Circuit Splits and Supreme Court Preview

Breakfast Session

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Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

Hon. Dennis R. Dow
U.S. Bankruptcy Court (W.D. Mo.)
Kansas City

Hon. Margaret M. Mann
U.S. Bankruptcy Court (S.D. Cal.)
San Diego

Hon. Robert E. Gerber
U.S. Bankruptcy Court (S.D.N.Y.); New York

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THE 30TH ANNUAL AMERICAN BANKRUPTCY INSTITUTE SPRING MEETING

Circuit splits

Panelists:

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Moderator:

John W. Ames
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CIRCUIT SPLITS

I. Hon. Dennis R. Dow: 11 U.S.C. § 1325(b)(1)(B)

"Projected Disposable Income Test" and the Applicable Commitment Period

II. Hon. Robert E. Gerber: 11 U.S.C. § 365(c)(1)

Assumption and Assignment of Intellectual Property Interests

III. Hon Kevin J. Carey: 11 U.S.C. § 1129(b)(2)(A)

Credit Bidding

IV. Hon. Margaret M. Mann: Limitations on the Jurisdiction of the Bankruptcy Courts

Stern v. Marshall

I. "Projected Disposable Income Test" and the Applicable Commitment Period

11 U.S.C. § 1325(b)(1)(B), as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), allows courts to approve Chapter 13 plans of reorganization over objections of the trustee or holders of allowed unsecured claims, if, as of the effective date of the plan, "the plan provides that all of the debtor's projected disposable income to be received in the *applicable commitment period* beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan" (emphasis added). By adding the phrase "applicable commitment period" to 11 U.S.C. § 1325, however, BAPCPA created a difficult problem because it effectively established different applicable commitment periods depending on whether the "current monthly income" is above or below the relevant state's median income.

Currently, there are at least three different views on the applicable commitment period. Majority of courts hold that in order for a plan to be confirmed over objections, the plan must require the debtor to be committed to the plan for a fixed number of years (the temporal approach). *Baud v. Carroll*, 634 F.3d 327 (6th Cir. 2011); *In re Frederickson*, 545 F.3d 652 (8th Cir. 2008). A significant minority of courts reject the temporal approach all together, instead holding that the "applicable commitment period" is a monetary requirement and therefore only used in the monthly disposable income calculation to determine the amount of money that must be paid under the plan. *See In re Kagenveama*, 541 F.3d 868 (9th Cir. 2008) and *In re Tennyson*, 611 F.3d 873 (11th Cir. 2010). Finally, to further complicate the issue, some circuits hold that the "applicable commitment period" should be applied even if a debtor has zero or negative projected disposable monthly income, *see Baud* and *Frederickson*, *supra*, while other hold that it is inapplicable where debtor's projected

disposable monthly income is zero or negative, *see Kagenveama*, *supra*. The Court of Appeals decisions addressing these differing approaches to the "applicable commitment period" are briefly outlined below.

A. *Baud v. Carroll, 634 F.3d 327 (6th Cir. 2011)*

In *Baud*, after filing their chapter 13 plan, the debtors were classified as above-median income debtors with negative disposable income (debtors included actual mortgage payments as expenses and excluded social security benefits from income, resulting in negative disposable income). Because debtors' plan projected payments for only 36 months, the Trustee objected to confirmation of the plan, arguing that the applicable commitment period for the debtors (above median income debtors) was 60 months. Ultimately, the bankruptcy court confirmed an amended (60-month) plan and the debtors appealed. The District Court disagreed with the bankruptcy court, instead holding that the 60-month commitment period does not apply in cases of negative disposable income. Trustee appealed the District Court's decision.

In reversing the District Court's holding that the applicable commitment period does not apply to negative income debtors, the Sixth Circuit first recognized that when debtors with positive projected disposable income file a plan that does not propose to pay unsecured claims in full and an objection to the plan is filed, debtors' proposed plan must extend for the entire applicable commitment period. The same holds true even if substantial portion of Debtor's income is Social Security income, which is statutorily excluded from calculation of projected disposable income.

With respect to zero or negative projected disposable income, the Sixth Circuit interpreted the language of 11 U.S.C. §1325(b) as applicable to both debtors with zero or negative projected disposable income and those with positive projected disposable income.

B. *In re Frederickson, 545 F.3d 652 (8th Cir. 2008)*

Identical to *Baud*, the Chapter 13 debtor in *Frederickson* was an above-median income debtor, with negative disposable income[1], who proposed a plan with duration of less than 60 months. The Trustee objected to plan confirmation on the ground that the applicable commitment period (60 months) applied, even if a debtor has negative projected disposable income. Unlike *Baud*, however, both lower courts disagreed with the Trustee and confirmed debtor's plan even though the plan did not extend for the full applicable commitment period.

Although acknowledging that the language of 11 U.S.C. § 1325(b) is "not at all clear," on appeal, the Eight Circuit reversed the lower courts, holding that the "applicable commitment period" of 11 U.S.C. § 1325(b) is a temporal requirement and that it applied to debtors with negative projected disposable income. The Court reasoned that its "…approach realistically determines how much a debtor can afford to pay his creditors and maximizes the amount the debtor must pay to his unsecured creditors…the object is not to select the right form, but to reach a reality-based determination of a debtor's capabilities to repay creditors. Additionally, under this interpretation, the "applicable commitment period" is logically a temporal requirement that does not lead to anomalous or absurd results." *Id.* at 660 (internal quotations and citations omitted).

[1]As noted by Judge Dow in footnote five of his decision in *In re Arlen*, 461 B.R. 550 (Bankr. W.D. Mo. 2011), "[w]hether *Frederickson* involved a situation in which the debtors had no *projected* disposable income is unclear. While the court states that the parties supposedly stipulated that Frederickson had no *projected* disposable income, the court nonetheless observes that he had excess income over expenses as indicated on Schedules I and J and concludes he has actual projected disposable income." (internal citations omitted).

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

Tennyson represents a hybrid approach to the "applicable commitment period" problem. In *Tennyson*, debtor filed for chapter 13 bankruptcy. Based on his disposable income calculations, debtor was classified as an above-median income debtor with a negative projected monthly income. Subsequently, debtor proposed a 36-month plan that did not provide for full repayment of unsecured claims. Both the Bankruptcy Court and the District Court confirmed the plan over Trustee's objections. Trustee appealed to the Eleventh Circuit.

Like the Sixth Circuit in *Baud* and the Eight Circuit in *Frederickson*, the Eleventh Circuit held that a plain reading of 11 U.S.C § 1325(b) requires a finding that "applicable commitment period" is a temporal term. The Eleven Circuit also noted that when a debtor's plan proposes to pay the unsecured creditors in full, the "applicable commitment period" does not apply.

D. *In re Kagenveama, 541 F.3d 868 (9th Cir. 2008)*

Kagenveama provides an example of the monetary approach courts adopt in dealing with the issues arising from the interpretation of 11 U.S.C. § 1325(b). Moreover, *Kagenveama* also stands for the proposition that the "applicable commitment period" does not apply in cases where a debtor has zero or negative projected disposable income.

Kagenveama also involved an above-median income debtor with a negative projected disposable monthly income. Debtor proposed a three-year plan and the Trustee objected. Bankruptcy Court overruled Trustee's objections and confirmed the three-year plan. Trustee directly appealed to the Ninth Circuit.

The Ninth Circuit agreed with the debtor, holding that projected disposable income is directly linked to disposable income. The Court held that the "applicable commitment

period" should simply be used as a multiplier to determine the projected disposable monthly income. In addition, the Ninth Circuit adopted that position that if a debtor's projected disposable income is zero or negative, the "applicable commitment period" is inapplicable. Specifically, the Court reasoned:

> Here, the "applicable commitment period" is irrelevant because it applies only to the payment of "projected disposable income," and, in this case, there is no "projected disposable income." Kagenveama's voluntary payments come from money other than "projected disposable income"; therefore, there is no requirement that these payments occur for five years. Because her "projected disposable income" was zero or less and, therefore, the "applicable commitment period" did not apply, the bankruptcy court properly confirmed her plan.

Id. at 877. Therefore, the Court affirmed the bankruptcy court's ruling and confirmed the debtor's three-year plan.

II. Assumption, Rejection and Assignment of Intellectual Property Interests

Section 365 of the Bankruptcy Code allows a debtor to assume, reject or assign executory contracts and unexpired leases despite provisions to the contrary in those contracts/leases. *See* 11 U.S.C. § 365(a), (f). Section 365(c)(1), however, provides an exception to the general rule and prohibits assumption or assignment of contracts/unexpired leases if:

> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
>
> (B) such party does not consent to such assumption or assignment....

11 U.S.C. § 365(c)(1). It is this exception, which requires an interpretation of Section 365(c)(1), that has given our courts significant challenges in deciding assumption/assignment

of executory contracts and unexpired leases, especially in the area of intellectual property licenses. When faced with issues relating to assumption/assignment of intellectual property licenses, some courts favor the licensor and utilize the hypothetical test in interpreting Section 365(c)(1) (CATAPULT) while others are more debtor-friendly and follow the "actual test" (Institut Pasteur, Leroux, and Bonneville). More recently, some circuits have elected to follow a newer test, the so-called *Footstar* analysis, in deciding the assumption/assignment issues under 11 U.S.C. § 365. [SEE Sunterra and West Electronics). The three different approaches of interpreting Section 365(c)(1) are briefly outlined below.

A. *The "Hypothetical" Test*

Courts that follow the "hypothetical" test in determining whether a debtor can assume/assign intellectual property licenses interpret the language of Section 365(c)(1) as requiring the courts to analyze whether a debtor *could* assign the IP license even if that debtor only seeks to assume it. The leading case that adopted the "hypothetical" test is *In re Catapult Entertainment*, 165 F.3d 747 (9th Cir.), *cert. dismissed*, 120 S. Ct. 369 (1999).

In *Catapult*, the debtor was a licensee under two patent license agreements. When the debtor filed for bankruptcy protection, the debtor sought to assume the two license agreements as part of its reorganization plan. The licensor objected to the assumption of the license agreements, but both lower courts allowed debtor to assume the agreements. Licensor appealed to the Ninth Circuit.

The issue before the Ninth Circuit was whether the language of 11 U.S.C. § 365(c)(1) allows the debtor to assume the license agreements without the licensor's consent. Recognizing the circuit split with respect to the interpretation of Section 365(c)(1), the Ninth

Circuit chose to follow the Third,[2] Fourth[3] and Eleventh[4] Circuits and adopt the hypothetical test as governing the assumption of executory contracts. *See Catapult*, 165 F.3d at 749.

In reaching its decision, the Court first noted that Section 365(c)(1) prohibited a debtor from assuming an executory contract without consent when assignment of the contract was barred by "applicable law." Therefore, the Court concluded, "[t]he literal language of § 365(c)(1) is thus said to establish a "hypothetical test": a debtor in possession may not assume an executory contract over the nondebtor's objection if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession has no intention of assigning the contract in question to any such third party." *Id.* at 750. The Court, then, applied the "hypothetical" test to the facts of the case and found that under applicable law, the federal patent law, patent licenses were not assignable without the consent of the licensor. As the applicable law barred assignment of patent licenses, the Court held that Section 365(c)(1) prohibited the debtor from assuming the two patent licenses without licensor's consent, even though the debtor had no intention of assigning the patent licenses in question.

B. *The "Actual" Test*

On the other side of the spectrum are those courts that follow the "actual" test in determining whether a debtor can assume intellectual property licenses. These courts only look at what the debtor is *actually* proposing to do, rather than focusing on hypothetical behavior. The seminal decision discussing the "actual" test is *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997).

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[2] *See Matter of West Electronics, Inc.*, 852 F.2d 79 (3rd Cir.1988) (holding that 11 U.S.C. § 365(c)(1) creates a hypothetical test).
[3] *See In re Sunterra Corp.*, 361 F.3d 257 (4th Cir. 2004) (holding that Section 365(c)(1) requires a debtor obtain consent to assume an executory contract and also obtain consent to assign the contract because assumption and assignment are two distinct actions).
[4] *See In re James Cable Partners*, 27 F.3d 534 (11th Cir. 1994).

In *Pasteur*, the debtor entered into mutual cross-license agreements where each agreement prohibited the licensee from assigning the licenses to third-parties. Debtor subsequently entered into bankruptcy and proposed to sell all of its stock to a third-party as part of its reorganization process. Licensor objected to the plan, arguing that the sale of the stock to a third-party constituted assumption of the cross-license agreements and a "de facto" assignment of the licenses to the buyer of the stock. Both the bankruptcy court and the District Court allowed the assumption of the licenses, finding that the sale of the stock did not constitute a "de facto" assignment but merely an assumption of the licenses by the debtor under new ownership. An appeal was taken to the First Circuit.

When faced with the issue of interpretation of Section 365(c)(1) to determine whether the debtor was authorized to assume the licenses at issue, the First Circuit rejected the "hypothetical" test and adopted the "actual" test, as mandated by its decision in *In re Leroux*, 69 F.3d 608 (1st Cir. 1995). The Court reasoned:

> We rejected the proposed hypothetical test in *Leroux*, holding instead that subsections 365(c) and (e) contemplate a case-by-case inquiry into whether the nondebtor party (viz., Pasteur) actually was being "forced to accept performance under its executory contract from someone other than the debtor party with whom it originally contracted." Where the particular transaction envisions that the debtor-in-possession would assume and continue to perform under an executory contract, the bankruptcy court cannot simply presume as a matter of law that the debtor-in-possession is a legal entity materially distinct from the prepetition debtor with whom the nondebtor party (viz., Pasteur) contracted. Rather, "sensitive to the rights of the nondebtor party (viz., Pasteur)," the bankruptcy court must focus on the performance actually to be rendered by the debtor-in-possession with a view to ensuring that the nondebtor party (viz., Pasteur) will receive "the full benefit of [its] bargain."

Id. at 493. Therefore, the Court found that the debtor could assume the licenses because it was not *actually* proposing to assign them to a third party. The Court also found that the sale

of the stock to another party did not constitute a "de facto" assignment because, even after the stock sale, the debtor remained "in all material respects the legal entity with which [licensor] freely contracted…" *Id.* at 495.

Although technically a minority approach among appellate courts, the "actual" test advocated in *Pasteur* was also followed by the Fifth Circuit in *In re Mirant Corp.*, 440 F.3d 238 (5th Cir. 2006), where the Fifth Circuit relied on the "actual" test to hold that an *ipso facto* clause in an executory contract was void under Section 365(e)(1) because the debtor was not actually proposing to assign that contract.

C. *The Footstar Approach*

The *Footstar* approach was coined by Judge Hardin in *In re Footstar, Inc.*, 323 B.R. 566 (Bankr. S.D.N.Y. 2005) and In re Footstar 337 B.R. 785 (Bankr. S.D.N.Y 2005) (holding the same) and made applicable to the intellectual property realm (specifically, cable franchise agreements) by Judge Gerber in *In re Adelphia Communications Corp.*, 359 B.R. 65 (Bankr. S.D.N.Y. 2007).

The *Footstar* approach represents a new way of reading Section 365(c)(1) because it differentiates between a debtor in possession's right to assume from a trustee's right to assume. Therefore, where a debtor in possession (rather than a trustee) seeks to assume an executory contract, the fact that a non-debtor can object to an *assignment* does not have any effect on the *assumption*. In essence, the *Footstar* approach reaches the same conclusion as the "actual" test, except that it employs a different analysis in reaching that same conclusion.

III. Credit Bidding

11 U.S.C § 1129 outlines the requirements for confirmation of chapter 11 plans of reorganization. Generally, in order to be confirmed, plans of reorganization must be accepted

by each class of impaired claimants (*see* 11 U.S.C. §1129(a)), unless they can be classified as "cramdown" plans under 11 U.S.C. § 1129(b). If a plan is a "cramdown" plan, it can be confirmed over the objections of a class of creditors if it is "fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). Section 1129(b)(2)(A) defines "fair and equitable" and specifies that a "fair and equitable" plan must provide:

> (i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
>
> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A).

Generally, Debtors who seek to confirm liquidating "cramdown" plans under subsection ii of Section 1129(b)(2)(A) have not given the courts any difficulties in making the confirmation decision. Under subsection ii, "cramdown" plans that seek to sell all of debtors' assets free and clear of liens can be confirmed over objections of secured creditors if those plans permit secured creditors to credit bid on debtors' assets. Debtors who seek to confirm a liquidating "cramdown" plan under subsection iii of Section 1129(b)(2)(A), however, create

a challenge because courts find it difficult to (1) determine whether a liquidating "cramdown" plan even falls under the scope of subsection iii and (2) determine the meaning of "indubitable equivalent."

Recently, the Seventh, Third and Fifth Circuits have faced the dilemma surrounding the interpretation of Section 1129(b)(2)(A) in the context of liquidating "cramdown" plans. The Seventh Circuit interprets Section 1129(b)(2)(A) as allowing confirmation of liquidating "cramdown" plans over secured creditors' objections only if the plans meet the requirements of subsection ii of Section 1129(b)(2)(A), while the Fifth and Third Circuits hold that subsection iii provides an alternative basis for confirming such plans. These Circuit cases are briefly outlined below.

A. *River Road Hotel Partners, LLC v. Amalgamated Bank, 651 F.3d 642 (7th Cir. 2011)*

After defaulting on loans incurred in connection with building a hotel and event space, Debtors filed for protection under chapter 11 of the Bankruptcy Code. As part of their reorganization process, Debtors proposed to sell substantially all of their assets and sought court's approval of certain bidding procedures. Because the bidding procedures did not give the secured lenders the right to credit-bid, the Lender objected, arguing that Debtors' proposed plans violated 11 U.S.C. § 1129(b)(2)(A)(ii). Debtors' countered with the argument that their plans satisfied the requirements of Section 1129(b)(2)(A)(iii) and, therefore, were confirmable even though they did not comply with Section 1129(b)(2)(ii). Relying on Judge Ambro's dissent in *Philadelphia Newspapers* (*infra)*, the Bankruptcy Court held that Section 1129(b)(2)(A)(ii) provides the exclusive means of confirming a liquidating plan that has not been approved by secured creditors and denied Debtors' bidding procedure motions. Debtors directly appealed to the Seventh Circuit.

The issue before the Seventh Circuit was whether the bankruptcy court correctly interpreted Section 1129(b)(2)(A)(ii) as providing the exclusive means of confirming a liquidating "cramdown" plan. Finding the statutory analysis by the dissent in *Philadelphia Newspapers* compelling, the Seventh Circuit found that the language of Section 1129(b)(2)(A) was ambiguous as to whether subsection (iii) could be used as a distinct option for confirming liquidating "cramdown" plans. *Id.* at 649. According to the Court, there were two possible interpretations of subsection (iii): "one that reads Subsection (iii) as having global applicability and one that reads it as having a much more limited scope." *Id.* at 649-650.

Relying on the principles of statutory interpretation, the Court rejected Debtor's reading of subsection (iii) and found that subsection (iii) should be interpreted as being limited in its scope. Specifically, the Court stated:

> If, as the Debtors propose, Subsection (iii) permits a debtor to sell an asset free and clear of liens without permitting credit bidding, then it is difficult to see what, if any, significance Subsection (ii) can have. Similarly, the Debtors' interpretation would permit properly-designed reorganization plans to sell encumbered assets without satisfying the conditions set forth in Subsection (i). We cannot conceive of a reason why Congress would state that a plan must meet certain requirements if it provides for the sale of assets in particular ways and then immediately abandon these requirements in a subsequent subsection. The infinitely more plausible interpretation of Section 1129(b)(2)(A) would read each subsection as stating the requirements for a particular type of sale and "construing each of the [ ] subparagraphs ... [as conclusively governing] the category of proceedings it addresses." Under such a reading, plans could only qualify as "fair and equitable" under Subsection (iii) if they proposed disposing of assets in ways that are not described in Subsections (i) and (ii).

Id. at 652 (internal citations omitted). The Court also found that Debtors' interpretation of Section 1129(b)(2)(A) was not consistent with the way that secured creditors' interest are

treated in other parts of the Bankruptcy Code (Sections 363(k) and 1129(b)(2)(A)(ii) give secured creditors the right to credit bid and Section 1111(b) gives secured creditors the right to protect their claims when a debtor seeks to retain possession of an encumbered asset). *Id.* at 653.

B. *In re Philadelphia Newspapers, LLC, 599 F.3d 298 (3rd Cir. 2010).*

In *Philadelphia Newspapers*, owners of the Philadelphia Inquirer, Philadelphia Daily News and online publication philly.com filed for chapter 11 bankruptcy protections after defaulting on a loan obtained to acquire these assets. Debtors proposed a joint liquidating plan of reorganization, seeking to sell all of their assets to a stalking-horse bidder. Debtors also filed a motion to approve bidding procedures, providing that all competing bids must be cash bids and barring Debtors' secured Lenders from credit bidding on the assets. The Lenders, the US Trustee and other creditors filed objections to the credit bidding motion.

The bankruptcy court refused to approve Debtors' bidding procedures, holding that Section 1129(b)(2)(A)(ii) required the Debtor to allow the secured creditors to credit bid on their assets. The District Court, however, reversed the bankruptcy court's decision, instead finding that subsection (iii) of Section 1129(b)(2)(A) provided a distinct ground for approving a liquidating "cramdown" plan. An appeal was taken to the Third Circuit.

Over a strong dissent, the Third Circuit majority agreed with the District Court and held that subsection (iii) should be interpreted as including in its scope the liquidating "cramdown" plans and that such plans could be confirmed under subsection (iii) of Section 1129(b)(2)(A) as long as they met the "indubitable equivalent" requirement. With respect to the meaning of the phrase "indubitable equivalent," the Court found that its meaning was unambiguous, defining it as "the unquestionable value of lender's secured interest in the

collateral." *Id.* at 310. In this case, the cash generated at the sale could constitute the "indubitable equivalent" required by subsection (iii).

Judge Ambro strongly dissented and argued that Section 1129(b)(2)(A) was ambiguous and, therefore, should be interpreted in the context of the entire Bankruptcy Code and Congressional intent. Judge Ambro argued that subsection (ii) provided the exclusive means of confirming a liquidating "cramdown" plan without consent of secured creditors. Judge Ambro summarized his views on the issue by stating:

> I cannot agree that the plain language of § 1129(b)(2)(A) is unambiguous and compels the sole interpretive conclusion they see as the plain meaning of the words. There is more than one reasonable reading of the statute, and thus we cannot simply look to its text alone in determining what Congress meant in enacting it. When we apply long-established canons of statutory interpretation to § 1129(b)(2)(A), examine it in the context of the entire Bankruptcy Code, and look at the section's legislative history and the comments of Code drafters, they all point to the conclusion that the Code requires cramdown plan sales free of liens to fall under the specific requirements of § 1129(b)(2)(A)(ii) and not to the general requirement of subsection (iii). Thus I would reverse the judgment of the District Court and restore the presumptive right to "credit bid" provided in subsection (ii).

Id. at 319. It is Judge Ambro's dissenting opinion that provided the basis for the Seventh Circuit's decision in *River Road, supra.*

C. *In re Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009).*

Following the majority in *Philadelphia Newspapers*, the Fifth Circuit reached the same conclusion in *Pacific Lumber* and held that subsection (iii) of Section 1129(b)(2)(A) provided independent grounds for confirming a liquidating "cramdown" plan over objections that the plan failed to provide the noteholders with the right to credit bid.

In *Pacific Lumber*, after debtors' exclusivity period was terminated, two viable competing plans were presented, one by a secured creditor and competitor and the other by the Indenture Trustee. Both plans provided for a sale of substantially all of Debtors' assets. The bankruptcy court approved the plan proposed by the secured creditor and competitor, finding that the 513.6 million in cash that the noteholders stood to receive under the plan constituted "indubitable equivalent" of their claim and met the requirements of 11 U.S.C. § 1129(b)(2)(A)(iii). The Indenture Trustee directly appealed to the Fifth Circuit, arguing, *inter alia*, that the confirmed plan was not "fair and equitable" because it did not permit the noteholders to credit bid on Debtors' assets.

In finding that the plan proposed by the secured creditor and competitor should be confirmed under subsection (iii) of Section 1129(b)(2)(A), Fifth Circuit focused on the disjunctive "or" separating the subsections of Section 1129(b)(2)(A). Because the subsections are separated by an "or," the Court found that each subsection provides an alternative for confirming a "cramdown" plan. The Court also found that the "indubitable equivalent" requirement imposed by subsection (iii) of Section 1129(b)(2)(A) was met by providing the noteholders with the cash equivalent to the value of the collateral, thereby warranting confirmation of the plan.

IV. Limitations on Jurisdiction of the Bankruptcy Courts

On June 23, 2011, the United States Supreme Court sent shockwaves throughout the bankruptcy community when it issued its decision in *Stern v. Marshall*, 131 S.Ct. 2594 (2011), ruling that a bankruptcy court lacked the Constitutional authority to decide a claim that was exclusively based on state law rights.

The *Stern* case arose from the infamous marriage between Vickie Lynn Marshall (Anna Nicole Smith) and J. Howard Marshall II and Anna Nicole's hostile relationship with Mr. Marshall's son, E. Pierce Marshall. Even before Mr. Marshall's death, Anna Nicole sued E. Pierce Marshall in Texas probate courts, arguing that Pierce fraudulently induced Mr. Marshall to exclude her from his will. Pierce, in turn, filed an adversary proceeding (alleging defamation) against Anna Nicole in Anna Nicole's subsequent bankruptcy case. He also filed a proof of claim against Anna Nicole, alleging that his defamation claim was not dischargeable in the bankruptcy case. Anna Nicole filed a counterclaim, essentially making the same argument as her in her claim in probate court (tortious interference by Pierce).

Concluding that Anna Nicole's counterclaim was a core proceeding, the Bankruptcy Court considered the merits of the counterclaim and ruled in Anna Nicole's favor, awarding her approximately $400 million in compensatory and $25 million in punitive damages. The probate court, however, ruled in favor of Pierce. On appeal from the Bankruptcy Court, the District Court reversed the Bankruptcy Court's decision regarding whether the counterclaim was a "core" proceeding but, nonetheless, ruled in Anna Nicole's favor on the merits. The Supreme Court granted certiorari for the second time (the case had already gone to the Supreme Court on another issue), this time to decide (1) whether the Bankruptcy Court had the statutory authority under 28 U.S.C. § 157(b) to issue a final judgment on Anna Nicole's counterclaim and (2) if, so, whether conferring that authority on the Bankruptcy Court is constitutional. *Id.* at 2600.

Although finding that the counterclaim was indeed a "core" proceeding under the Bankruptcy Code, the Supreme Court found that the Bankruptcy Court violated Article III when it entered a final judgment on Anna Nicole's counterclaim. The Supreme Court found

that "[w]hen a suit is made of 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789,' and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts." *Id.* at 2609 (internal citations omitted). The Court found that the "…case involve[d] the most prototypical exercise of judicial power: the entry of a final, binding judgment by a court with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime." *Id.* at 2615. Therefore, only Article III judges had the power to adjudicate the case.

Although the Supreme Court specified that its decision in *Stern* should be construed narrowly, this ruling continues to trouble bankruptcy courts across our Nation. Currently, only two Circuits (the Seventh and the Second) have directly addressed issues arising out of *Stern*, however, we await decisions from the Fifth and Ninth Circuits on their pending appeals involving *Stern* issues. The Seventh and Second Circuit cases are briefly outlined below.

A. *Ortiz v. Aurora Health Care, Inc., 665 F.3d 906 (7th Cir. 2011)*

When Aurora Health Care, Inc. filed proofs of claim against numerous debtors without redacting debtors' medical treatment information, two groups of Debtors filed separate class action suits against Aurora under a Wisconsin statute that requires that all patient records remain confidential. Although both groups of Debtors filed suit based on the same state statute, the first group of Debtors filed their class action in a bankruptcy court, while the second group filed their suit in a Wisconsin state court. Aurora then removed the state court action to the Bankruptcy Court. Both sides, however, did not want to litigate the case in the

Bankruptcy Court and filed separate motions that sought to strip the Bankruptcy Court from the jurisdiction to hear the issues.

The Bankruptcy Court disagreed, finding that it had jurisdiction because the cases were "core" proceedings under 11 U.S.C. § 157(b)(2)(B) and (C). The Bankruptcy Court reasoned that "the cases constituted core proceedings because the debtors' claims could only arise in a bankruptcy context and Congress included the allowance or disallowance of claims and counterclaims by the estate against persons filing claims against the estate in its definition of core proceedings." *Id.* at 909. The Bankruptcy Court then granted Aurora's motion for summary judgment, dismissing the adversary complaint of the first group Debtors, finding that the Wisconsin statute required proof of actual damages, which the Debtors failed to prove. A direct appeal was taken to the Seventh Circuit.

In light of *Stern v. Marshall*, where the United States Supreme Court held that Article III barred bankruptcy judges from deciding claims that constitute "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789," *Stern*, 131 S. Ct. at 2609, the Seventh Circuit dismissed the appeals and remanded the cases to the Bankruptcy Court. Essentially, the Seventh Circuit broadly applied *Stern* to conclude that a bankruptcy court did not have final adjudicative authority to decide claims based on a Wisconsin state law that banned health care providers from revealing patients' confidential information. Although the Court found that Debtors' claims were "core" proceedings, the claims asserted against Aurora constitutes state law claims because they were based on a state statute. Therefore, these claims would not normally be adjudicated through the claims allowance process. Consequently, only an Article III court could adjudicate these claims.

B. *In re DPH Holdings Corp., 2011 WL 5924410 at *1 (2nd Cir. Nov. 29, 2011)*

Comparing *DPH Holdings* with *Ortiz* leaves the impression that that the Second Circuit favors a more narrow interpretation of *Stern* than the Seventh. In *DPH Holdings Corp*, an adversary proceeding was filed against the chapter 11 debtor and against state workers' compensation agency and fund, seeking a declaration that insurance policies issued to the debtor did not provide workers' compensation coverage for debtor's employees. Defendants moved to dismiss the adversary proceeding and the motion was denied by the Bankruptcy Court and the District Court. Defendants appealed to the Second Circuit, arguing that the Bankruptcy Court did not have jurisdiction over the adversary proceeding because the adversary proceeding did not constitute a "core" proceeding under the Bankruptcy Code.

In a very short opinion, the Second Circuit held that, post-*Stern*, it continues to interpret "core proceedings" as broadly as permitted under the Constitution. The Court found that the adversary proceeding in question was a contract-based adversary and constituted a "core" proceeding because most of the contracts were post-petition contracts, which made them part of the bankruptcy estate, thereby making the adversary proceeding one concerning the administration of the estate. The Court also held that even the pre-petition contract were "core" because "the nature of the adversary proceeding is one that is likely to 'directly affect a core bankruptcy function.'" *Id.* at *2 (internal citations omitted).

C. Pending Circuit Cases

There are two pending cases in the Fifth and Ninth Circuits that also merit discussion because these cases could add to the Circuit level split. On appeal to the Ninth Circuit is The 412(i) Company or *Bellingham Insurance Agency, Inc. v. Executive Benefits Insurance Agency, Inc.,* No. 11-35162. As phrased by the Ninth Circuit in that case

(when it invited supplemental briefs by amicus curiae), the jurisdictional issues presented are whether *Stern v. Marshall* "prohibits bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance? If so, may the bankruptcy court hear the proceeding and submit a report and recommendation to a federal district court in lieu of entering a final judgment?" *Bellingham* involves a chapter 7 trustee's fraudulent conveyance and related state law claims against several former executives, shareholders and employees of the debtor, some of whom had not filed claims against the estate. After the bankruptcy court granted summary judgment, the case was appealed to the District Court, which conducted a de novo review and affirmed the Bankruptcy Court's decision. Since the case went up to the Ninth Circuit before *Stern* was decided, the jurisdictional issues were introduced after the initial briefing.

With respect to the jurisdictional issues, the trustee/appellee has argued that: (i) *Stern* does not divest the Bankruptcy Court of subject matter jurisdiction to hear state law claims related to fraudulent conveyance actions; (ii) even if *Stern* does divest the Bankruptcy Court of final adjudicative authority, the Article III District Court's de novo review and subsequent affirmance in a final order renders any procedural misstep moot; and (iii) by litigating the case in the Bankruptcy Court and the District Court, the appellant waived his objections to subject matter jurisdiction by not raising them. The defendants/appellants have argued that the Bankruptcy Court lacked jurisdiction to enter summary judgment against them. Those amici similarly advocating a broad interpretation of the *Stern* decision rely heavily on the Supreme Court's decision in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) in which the Court stated that "a bankruptcy trustee's right to recover a fraudulent conveyance under

11 U.S.C. § 548(a)(2) seems to us more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions."

Other issues raised on appeal are whether the Bankruptcy Court maintains the ability to submit reports and recommendations to the District Court, whether withdrawal of the reference is required and whether the Bankruptcy Court lacks all authority to hear or determine fraudulent transfer claims.

Pending in the Fifth Circuit is *Technical Automation Services Corp. v. Liberty Surplus Insurance Corporation*, Case No. 10-20640. In this case, the Fifth Circuit, *sua sponte*, raised the issue of whether the reasoning of the Supreme Court's decision in *Stern v. Marshall* applies to bar non-Article III magistrate judges from entering final judgment in a case tried by consent under 28 U.S.C. § 363(c), where jurisdiction is based on diversity of citizenship and state law provides the rule of decision.

Both of the parties in *Technical Automation* contend that the *Stern* decision did not affect magistrate judges' authority to issue final orders in diversity cases involving state law claims tried by consent, which has generally been confirmed previously by the Fifth Circuit. The plaintiff advocates limiting *Stern* to bankruptcy cases involving state-law based counterclaims. The defendant also distinguishes *Stern* on two additional grounds. First, that there is "significantly greater oversight of magistrate judges than bankruptcy judges." And second, that the *Liberty* case was tried by an Article I judge with the parties' independent and free consent, which had been previously held to be jurisdictionally sound in *Roell v. Withrow*, 538 U.S. 580, 583 (2003).