would be brought based on Rule 3001(c), (d).

3. Procedurally, objections to claims must be filed according to Rule 3007.

4. There are several bases for the disallowance of claims even where no objection is filed, such as: (1) under § 502(d), the court is required to disallow a claim where the creditor owes money to the estate based on the turnover or avoidance action provisions of the Code and, in general, (2) claims for reimbursement by a co-debtor, surety of the debtor, or guarantor of an obligation of the debtor, unless the entity has paid the obligation. § 502(e)(1).

F. Estimation of Claims

Claims that are contingent or unliquidated must be estimated by the court for the purposes of allowance and distribution under § 502(c). Estimation is a key issue for pending personal injury claims and in mass tort bankruptcies because of the inherent difficulty in fixing the amount of contingent or unliquidated claims and because those claims can represent the largest claims against the estate.

Cases:

In re G-I Holdings, Inc., 323 B.R. 583 (Bankr. D.N.J. 2005) (discussing the process of estimation of claims in asbestos cases).

G. Subordination of Claims: Under § 510(b), the Code provides for the subordination of claims arising from the purchase or sale of a security of a debtor or of an

affiliate to the priority of common stock (priority of an “interest”). Section 510(c) provides for the “equitable subordination” of claims that, in reality, represent a disguised equity security interest. Equitable subordination has been ordered where a principal “loans” money to his undercapitalized corporation and the principal takes a security interest in one or more assets of the corporation. Upon a filing in bankruptcy, the principal asserts a claim against the estate for the amount of the “debt.” Courts reason that where principals loan money to an undercapitalized entity, they are, in fact, investing in the future success of the entity and therefore, their “loan” is, in fact, an equity interest and not a claim against the bankruptcy estate.

Cases:

Pepper v. Litton, 308 U.S. 295 (1939) (describing equitable subordination within the jurisdiction of the bankruptcy courts as courts of equity).

III. Property of the Estate.

A. **Definition under § 541(a)**, includes: “all legal or equitable interests of the debtor in property as of the commencement of the case.”

1. The commencement of the case is defined under sections 301, 302 or 303 of Title 11 as the filing of a petition in bankruptcy. Upon the commencement of a case, the Estate is created and all non-exempt assets—all legal or equitable interests of the debtor in property—become Property of the Estate.

2. The rule is more of an inclusionary rule than an exclusionary one. Property of the Estate is the default. All property of the debtor upon the filing of the case is Property of the Estate, unless the property is exempted out of the estate under § 522 or otherwise specifically excluded from the estate.

3. In Chapter 7 cases, Property of the Estate is primarily determined by reference to the petition date. In contrast, Chapter 11 contemplates that the debtor will retain control of its property and propose a plan to repay debt out of future earnings. Thus, Property of the Estate in Chapter 11 also includes property acquired during the bankruptcy, including wages earned post-petition.

4. *Ipsa facto* clauses in contracts with the debtor, which state that a bankruptcy filing constitutes a contract default or which grant to the non-debtor a right to terminate the contract, are unenforceable after the bankruptcy petition is filed. See § 365(e)(1). Instead, these contracts become Property of the Estate and may be assumed, assigned or rejected under § 365.

5. Property of the Estate also includes income derived from Property of the Estate, such as rental income derived from the ownership of real property, interest earned on bank accounts, or other proceeds from Property of the Estate. § 541(a)(6).

6. Property of the Estate also includes any property recovered under the Trustee's avoiding powers, such as preference actions and lien avoidance. The Trustee's avoidance powers will be discussed in more detail during Session # 2.

7. Property of the Estate is also deemed to include interests the debtor acquires by in an inheritance, bequest, devise, settlement, insurance policy or death benefit plan within 180 days after the filing under § 541(a)(5).

B. Exclusions from Property of the Estate

1. § 541 contains a number of specific exclusions covering special types of property. The section excludes from the Estate, among other things, educational savings accounts, tuition benefit funds, spendthrift trusts and contributions to certain employee benefit funds and pension plans.

2. Although Property of the Estate, in a Chapter 7 case, does not include post-petition income from personal services (see § 541(a)(6)), as noted above, the post-petition earnings of an individual will be included in the Chapter 11.

3. Exemptions are rights granted to debtors to protect certain items of property from the reach of creditors. Although exempt assets do become Property of the Estate, the Debtor is permitted to exempt them back out of the estate. § 522 lists a standard set of federal exemptions, however, states are permitted to opt-out of the federal exemptions and to use state drafted exemptions. Most states have exercised this power and there is, therefore, a wide disparity between what may be exempted in the various states.

B. The Legislative History: The definition of “property of the estate” is broad enough to encompass all kinds of property, both tangible and intangible, including contracts, intellectual property (such as copyrights and patents), as well as causes of action. *See* H.R. REP. 95-595, 95th Cong., 1st Sess. 367 (1977).

Cases:

*There is a plethora of case law on what constitutes Property of the Estate. These cases are included as illustrative only.

Kokoszka v. Belford, 417 U.S. 642 (1975) (holding consumer debtor’s tax refund constituted Property of the Estate where refund was based on income earned pre-petition).

Official Committee of Unsecured Creditors v. PSS Steamship Company, Inc. (In re Prudential Lines, Inc.), 928 F.2d 565 (2d Cir. 1991) (holding a NOL carryover is Property of the Estate as an interest in intangible property).

Patterson v. Shumate, 112 S.Ct. 2242 (1992) (holding ERISA-qualified pension funds are excluded from Property of the Estate by the “spendthrift trust” provision of § 541(c)(2)).

C. **State Law Determines the Interest of the Debtor in Property:** While the Bankruptcy Code determines what constitutes Property of the Estate, state law determines the nature of the interest of the debtor in such property, under the rule of *Butner v. United States*, 440 U.S. 48 (1979).

D. **Turnover Under § 542:** Section 542 provides for the turnover to the Trustee of any Property of the Estate, or the value of such property. Turnover assists a Trustee in marshaling the assets of the debtor.

Cases:

U.S. v. Whiting Pools, 462 U.S. 198 (1983) (requiring the IRS to turnover property that had been seized pre-petition).

E. **Abandonment Under § 554:** The Code provides that the Trustee may abandon property of the estate that is “burdensome” or that is of “inconsequential value and benefit” to the estate.

Cases:

Midlantic Nat’l Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 507 (1986) (holding “a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards”).