

Great Debates

Brian T. Fenimore, Moderator

Lathrop & Gage LLP; Kansas City

Consumer Debate

Resolved: Limited-scope representation should be allowed in consumer bankruptcy cases.

PRO: Theresa V. Brown-Edwards

DARBY | BROWN-EDWARDS LLC; Wilmington, Del.

CON: Hon. Robert D. Berger

U.S. Bankruptcy Court (D. Kan.); Kansas City

Business Debate

Resolved: Bankruptcy judges are authorized to do structured dismissals in chapter 11 bankruptcies.

PRO: G. David Dean, II

Cole, Schotz, Meisel, Forman & Leonard, PA; Baltimore

CON: T. Patrick Tinker

Office of the U.S. Trustee; Wilmington, Del.

Judicial Debate

Resolved: A debtor can force a secured creditor to accept title to its collateral pursuant to a plan that provides for its surrender or vesting in that creditor.

PRO: Hon. Robert E. Nugent

U.S. Bankruptcy Court (D. Kan.); Wichita

CON: Hon. Arthur B. Federman

U.S. Bankruptcy Court (W.D. Mo.); Kansas City



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Limited Scope Representation in Bankruptcy Practice: Permitted. Prudent?

MIDWESTERN BANKRUPTCY INSTITUTE OCTOBER 16-17, 2014



Context.

PROFESSIONAL RESPONSIBILITY
IN BANKRUPTCY PRACTICE.

Context: Ethics in Bankruptcy Court.

Kansas Rules of Professional Conduct apply in Bankruptcy Court in the District of Kansas.

D. Kan. Rule 83.6.1(a): “The Kansas Rules of Professional Conduct as adopted and amended by the Supreme Court of Kansas are adopted by this court as the applicable standards of professional conduct, except as otherwise provided by a specific rule of this court.”

Context: Ethics in Bankruptcy Court.

Local Rules also govern bankruptcy practice in the District of Kansas.

LBR 1001.1(a): “These supplemental rules are promulgated under the authority of Fed. R. Bankr. P. 9029 and D. Kan. Rule 83.8.12. Practice before this court is governed by applicable D. Kan. Rules, unless there is a more specific Fed. R. Bankr. P. or D. Kan. LBR. See D. Kan. Rule 83.8.2.”

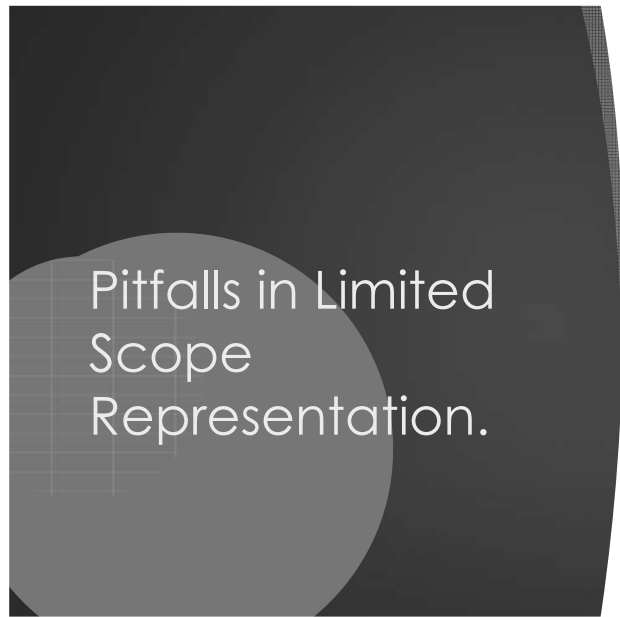
Context: Ethics in Bankruptcy Court.

D. Kan. Rule 83.8.2: “These local district court rules govern practice and procedure in this district of all cases under Title 11 United States Code and of all civil proceedings arising under, in or related to Title 11. They implement and complement Title 11 United States Code, . . . and other local rules of this court.”

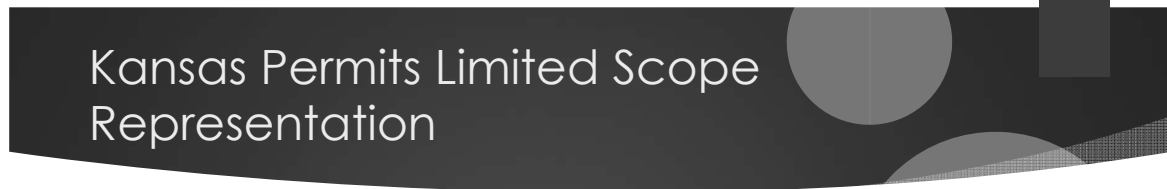
Context: Ethics in Bankruptcy Court.

Missouri’s Rules of Professional Conduct apply in Bankruptcy Court in the Western District of Missouri.

W. D. Mo. Local Rule 83.5 (c)(2): “The Code of Professional Responsibility adopted by this Court is the Code of Professional Responsibility adopted by the highest court of the state in which this Court sits, as amended from time to time by that state court, except as otherwise provided by specific Rule of this Court”



PERMITTED.
PRUDENT?



Limited scope representation is *permitted*, but remains subject to professional responsibility constraints.

New D. Kan. Rule 83.5.8(c): “Participation. The United States District Court for the District of Kansas allows any attorney registered as active to practice before this court to offer limited scope representation.”

Missouri Permits Limited Scope Representation

Missouri S. Ct. Rule 4-1.2(c): “A lawyer may limit the scope of representation if the client gives informed consent in a writing signed by the client to the essential terms of the representation and the lawyer’s limited role.”

Missouri S. Ct. Rule 4-1.1, Comment [5]: “An agreement between the lawyer and the client regarding the scope of the representation may limit the matters for which the lawyer is responsible.”

Kansas Restrictions on Limited Scope Representation

The District of Kansas adopted certain of the State of Kansas’ professional responsibility restrictions on limited scope representation.

New D. Kan. Rule 83.5.8(a) adopted language from KRPC 1.2(c) verbatim:

“A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent in writing.”

Kansas Restrictions on Limited Scope Representation

The District of Kansas also adopted new procedural requirements based on those used by the State of Kansas.

New D. Kan. Rule 83.5.8(b):

“(b) Procedures. A lawyer who provides limited representation must comply with Kansas Supreme Court Rule 115A, as later amended or modified, with two exceptions.

“First, the lawyer must use the federal forms rather than the Kansas State Court forms.

“Second, Rule 115A(c) does not apply in the District of Kansas. Any attorney preparing a pleading, motion or other paper for a specific case must enter a limited appearance and sign the document. . . .”

Kansas Restrictions on Limited Scope Representation

New D. Kan. Rule 83.5.8(b) expressly allows the Bankruptcy Court rules governing limited scope representation to differ from the District Court rules.

▶ ***“The Bankruptcy Court may have additional Local Rules that govern its limited scope practice.”*** (italics added)

The Bankruptcy Court for the District of Kansas recently issued an “additional” rule governing limited scope practice.

Kansas Restrictions on Limited Scope Representation

New Bankruptcy Standing Order No. 14-1:

“IT IS HEREBY ORDERED that D. Kan. Rule 83.5.8, except to the extent ordered below, shall not apply in the United States Bankruptcy Court for the District of Kansas without further order of the Court. The purpose of this Standing Order is to preserve the status quo of bankruptcy practice, without adding the additional pleadings required by D. Kan. Rule 83.5.8.”

Kansas Restrictions on Limited Scope Representation

HOWEVER, Standing Order No. 14-1 does NOT suspend:

- ▶ **Rules of Professional Conduct or**
- ▶ **Standards of practice established by the Court.**

Standing Order No. 14-1: “IT IS FURTHER ORDERED that no provision of this Standing Order in any way negates or avoids a lawyer’s duty to abide by the Rules of Professional Conduct and any standards of practice established by this Court.”

Questions to ask.

WHEN CONSIDERING LIMITED
SCOPE REPRESENTATION:
IS THIS CASE WORTH IT?

Did you specify the limited scope of your representation with adequate clarity and specificity in writing?

D. Kan. Rule 83.5.8(a) and KRPC 1.2(c): “A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent in writing.”

11 U.S.C. § 528(a)(1): “A debt relief agency shall- (1) . . . Execute a written contract with such assisted person that explains clearly and conspicuously—(a) the services such agency will provide to such assisted person; and (b) the fees or charges”

Did you specify the limited scope of your representation with adequate clarity and specificity in writing?

Missouri S. Ct. Rule 4-1.2(c): “A lawyer may limit the scope of representation if the client gives informed consent in a writing signed by the client to the essential terms of the representation and the lawyer’s limited role.”

Did you specify the limited scope of your representation with adequate clarity and specificity in writing?

Missouri S. Ct. Rule 4-1.2(d) lists exceptions to the requirement of a writing signed by the client: initial consultation, pro bono services offered through qualifying programs, and not-for-profit services funded through the Legal Services Corporation.

Note, however, that the exceptions do not eliminate the requirement to provide informed consent.

Missouri S. Ct. Rule 4-1.2, Comment [2]: “If a written agreement is not required by Rule 4-1.2, the better practice is for the attorney to memorialize in writing the contact and services provided. . . . The lawyer shall explain to the client the risks and benefits of limited representation during the consultation on limiting the scope of representation.”

Did you specify the limited scope of your representation with adequate clarity and specificity in writing?

State of Missouri affords attorneys certain presumptive protections in limited scope representations—if the language used in the agreement is sufficiently clear.

Missouri S. Ct. Rule 4-1.2(c): “Use of a written notice and consent form substantially similar to that contained in the comment to this Rule 4-1.2 creates the presumptions:

(1) the representation is limited to the lawyer and the services described in the form, and

(2) the lawyer does not represent the client generally or in any matters other than those identified in the form.”

Did you fully advise your client on all matters necessary to give informed consent to enter a limited scope representation agreement?

KRPC 1.4(b): “A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.”

KRPC 1.4(b), Comment [1]: “The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued, to the extent the client is willing and able to do so.”

Did you fully advise your client on all matters necessary to give informed consent to enter a limited scope representation agreement?

Missouri S. Ct. Rule 4-1.2(a): “A lawyer shall abide by a client’s decisions concerning the objectives of representation . . . and shall consult with the client as to the means by which they are to be pursued.”

Missouri S. Ct. Rule 4-1.2, Comment [2]: “The lawyer shall explain to the client the risks and benefits of limited representation during the consultation on limiting the scope of representation.”

Can you handle this case competently if you only represent the client in a limited scope?

KRPC 1.16(b)(4), Comment [1]: “A lawyer should not accept representation in a matter unless it can be performed competently, promptly, without improper conflict of interest and to completion.”

Can you handle this case competently if you only represent the client in a limited scope?

Missouri S. Ct. Rule 4-1.1 “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.”

Missouri S. Ct. Rule 4-1.2, Comment [2]: “An agreement for limited representation does not exempt a lawyer from the duty to provide competent representation; however, the limitation of the scope of representation is a factor to be considered when determining the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation as required in Rule 4-1.1.”

Have you fully checked for conflicts?

KRPC 1.16(b)(4): “Except as stated in paragraph (c), a lawyer may withdraw from representing a client if withdrawal can be accomplished without material adverse effect on the interests of the client”

KRPC 1.16(b)(4), Comment [1]: “A lawyer should not accept representation in a matter unless it can be performed competently, promptly, without improper conflict of interest and to completion.”

Have you fully checked for conflicts?

Missouri S. Ct. Rule 4-1.16(a): “Except as stated in Rule 4-1.16(c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if: (1) the representation will result in violation of the rules of professional conduct or other law”

Missouri S. Ct. Rule 4-1.16, Comment [2]: “A lawyer should not accept representation in a matter unless it can be performed competently, promptly, without improper conflict of interest, and to completion.”

Are you sufficiently aware of issues outside the scope of your representation to give advice that considers all relevant factors?

Sometimes, the professional rules require more than purely technical legal advice on the limited range of legal issues covered by your limited scope agreement.

KRPC 2.1: “In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.”

KRPC 2.1, Comment [2]: “Advice couched in narrowly legal terms may be of little value to a client, especially where practical considerations, such as cost or effects on other people, are predominant. Purely technical legal advice, therefore, can sometimes be inadequate.”

Are you sufficiently aware of issues outside the scope of your representation to give advice that considers all relevant factors?

Missouri S. Ct. Rule 4-2.1: “In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors that may be relevant to the client’s situation.”

Missouri S. Ct. Rule 4-2.1, Comment [2]: “Advice couched in narrowly legal terms may be of little value to a client, especially where practical considerations, such as cost or effects on other people, are predominant. Purely technical legal advice, therefore, can sometimes be inadequate.”

Are you willing to accept the risk that you might not be permitted to withdraw, despite your limited scope representation agreement?

KRPC 1.16(c): “When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.”

KRPC 1.16, Comment [7]: “A lawyer may withdraw from representation in some circumstances. The lawyer has the option to withdraw if it can be accomplished without material adverse effect on the client’s interests.”

Are you willing to accept the risk that you might not be permitted to withdraw, despite your limited scope representation agreement?

This risk of being unable to withdraw appears to be greater in Federal Court in the Western District of Missouri than in Missouri State Court.

W. D. Missouri Local Rule 83.5(o): “Withdrawal of Counsel and Entry of Appearance of New Counsel. Counsel may not be relieved from further representation of a client without obtaining leave of Court. Such leave will ordinarily be denied unless entry of appearance by substitute counsel is assured or has occurred.”

Are you willing to accept the risk that you might not be permitted to withdraw, despite your limited scope representation agreement?

Missouri S. Ct. Rule 4-1.16(b): “Except as stated in Rule 4-1.16(c), a lawyer may withdraw from representing a client if: (1) withdrawal can be accomplished without material adverse effect on the interests of the client.”

Missouri S. Ct. Rule 4-1.16(c): “A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation unless the lawyer has filed a notice of termination of limited appearance. Except when such notice is filed, a lawyer shall continue representation when ordered to do so by a tribunal notwithstanding good cause for terminating the representation.”

Missouri S. Ct. Rule 4-1.16, Comment [8]: “A lawyer may withdraw if the client refuses to abide by the terms of an agreement relating to the representation, such as . . . an agreement limiting the objectives of the representation.”

How will you provide your client sufficient advance notice if other counsel are needed to address matters outside your scope?

KRCP 1.16(d): “Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client’s interests, such as giving reasonable notice to the client, allowing time for employment of other counsel”

Missouri S. Ct. Rule 4-1.16(d): “Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client’s interests, such as giving reasonable notice to the client, allowing time for employment of other counsel”

How will you assure that the client receives papers or property in your possession to respond to matters outside your scope?

KRCP 1.16(d): “Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client’s interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee that has not been earned.”

Missouri S. Ct. Rule 4-1.16(d): “Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client’s interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee that has not been earned.”

Did you communicate unambiguously to your client and the court when your representation ended?

KRPC 1.3, Comment [3]: “Unless the relationship is terminated as provided in Rule 1.16, a lawyer should carry through to conclusion all matters undertaken for a client. If a lawyer’s employment is limited to a specific matter, the relationship terminates when the matter has been resolved. If a lawyer has served a client over a substantial period in a variety of matters, the client sometimes may assume that the lawyer will continue to serve on a continuing basis unless the lawyer gives notice of withdrawal. Doubt about whether a client-lawyer relationship still exists should be clarified by the lawyer, preferably in writing, so that the client will not mistakenly suppose the lawyer is looking after the client’s affairs when the lawyer has ceased to do so. For example, if a lawyer has handled a judicial or administrative proceeding that produced a result adverse to the client but has not been specifically instructed concerning pursuit of an appeal, the lawyer should advise the client of the possibility of appeal before relinquishing responsibility for the matter.”

Did you communicate unambiguously to your client and the court when your representation ended?

Missouri S. Ct. Rule 4-1.16(c): “A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation unless the lawyer has filed a notice of termination of limited appearance. Except when such notice is filed, a lawyer shall continue representation when ordered to do so by a tribunal notwithstanding good cause for terminating the representation.”

Did you advise opposing counsel in writing that they must communicate to your client through you regarding subjects within your scope?

Missouri S. Ct. Rule 4-1.2(d): “An otherwise unrepresented party to whom limited representation is being provided or has been provided is considered to be unrepresented for purposes of communication under Rule 4-4.2 and Rule 4-4.3 except to the extent the lawyer acting within the scope of limited representation provides other counsel with a written notice of a time period within which other counsel shall communicate only with the lawyer of the party who is otherwise self-represented.”

Also: When dealing with an attorney providing limited scope representation to the opposing party, be careful to communicate with the proper person.

PREPARED BY AND USED WITH THE PERMISSION OF:
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AMERICAN BANKRUPTCY INSTITUTE JOURNAL

June 2010 • The Essential Resource for Today's Busy Insolvency Professional • Vol. XXIX, No. 5

Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales

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In recent years, it has become commonplace for a chapter 11 debtor to utilize bankruptcy to effectuate an orderly sale of all or substantially all of its assets pursuant to § 363 of the Bankruptcy Code, prior to confirmation of a chapter 11 plan. This is especially true in cases where the pre-petition lender is undersecured and the case is administratively insolvent. After a sale of all or substantially all of a debtor's assets, which could be in the form of a going-concern or a liquidation, and absent the agreement of the undersecured creditor, the debtor is typically left with no unsecured assets to administer or with insufficient unsecured assets to fund a confirmable chapter 11 plan.



Norman L. Pernick

Chapter 11 debtors have traditionally chosen among three possible courses of action after a sale of their assets. First, a debtor could proceed with confirmation of a liquidating chapter 11 plan, which requires compliance with §§ 1123 and 1129. The path of a chapter 11 liquidating plan is consequently not available to every debtor, as a liquidating plan requires enough cash to satisfy administrative-expense and priority claims and to fund the chapter 11 plan process. This is a particular challenge in cases

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involving an undersecured creditor with a blanket lien on all of a debtor's assets, especially without that secured creditor's agreement to fund the often-significant costs of both a liquidating plan and the plan process. Second, a debtor could convert the chapter 11 case to a case under chapter 7 and allow a chapter 7 trustee to distribute a debtor's remaining assets, if any, to creditors and to prosecute any available avoidance actions. Third, a debtor could seek entry of a simple order dismissing the chapter 11 case, returning the parties to their state law rights and remedies.



G. David Dean

This article discusses a less common but increasingly used approach known as a "structured" dismissal. A structured dismissal is a dismissal coupled with some or all of the following additional provisions in the dismissal order: releases (some more limited than others), protocols for reconciling and paying claims, "gifting" of funds to unsecured creditors and provisions providing for the bankruptcy court's continued retention of jurisdiction over certain post-dismissal matters.

Although cases involving structured dismissals have not yet resulted in memorandum decisions (published

or unpublished), there have been a number of rulings that are useful to understanding how structured dismissals have been presented by parties and viewed by courts. We begin with a discussion of the statutory bases relied on for structured dismissals, what factual showing might be required to obtain a structured dismissal and common provisions approved in structured dismissal orders.¹

Statutory Framework

Parties requesting approval of structured dismissals rely on § 1112(b) and/or § 305(a)(1) of the Bankruptcy Code. Structured-dismissal motions grounded in either statutory provision are often coupled with a request pursuant to § 105(a) of the Code, which allows a bankruptcy court to enter orders that are "necessary or appropriate to carry out the provisions of" the Code. 11 U.S.C. § 105(a).

Section 1112(b), governing conversion or dismissal of a chapter 11 case, is generally utilized as the statutory basis for a structured dismissal when a debtor has administered its assets and is either administratively insolvent and/or lacks the funding to proceed with confirmation of a liquidating chapter 11 plan.² Section 1112(b)(1) provides, in part, that "the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of

¹ This article is intended to highlight structured dismissal as a possible option for a debtor to consider following a pre-confirmation "all asset" sale(s). It is not intended to take a position regarding the appropriateness of a structured dismissal in the first instance; the factual showing (if any) required to obtain a structured dismissal before any particular court, or the propriety of any particular provision in a structured-dismissal order.

² In at least one case, § 305(a)(1) was used as the sole-statutory basis to obtain a structured dismissal, on the grounds that the debtor was likely administratively insolvent and therefore could not confirm a plan. See *In re CSJ Inc.*, Case No. 01-12923 (REG) (Bankr. S.D.N.Y. July 24, 2006) [Dkt. No. 284] (Motion). In addition, in *In re KB Toys Inc.*, Case No. 08-13269 (KJC) (Bankr. D. Del. Feb. 16, 2010) [Dkt. No. 993] (Order), the court entered a dismissal order under both §§ 1112(b) and 305(a)(1).

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Structured Chapter 11 Dismissals: An Alternative after Asset Sales

from cover

creditors and the estate, if the movant establishes cause.” 11 U.S.C. § 1112(b)(1). Section 1112(b)(4) contains a non-exhaustive list of circumstances justifying “cause” under § 1112(b)(1).

Two primary justifications advanced by proponents of structured dismissals are that there exists “a substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation,” and that the debtor is unable to effectuate substantial consummation of a plan. *See id.* at §§ 1112(b)(4)(A), (M).³ Because § 1112(b)(4)’s list is non-exhaustive, in cases where cause might not fit neatly in one of the stated provisions of § 1112(b)(4), parties argue that a bankruptcy court is not limited to the examples of “cause” listed in § 1112(b)(4).⁴ Assuming that “cause” exists, a bankruptcy court is required to convert or dismiss the chapter 11 case, “absent unusual circumstances...that the requested conversion or dismissal is not in the best interest of creditors and the estate.” 11 U.S.C. § 1112(b)(1). In the context of structured-dismissal requests, parties assert that the costs of converting to and administering a case under chapter 7, as well as the enhanced provisions in the structured dismissal order, are in the best interest of creditors and the estate and that dismissal is a preferable remedy over conversion.

Section 305 has provided additional statutory support for obtaining a structured dismissal in some cases. Section 305 provides, in part, that the court may dismiss a case under any chapter of the Bankruptcy Code if “the interests of creditors and the debtor would be better served by such dismissal.” 11 U.S.C. § 305(a)(1). Although § 305 has historically been used to dismiss involuntary cases, courts have found the statute to be applicable to voluntary cases as well.⁵

Because a dismissal under § 305(a) is not appealable, 11 U.S.C. § 305(c), courts universally recognize that § 305(a) is an “extraordinary remedy.”

and that “dismissal is appropriate under § 305(a)(1) only where both ‘creditors and the debtor’ would be ‘better served’ by a dismissal.”⁶ Indeed, several courts have noted that, “[g]ranted an abstention motion pursuant to § 305(a)(1) requires more than a simple balancing of harm to the debtor and its creditors; rather, the interests of both the debtor and its creditors must be served by granting the requested relief.”⁷

Required Factual Showing

The statutory grounds for dismissal under §§ 1112(b)(2) and 305(a)(1) are relatively straightforward. “Cause” must be established under § 1112(b)(2), and the dismissal must be in the best interest of the debtor and creditors under § 305(a)(1). Given the absence of reported or unreported decisions on the subject, however, the application of these standards in the context of structured dismissals is not so clear.

Before considering the factual record necessary for approval of a structured-dismissal motion, a bankruptcy court may first question the propriety of a structured dismissal as a matter of law. In so doing, a court may take the view that the Code does not authorize a structured dismissal, and that a structured dismissal equates to a *sub rosa* plan. Therefore, such a court might find that the debtor has three choices post-sale: (1) proceed with confirmation of a liquidating chapter 11 plan, (2) convert the case to chapter 7 and allow a chapter 7 trustee to administer the assets or (3) dismiss the case via a simple dismissal order with no “bells and whistles.”⁸

If a bankruptcy court finds that structured dismissal is permissible, which most courts considering the issue to date appear to conclude, the next question is what factual showing is necessary to justify entry of a structured dismissal order. Although there are no definitive answers, three factual scenarios describe the circumstances in which

most structured dismissals have been approved to date.

The first such case is one in which the debtor’s assets have been sold in the chapter 11 case but the debtor is administratively insolvent or is potentially administratively solvent and does not have the means to fund the confirmation process.⁹ Proponents of such structured dismissals focus primarily on the argument that “cause” exists under §§ 1112(b)(4)(A) and (M), because the debtor cannot confirm a chapter 11 plan, and that conversion is not in the best interest of creditors due to costs associated with conversion to and administering of a chapter 7 case. In these cases, dismissal primarily is grounded in one of two structures: (1) the debtor proposes to pay administrative and priority creditors a *pro rata* distribution, with no payments to unsecured creditors; or (2) the debtor proposes to pay unsecured creditors without paying administrative and priority creditors in full, through the creation of a trust funded by a “gift” consensually carved out of the undersecured senior lender’s recovery as part of a settlement agreement. A “gift” trust settlement could be entered into as part of the sale process and carried over into a dismissal motion, or made part of a consensual motion to dismiss the case. Either way, a carve-out gift trust has served as a vehicle for granting a recovery to subordinate creditors in a way that would likely violate the absolute priority rule in a plan scenario.

The second type of case is one in which the debtor has liquidated all of its assets and potentially could confirm a chapter 11 liquidating plan.¹⁰ In such cases, proponents argue that a structured dismissal is most appropriate because funding the plan process would eliminate or reduce the remaining pot of money available for distribution to pay unsecured creditors. Parties seeking approval of such structured dismissals typically argue that § 1112(b)(4)’s list

⁶ *Id.* (citing several cases in support of limited application of § 305(a)(1)).

⁷ *See, e.g., id.* (citations omitted).

⁸ In *In re BT Holding III LLC*, Case No. 09-11173 (CSS) (Bankr. D. Del. Oct. 5, 2009), the court denied the debtors’ and creditors’ committee’s joint motion for entry of a structured dismissal order on the grounds that it was premature and that no current controversy existed that required a court order. In so ruling, however, the court questioned, in *dicta*, whether any basis existed in the Bankruptcy Code for a dismissal order with “extra bells and whistles,” such as the retention of post-dismissal jurisdiction and claims administration procedures. Transcript of Oct. 5 2009 hearing, at 47, lines 1-15.

⁹ *See Foamex* [Dkt. No. 712] (Motion dated Nov. 19, 2009); *Alternative Distr. Sys. Inc.*, Case No. 09-13099 (PJW) (Bankr. D. Del. Nov. 3, 2009) [Dkt. No. 194] (Motion); *In re Wickes Holdings LLC*, Case No. 08-10212 (KJC) (Bankr. D. Del. 2008) [Dkt. No. 1346] (Motion); *In re Princeton Ski Shop Inc.*, Case No. 07-26206 (MS) (Bankr. D. N.J. Dec. 23, 2008) [Dkt. No. 472] (Motion); *In re New Weatherlane Retail Corp.*, Case No. 04-11649 (PJW) (Bankr. D. Del. Aug. 4, 2005) [Dkt. No. 543] (Motion).

¹⁰ *See BT Holding* [Dkt. No. 268] (Motion dated July 23, 2009); *In re Dawarhars of Lexington LLC*, Case No. 08-51381 (JMS) (Bankr. E.D. Ky. Dec. 10, 2008) [Dkt. No. 304] (Motion); *In re Blades Board & Skate LLC*, Case No. 03-48818 (NLW) (Bankr. D. N.J. June 7, 2004) [Dkt. No. 110] (Motion).

of what constitutes “cause” for dismissal is nonexclusive and that the bankruptcy court has broad discretion to approve a structured dismissal, if it is in the best interest of creditors.¹¹

The final scenario where structured dismissals are sought is where a debtor’s assets have not been fully administered by way of a pre-confirmation sale process, but rather a workout has been achieved. In such cases, proponents have relied on § 305(a)(1) as the primary statutory basis for relief, as opposed to § 1112(b). There is at least one published opinion with this scenario, *In re Colonial Ford Inc.*¹² In that case, the debtor entered into a pre-petition workout that had the effect of restructuring the entire company and resolving multiple litigations. The debtor then filed a voluntary chapter 11 case and the creditors moved for an order of abstention from bankruptcy under § 305(a)(1). The court granted the motion, holding that “[s]ection 305(a)(1) reflects a policy, embodied in several sections of the Code, which favors ‘workouts’: private, negotiated adjustments of creditor-company relations.”¹³ The court further noted that such an out-of-court workout would require near universal agreement among the creditors and would need to be adequate to rehabilitate the business outside of bankruptcy.

The more recent case of *In re Magnolia Energy LP*¹⁴ also used § 305(a)(1) as the basis to grant the debtor’s motion to dismiss the chapter 11 case. In that case, after the chapter 11 filing, the debtors’ indirect equity-holder was able to obtain refinancing that would be used, in part, to pay creditors in full. The order granting the motion provided for payment of all scheduled claims, all professional claims and the establishment of a \$300,000 reserve account to pay any other claims that might not have been properly scheduled. The order conditioned dismissal on a subsequent closing, including evidence that the payments contemplated by the order had been made.

The previous two scenarios illustrate cases where structured dismissals were approved even though a chapter 11 plan was at least feasible. Notwithstanding that economic reality, given the apparent growing trend of approved structured dismissals throughout the country,

debtors (and their senior secured creditor(s) and the creditors’ committees) may more frequently consider structured dismissal as a cheaper and quicker alternative to a liquidating chapter 11 plan. In fact, the efficacy and cost of a liquidating plan and the confirmation process might be questioned altogether, under the appropriate set of facts, if a structured dismissal with satisfactory provisions could be obtained.

Relief Granted in Structured-Dissmissal Orders

Orders entered approving structured dismissals in various jurisdictions have proven one thing: A number of courts have been willing to date to sign structured-dismissal orders that arguably go well beyond earlier plain-vanilla dismissal orders, although most have been entered consensually. The absence of reported or unreported decisions makes it difficult to predict how bankruptcy courts might view certain provisions in the future, particularly in contested situations. Consideration of the types of relief granted in various structured-dismissal orders entered since 2004 may provide some guidance. The most frequently used provisions fall into five general categories:

1. *Release and exculpation provisions.* Several structured-dismissal orders contain release provisions, some being broader in scope than others. The scope of releases ranges from the more traditional releases seen in a chapter 11 plan,¹⁵ to releases limited to actions related to the structured-dismissal motion.¹⁶

2. *Claims reconciliation process and distribution procedures.* Most structured-dismissal orders contain some type of claims-reconciliation process. While exact language of the orders varies, they generally attempt to incorporate an expedited, cost-effective way to reconcile claims and distribute funds to creditors. In some cases, claims are allowed in the amounts submitted in the dismissal motion, in the absence of an objection.¹⁷ In one case, creditors were required to object to amounts stated in the dismissal motion, and pay the costs associated with contesting any such

objection.¹⁸ Another case incorporated an *omnibus* claim objection into the dismissal motion, binding creditors who failed to object.¹⁹

Structured dismissal orders with claim reconciliation procedures typically also contain provisions similar to those contained in chapter 11 plans governing distributions. Such provisions include minimum distribution limitations, check-cashing periods, limitations of the number of distributions to be made and authorization to donate nominal remaining amounts to charity.

3. *Carveouts and “gift” trusts.* As part of negotiating an acceptable sale order, or later a consensual structured dismissal, a debtor’s senior secured lender often agrees to carve out a portion of its collateral from the proceeds of sale and “gift” it to a trust. If an estate does not have sufficient funds to pay administrative and priority claims, and therefore cannot confirm a plan, a structured-dismissal order usually is premised on distributing the gift-trust money to a debtor’s unsecured creditors.²⁰ On the other hand, if administrative and priority claims are being paid in full, and a gift trust is not formally established, the remaining assets will simply be set aside for the payment of unsecured creditors after administrative and priority claims are fully satisfied.²¹

4. *Conditions to dismissal.* Most structured-dismissal orders (even some providing for claims reconciliation and distributions after entry of the order) do not contain conditions to dismissal. At least one structured-dismissal order, however, has placed conditions subsequent on dismissal become effective.²²

5. *Enforceability of prior orders and retention of jurisdiction.* Structured-dismissal orders often provide that, notwithstanding § 349 of the Bankruptcy Code, prior orders of the court survive dismissal.²³ Another common provision appearing in structured-dismissal orders is a provision providing for a bankruptcy court’s retention of jurisdiction—usually at least over fee applications and/or implementation of the structured-

¹¹ In at least one case, the proponent argued that “cause” existed under § 1112(b)(4)(A) because there was nothing left to reorganize post-sale, and that a plan of “reorganization” could not be confirmed. *In re BAG Liquidation Ltd.*, Case No. 08-32096 (SGJ) (Bankr. N.D. Tex. Aug. 14, 2009) [Dkt. No. 672] (Motion).
¹² 24 B.R. 1014 (Bankr. D. Utah 1982).
¹³ *Id.* at 1015.
¹⁴ Case No. 06-11069 (MFW) (Bankr. D. Del. Feb. 12, 2007) (*Magnolia*) [Dkt. No. 196] (Order).

¹⁵ *Cape May* [Dkt. No. 313] (order entered Dec. 23, 2004) (releases approved for debtors, secured lender, official committee, their estates, shareholders, officers and directors and counsel, for everything up to date of dismissal order).
¹⁶ *Dawarhars’s* [Dkt. No. 304] (order entered Dec. 18, 2008); *In re Harvey Electronics Inc.*, Case No. 07-14051 (ALG) (Bankr. S.D.N.Y. Dec. 16, 2008) [Dkt. No. 177] (Order); *New Weatherlane* [Dkt. No. 566] (order entered Sept. 2, 2005).
¹⁷ *Wickes* [Dkt. No. 1346] (order entered March 23, 2009); *Blades* [Dkt. No. 126] (order entered June 7, 2004).

¹⁸ *New Weatherlane* [Dkt. No. 566] (order entered Sept. 2, 2005).
¹⁹ *CSI* (Bankr. S.D.N.Y. July 24, 2006) [Dkt. No. 271] (order entered July 24, 2006).
²⁰ *Wickes* [Dkt. No. 1346] (order entered March 23, 2009).
²¹ *Blades* [Dkt. No. 126] (order entered June 7, 2004).
²² *Magnolia* [Dkt. No. 196] (order entered Feb. 12, 2007) (dismissal not effective until certification of counsel filed evidencing payment of claims).
²³ See, e.g. *In re CFM U.S. Corp.*, Case No. 08-10668 (KJC) (Bankr. D. Del. Feb. 1, 2010) [Dkt. No. 1282] (Order); *New Weatherlane* [Dkt. No. 566] (order entered Sept. 2, 2005).

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dismissal order.²⁴ Last, the vast majority of structured-dismissal orders were entered only after notice of the motion to dismiss was provided to all creditors.

Conclusion

Although there are very few reported or unreported decisions approving structured dismissals, there is clearly a

trend developing where courts are more frequently entering orders approving structured-dismissal orders containing varying degrees of “bells and whistles,” as opposed to “plain vanilla” dismissal orders. Many of those cases involve § 363 sales in chapter 11 of all or substantially all of the debtor’s assets in situations of administrative insolvency. In others, a confirmed chapter 11 plan is feasible, but the court instead approves

a structured-dismissal order with some of the provisions that one would expect to see in a plan. Whatever the factual scenario, one thing is clear: If you are representing a debtor or an official committee in a chapter 11 case, a structured dismissal along the lines of the cases described in this article may now be the quickest and most cost-effective way to conclude your chapter 11 case. ■

²⁴ *Princeton* [Dkt. No. 546] (order entered Dec. 23, 2008); *Dawarhara's* [Dkt. No. 304] (order entered Dec. 18, 2008); *Harvey* [Dkt. No. 177] (order entered Dec. 15, 2008).

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Structured Dismissals, or Cases Dismissed Outside of Code's Structure?

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A recent *ABI Journal* article discussed structured dismissals as an option for debtors who sell substantially all of their assets pre-confirmation, leaving them “with no unsecured assets to administer or with insufficient unsecured assets to fund a confirmable plan.”¹ The authors describe a structured dismissal as:

a dismissal coupled with some or all of the following additional provisions in the dismissal order: releases (some more limited than others), protocols for reconciling and paying claims, “gifting” of funds to unsecured creditors and provisions providing for the bankruptcy court’s continued retention of jurisdiction over certain post-dismissal matters.²

They concluded that structured dismissals could be “the quickest and most cost-effective way to conclude your chapter 11 case.”³ No one disputes that dismissal is appropriate in the right circumstances, including cases where insufficient assets exist to justify continued administration,⁴ but the structured dismissals described in the article seem to fall outside the three paths for concluding a chapter 11 case under the Bankruptcy Code—confirming a plan, converting to chapter 7 or dismissing without “bells and whistles”—and may sacrifice critical bankruptcy safeguards included in the traditional statutory options.⁵ Thus, properly evaluating structured dismissals requires comparison and contrast with the statutory options.

First, compared to plan confirmation, structured dismissals “end run...the protection granted creditors in chapter 11” and strongly resemble impermis-

¹ Norman L. Pernick and G. David Dean, “Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales,” 29 *Am. Bankr. Inst. J.*, June 2010, at 1, 58-59 (2010).

² *Id.* at 58.

³ *Id.*

⁴ 11 U.S.C. § 1121(b).

⁵ *Id.* at 58 (three options are “traditionally chosen”).

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sible *sub rosa* plans.⁶ Second, unlike chapter 7 liquidation, structured dismissals distribute assets without enforcing priorities, addressing litigation or ensuring accountability for distributing assets. Third, unlike traditional dismissals, structured dismissals fail to reinstate state law creditor remedies.

Plan Confirmation Updated Sub Rosa Plan?

Structured dismissals are typically sought after court approval of asset

Structured dismissals are a new permutation of the *sub rosa* plan. Because structured dismissals are sought separately from the earlier sale or settlement, the sale or settlement itself does not present *sub rosa* plan issues because nothing therein limits disclosure or voting or predetermines plan terms. It is the subsequent structured dismissal that defines or restricts what would otherwise have been in a plan, such as distribution of sale or settlement proceeds, or disenfranchises other creditor rights normally attendant to plan confirmation. This process effectively bifurcates a single *sub rosa* plan. Structured dismissals should be similarly evaluated and disapproved where confirmation safeguards are circumvented.

Alternatively, a well-crafted sale order can avoid *sub rosa* plan bifurcation by precluding a subsequent structured dismissal. The estate does not generally benefit from a debtor in possession (DIP) selling over-encumbered property, and

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sales or settlements.⁷ Courts treat a proper asset sale or settlement as “a step towards possible confirmation of a plan of reorganization and not an evasion of the plan confirmation process.”⁸ Courts generally disapprove asset sales or settlements that “short circuit...the Code’s carefully crafted scheme for creditor enfranchisement,”⁹ including “the safeguards of disclosure, voting, acceptance and confirmation.”¹⁰ *Braniff* is the seminal case rejecting an asset sale that predetermined future plan terms, calling it a “*sub rosa* plan.”¹¹ Since *Braniff*, courts have widely adopted the *sub rosa* plan language and analysis, but many now require objecting parties to identify the specific rights or protections denied by the sale or settlement.¹²

⁶ See *Institutional Creditors of Continental Air Lines Inc. v. Continental Air Lines Inc.* (In re Continental Air Lines Inc.), 780 F.2d 1223, 1224 (5th Cir. 1986).

⁷ See, e.g., *Committee of Equity Sec. Holders v. Lionel Corp.* (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983); *Trailer Ferry Protective Comm. for Indep. Stockholders of TMT Trailer Ferry Inc. v. Anderson*, 390 U.S. 414 (1968).

⁸ See *Motorola Inc. v. Official Comm. of Unsecured Creditors* (In re Iridium Operating LLC), 478 F.3d 452, 467 (2d Cir. 2007).

⁹ *PBGC v. Braniff Airways Inc.* (In re Braniff Airways Inc.), 700 F.2d 935, 940 (5th Cir. 1983).

¹⁰ *Lionel*, 722 F.2d at 1071.

¹¹ *Braniff*, 700 F.2d at 949.

¹² *Continental Air Lines*, 780 F.2d at 1228; *In re Gulf Coast Oil Corp.*, 404 B.R. 407, 422 (S.D. Tex. 2009).

the DIP can abandon it under § 554 as burdensome or of inconsequential value. However, most lenders prefer that the DIP liquidate the collateral in a § 363 sale so that the creditor can reap its attendant benefits. The DIP can and should negotiate for some benefit to the estate for selling over-encumbered property under § 363, including that secured creditors set aside sale proceeds to pay administrative expenses so the case can be administered in accordance with the Code.¹³ A sale order can also require the parties to either confirm a plan or convert to chapter 7.

Omitted Confirmation Safeguards

Structured chapter 11 dismissals ignore important chapter 11 safeguards that structured dismissals omit, including voting, acceptance, disclosure and the “fair and equitable” standards, including the absolute-priority rule.¹⁴ Three provisions discussed in the article illustrate the point.

Releases and Exculpations. The article suggested including releases and exculpations in a structured dismissal.

¹³ See 11 U.S.C. § 506(c).

¹⁴ See “Structured Chapter 11 Dismissals,” *supra*, n.1 at 57-58.

sal.¹⁵ However, § 1141(d)(3) bars “non-individual” debtor discharges in liquidating plans, just as § 727(a) bars equivalent discharges in chapter 7 liquidation. Thus, any release of a debtor entity in a structured dismissal contravenes the Code.

With respect to nondebtors, even with the procedural and substantive protections afforded by the disclosure statement and plan-confirmation process, courts disagree about the permissibility of nonconsensual releases.¹⁶ Courts consider the released party’s contribution to reorganization and the litigation’s impact on the ability to reorganize.¹⁷ In a structured dismissal, such justifications are absent because there is no reorganization.

Even in jurisdictions where nonconsensual releases are permitted at confirmation, they should not be permitted in a structured dismissal. A structured dismissal forecloses a creditor’s ability to assess and negotiate releases because the creditor has neither the information typically provided through the disclosure statement nor the leverage afforded by plan voting. Disclosure statements must address litigation and release issues.¹⁸ Plan voting and acceptance requirements then provide an opportunity for creditors and shareholders to obtain improved treatment, such as additional contributions from nondebtors seeking releases or the elimination of nondebtor releases as unnecessary or excessive. The Code’s protections against improper releases and indemnification are absent in a structured dismissal, and a court should generally deny nonconsensual releases as inconsistent with chapter 11.

Modified Claims-Objection Procedure. The article further recommended including an “expedited, cost-effective way to reconcile claims and distribute funds.”¹⁹ The suggested approaches include debtors’ unilaterally defining claim amounts in the dismissal motion and requiring creditors to object, requiring creditors to pay costs if they object and filing an omnibus claims objection that binds creditors who do not object.²⁰ These scenarios impermissibly alter the claim objection process defined in the Code and Federal Rules of Bankruptcy Procedure. “[T]he need for expedition...is not a justification for abandoning proper standards.”²¹

¹⁵ *Id.* at 57. The scope of the releases may be rather broad and include those “traditional releases seen in a chapter 11 plan.” *Id.*

¹⁶ *Airadigm Commc’ns v. FCC (In re Airadigm Commc’ns)*, 519 F.3d 640, 655-56 (7th Cir. 2008); see also *In re Continental Airlines*, 228 F.3d 203, 212-13 (3d Cir. 2000); *Bank of New York v. Official Unsecured Creditors’ Comm. (In re Pacific Lumber)*, 584 F.3d 229, 252-53 (5th Cir. 2009).

¹⁷ See, e.g., *Airadigm*, 519 F.3d at 656.

¹⁸ *In re U.S. Brass Corp.*, 194 B.R. 420, 429 (Bankr. E.D. Tex. 1996); *In re Metrocraft Pub. Servs. Inc.*, 39 B.R. 567, 571 (Bankr. S.D. Ga. 1984).

¹⁹ “Structured Chapter 11 Dismissals,” *supra*, n.1 at 58.

²⁰ *Id.* (omitting citations to unpublished case examples).

²¹ *TMT Trailer Ferry*, 390 U.S. at 450.

Bankruptcy Rule 3003(b) generally defines the schedule of liabilities as “*prima facie* evidence of the validity and amount” of a creditor’s claim, and § 502(a) presumes the validity of a filed claim absent objection.²² If a party objects to a proof of claim, the issue becomes a contested matter for hearing.²³ *Prima facie* validity for claims and mandatory hearings on claim objections “guard against abuse of the objection process.”²⁴ Although the article posits that modified claim procedures are “cost-effective,” in reality, each imposes extra burdens and costs on the creditor and impermissibly undermines protections afforded by the Code and Rules.

Although parties may...look for the “quickest and most cost-effective” exit from chapter 11, the supposed expediency of a structured dismissal should not trump the statutory protections it alters or ignores.

“*Gifting.*” The third structured-dismissal provision discussed is the “carve-out or ‘gift’ trust.”²⁵ When a debtor files for chapter 11 with substantially all assets encumbered, the secured creditor often seeks to monetize its collateral and reap the benefits of a sale under § 363. Such sales are not unusual, but the deals negotiated to secure sale or settlement approval are often problematic. Although funds allocated for distribution to junior creditors in a structured dismissal may be funded from the proceeds of a lender’s collateral, they should rarely be viewed as a “gift.”

To have the sale or settlement approved without objection, either the secured creditor or the purchaser sets aside funds for the *sole* benefit of a particular group, usually general unsecured creditors, from proceeds otherwise payable to the secured lender. Because there will be insufficient estate funds after the sale to pay administrative expenses or priority creditors in full, the lender makes a class-skipping “gift” to junior creditors who otherwise would receive no distribution under the Code’s priority rules.

²² A creditor that does not comply with the requirements of Rule 3001 does not enjoy *prima facie* validity. *In re Stoecker*, 5 F.3d 1022, 1028 (7th Cir. 1993) (Posner, J.) (“the creditor cannot rest on the proof of claim” if it failed to attach documentation required under Rule).

²³ Fed. R. Bankr. P. 3007(a); Fed. R. Bankr. P. 9014.

²⁴ See 9 Alan S. Resnick and Henry J. Sommer, *Collier on Bankruptcy*, ¶ 3007.01[1] (15th ed. rev. 2009).

²⁵ *Id.*

“Gifting” in structured dismissals contravenes the Code in several ways. First, the “gift” is typically provided in exchange for consideration, such as a release of claims or settlement of an objection. Because secured creditors do not typically make charitable contributions to their borrowers’ junior creditors, the “gift” may actually resolve avoidance, liability or other litigation issues. Thus, the structured dismissal should be adjudicated under the rules governing settlement or plan confirmation.

Second, funds from the sale of a lender’s collateral are estate property.²⁶ Accordingly, whether a senior creditor can “gift” directly to junior creditors—bypassing creditors in the middle—without violating the “absolute-priority rule” is unsettled.²⁷ When a structured dismissal alters the Code’s priorities of distribution, it should be reviewed under the standards for settlement approval or plan confirmation.²⁸

Third, “gifts” in structured dismissals pose disclosure problems. Without the disclosure required for plan confirmation, creditors and shareholders can neither assess whether the lender is resolving potential litigation claims nor determine whether the settlement amount is proper.

Conversion to Chapter 7

Chapter 7 incorporates checks and balances that structured dismissals lack, which make liquidation after a sale of substantially all estate assets preferable to a structured dismissal. Because chapter 7 trustees must account for all estate assets,²⁹ the chapter 7 trustee makes a “final report” addressing the assets liquidated, the claims quantified and the distribution proposed.³⁰ The trustee then distributes funds in accordance with the “final report” and files a “final account.”³¹ Structured dismissals may include a post-dismissal distribution, but they lack oversight by a disinterested chapter 7 trustee and the chapter 7 safeguards against error or abuse.

²⁶ *U.S. v. Whiting Pools Inc.*, 462 U.S. 198, 203-4 (1983).

²⁷ The Second and Third Circuits have each held that in chapter 11 cases, “gifting” plans violate the absolute priority rule of 11 U.S.C. § 1129(b)(2), without regard to whether the bypassed class would have received a distribution absent the gift. See *In re DBSD North America Inc.*, ___ F.3d ___, No. 10-1175, 2011 WL 350480 (2d Cir. Feb. 7, 2011); *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005). However, *DBSD* and *Armstrong* leave open the question of whether gifting distributions would also be impermissible in a chapter 7 liquidation. Cf. *Official Unsecured Creditors’ Comm. v. Stern (In re SPM Mfg. Corp.)*, 984 F.2d 1305, 1307, 1312 (1st Cir. 1993) (upholding undisputed lienholder’s “gift” to unsecured creditors in chapter 7 liquidation).

²⁸ See *Iridium*, 478 F.3d at 467; see also *United States v. AWECO Inc. (In re AWECO Inc.)*, 725 F.2d 293, 298 (5th Cir. 1984).

²⁹ 11 U.S.C. § 704(a)(2).

³⁰ 11 U.S.C. § 704(a)(9).

³¹ *Id.*

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Moreover, when a case converts to chapter 7 from chapter 11, chapter 7 administrative expenses have priority over chapter 11 administrative claims.³² This enables chapter 7 trustees to investigate preference, fraudulent transfer and litigation claims, as well as other possible assets. It also means that chapter 11 professionals will likely receive less and must wait for payment. A structured dismissal may avoid this result, giving the appearance that the chapter 11 professionals may be serving their own interests.

Dismissal and § 349 Unwinding

The article also detailed various statutory grounds supporting dismissal of administratively insolvent cases.³³ However, no one disputes that “cause” exists to convert or dismiss under § 1112; rather, the dispute is whether the cases should be converted, dismissed or dismissed with “bells and whistles” in a structured dismissal.

³² *In re Rittenhouse*, 76 B.R. 610, 611 (Bankr. S.D. Ohio 1987).
³³ “Structured Chapter 11 Dismissals,” *supra*, n.1 at 56.

If a case should be terminated, it can be dismissed, returning parties to the *status quo* ante and preserving their rights under state law in accordance with § 349. Section 349’s purpose is “to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case.”³⁴ Traditional dismissal typically reinstates receiverships, avoided transfers and avoided liens, and reverts property in the debtors.³⁵ Structured dismissals distribute assets and limit or foreclose a creditor’s state law property rights.

Although courts can alter the presumptive effect of § 349(b) for “cause,” the “power to override” § 349(b)’s requirements “is used sparingly.”³⁶ “Cause” under § 349(b) means an acceptable reason. Desire to make an end run around a statute is not an adequate reason... It is not part of the judicial office to seek out creative ways to defeat statutes.”³⁷

³⁴ H.R. Rep. No. 95-595, at 338 (1977); S. Rep. 95-89, at 48-49 (1978).
³⁵ See 11 U.S.C. § 349(b) (referencing reinstatement of these transactions).
³⁶ See 3 Resnick and Sommer, *Collier on Bankruptcy*, ¶ 349.03[2] (16th ed. rev. 2010).
³⁷ *In re Sadler*, 935 F.2d 918, 921 (7th Cir. 1991).

Conclusion

Chapter 11 is designed to administer estates and allocate rights and obligations through court-approved disclosure statements and plans. Alternatively, the Code provides for liquidation and distribution after conversion to chapter 7 or dismissal in accordance with § 349’s reinstatement of state law rights.

The purported need for a structured dismissal is often foreseeable—and thus avoidable—when estates arrive in chapter 11 over-encumbered by liens with a sale of substantially all estate assets the obvious strategy. Although parties may thereafter look for the “quickest and most cost-effective” exit from chapter 11, the supposed expediency of a structured dismissal should not trump the statutory protections it alters or ignores. Cases should be administered according to the structure set forth in the Code and not concluded in a summary manner that is “structured,” but flawed. ■

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The Great Debate

Compelling Lender's Acceptance of Surrendered Property in Chapter 13

The Honorable Robert E. Nugent¹, U.S. Bankruptcy Court for the District of Kansas
The Honorable Arthur B. Federman, U.S. Bankruptcy Court for the Western District of Missouri

I. The Problem

Sometimes chapter 13 debtors propose plans that provide for surrender of their residence to the secured creditor and that creditor fails to object. Following confirmation the creditor takes no action to initiate foreclosure or otherwise assert control over the real property. Property taxes, special assessments, and homeowner's fees, not to mention maintenance expenses, continue to accrue (post-petition) to the debtor who remains in title. Meanwhile, the property deteriorates, creating larger losses to the lender and, ultimately, to the unsecured creditors because of the lender's increasing unsecured claim. Can a bankruptcy court force a lender to accept and act on this surrender? Courts are divided.

In *In re Rose*, 512 B.R. 790 (Bankr. W.D.N.C. 2014), the debtors filed a motion for authority to quitclaim the property to the creditor without its consent. The bankruptcy court held that the Bankruptcy Code does not require a creditor to accept surrendered property, or do anything with it, under § 1325(a)(5)(C); does not require a creditor to accept title to property under § 1322(b)(9); and does not empower courts to compel transfers of surrendered property under § 105(a). Further, state law does not require a creditor to initiate foreclosure or accept title to property. But state conveyance law may allow debtors to quitclaim their property to the mortgage lender, *provided that the creditor does not object*. Note that North Carolina and Florida law (both of which were addressed in *Rose*) do not materially differ from Kansas and Missouri law, at least with respect to presumed acceptance on the part of the grantee. See ¶ II. A. 4, *infra*. *Rose* also contains a good discussion of several unintended consequences by reading the Code or state law to force a lender to take title to surrendered property including impairment of the creditor's rights in the collateral, subjecting the creditor to ownership liabilities it did not agree to pay, and actions that contravene state property law. See *Rose*, 512 B.R. at 795-96.

¹ We acknowledge the assistance of Jana D. Abbott, J.D., elbow clerk to the Hon. Robert E. Nugent, and Erica Garrett, J.D., judicial law clerk to the Hon. Arthur B. Federman. We also acknowledge the work of the Hon. Jeffrey R. Hughes, Karen L. Rowse-Oberle, Esq., Thomas Martin Hensel, Esq., and Christopher W. Jones, Esq., authors of *Surrender of Property in Chapter 13*, presented at the 2013 ABI Detroit Consumer Bankruptcy Conference, see <http://materials.abi.org/material/surrender-of-property-in-chapter-13>.

Contrast this with *In re Rosa*, 495 B.R. 522 (Bankr. D. Haw. 2013), where a mortgagee failed to object to a plan that surrendered the debtor's real estate in full satisfaction of the lender's claims. The plan also provided that title to the property vested in the creditor upon confirmation with the confirmation order constituting a deed of conveyance when properly recorded. By failing to object, the lender "accepted" the plan under § 1325(a)(5)(A), and the court confirmed the plan. *Rosa* didn't deal with forcing the creditor's hand in accepting legal responsibility for the property's ongoing expenses.

II. State Law Consequences of Surrendering Property by Deed

Before considering how the Bankruptcy Code affects these issues, it's useful to consider what state property law provides.

A. Kansas Law

Kansas law generally permits transfer of title by deed so long as there is valid delivery of the instrument either to the grantee or a third party. The grantee is deemed to have accepted the conveyance if the grant is clearly beneficial to the grantee and if the grantee does not expressly disclaim its newly-acquired interest.

1. Necessity of delivery.

Before a deed can operate as a valid transfer of title there must be a delivery of the instrument which becomes effective during the life of the grantor. *In re Estate of Hulteen*, 170 Kan. 515, 227 P.2d 112 (1951); *Wuester v. Folin*, 60 Kan. 334, 56 P. 490 (1899).

2. Sufficiency of delivery.

The question of the delivery of a deed is largely a question of intention and of fact. *Hoard v. Jones*, 119 Kan. 138, 237 P. 888 (1925). To be effective, the grantor must indicate by words or acts his intention to immediately divest himself of title and to vest it in another (*i.e.*, the grantor relinquishes all right to custody or control of the deed). *Agrelius v. Mohesky*, 208 Kan. 790, 494 P.2d 1095 (1972).

3. Delivery to a third person.

Where the grantor in a deed deposits it with a third person, to receive and hold the same for delivery to the grantee after the death of the grantor, *with a declared or manifest intention to place it beyond the custody and control of grantor and thereby to give it effect as a present conveyance*, it is a sufficient delivery, and title is deemed to vest at once in the grantee with only the possession and enjoyment of the property being postponed. *Yaple v. Morris*, 194 Kan. 149, 398 P.2d 320 (1965); *In re Estate of Hulteen*, 170 Kan. 515, 227 P.2d 112 (1951) (where grantor who deposits deed with a third person to deliver to the grantee after the grantor's death, delivery is sufficient); *Kelsa v. Graves*, 64 Kan. 777, 68 P. 607 (1902) (manual delivery of a deed is not necessary to make it effectual); *Wuester v. Folin*, 60 Kan. 334, 56 P. 490 (1899) (grantor need not deliver the deed to the grantee in person); *Pizel v. Pizel*, 7 Kan. App. 2d 388, 643 P.2d 1094 (1982) (where grantor left deed with his attorney for the sole reason that he might later wish to revoke the transfer and reclaim the deed, delivery is insufficient).

a. Recording

The recording of a deed is sufficient proof of delivery by the grantor and acceptance by the grantee. *Kelsa v. Graves*, 64 Kan. 777. The Supreme Court held in *Staats v. Staats*, 148 Kan. 808, Syl. ¶ 3, 84 P.2d 842 (1938) that the recording of a deed is presumptive evidence of its delivery. Even if the grantor retains possession of the recorded deed, delivery is effective. As stated in *Giefer v. Swenton*, 23 Kan. App. 2d 172, 175, 928 P.2d 906, 909-09 (1996):

We stated in *Fooshee v. Kasenberg*, [152 Kan. 100, 103, 102 P.2d 995 (1940)]:

‘It is well settled that the recording of a deed constitutes delivery to the grantee. (*Balin v. Osoba*, 76 Kan. 234, 91 Pac. 57; *Carver v. Main*, 146 Kan. 251, 257, 69 P.2d 681). Where the deed is intentionally recorded by the grantor manual delivery of the deed thereafter is not necessary to make it effectual. (*Turner v. Close*, 125 Kan. 485, 264 Pac. 1047.) In the absence of express disclaimer acceptance by the grantee is presumed. (*Wuester v. Folin*, 60 Kan. 334, 56 Pac. 490; *Miller v. Miller*, 91 Kan. 1, 136 Pac. 953.)’

“It seems to be a well settled rule of law in this state that the recording of a deed constitutes delivery to the grantee, and where the deed is intentionally recorded by the grantor, the manual delivery of the deed thereafter is not necessary to make it effectual. In the absence of express disclaimer, acceptance by the grantee is presumed. [Citations omitted.]” *Hansen v. Walker*, 175 Kan. 121, 124, 259 P.2d 242 (1953).

4. Necessity of acceptance by the grantee.

Acceptance by the grantor is presumed. Where delivery of the deed is sufficient, formal acceptance by the grantee is not required. If the grant is clearly beneficial to the grantee, acceptance is presumed in the absence of proof to the contrary. The presumption of acceptance is not overcome by anything short of the “actual dissent” of the grantee. *Wuester v. Folin*, 60 Kan. 334. Where the deed is recorded, acceptance by the grantee is presumed, absent an express disclaimer. *Hansen v. Walker*, 175 Kan. 121.

- a. Query: Is objecting to a plan, *i.e.*, not “accepting” it under § 1325(a)(1) the same as a disclaimer?

B. *Missouri Law*

1. The Essential Elements of a Deed

The essential elements of a deed are: “(1) names of the parties thereto, (2) words of grant, (3) description of the property, (4) execution and delivery by the grantor, and (5) acceptance by the grantee.” *Kindred v. City of Smithville*, 292 S.W.3d 420, 426-27 (Mo. Ct. App. 2009)

(quoting *Celtic Corp. v. Tinnea*, 254 S.W.3d 137, 142 (Mo. Ct. App. 2008)). The deed need only be subscribed by the grantor and acknowledged or proved and certified. MO. ANN. STAT. § 422.130 (West 2014). Once a deed signed only by the grantor is “delivered to and accepted by the grantee,” it becomes a contract. *Id.* at 427 (quoting *Blackburn v. Habitat Dev. Co.*, 57 S.W.3d 378, 388 (Mo. Ct. App. 2001)). “As the terms of the contract are in writing[,] the grantee’s acceptance of the deed in which the contract is set out, and of which it forms a part of the consideration, is considered equivalent to the signature of the grantee to the contract.” *Id.* (quoting *Employers’ Indem. Corp. v. Garrett*, 327 Mo. 874 (1931)).

2. Necessity of Delivery

Delivery of the deed is required to give effect to the instrument as a conveyance of estate to realty. *LeMehaute v. LeMehaute*, 585 S.W.2d 276, 279 (Mo. Ct. App. 1979). A deed may be delivered by word or act, even if the grantor maintains possession of the deed if the “act or word manifest that he relinquishes dominion or control over the deed and that the instrument operate[s] presently as a transfer of title[] and acceptance by the grantee.” *Id.*

3. Sufficiency of Delivery

Intent determines whether there is a delivery, which is a mixed question of law and fact. *Meadows v. Brich*, 606 S.W.2d 258, 260 (Mo. Ct. App. 1980). The key question of intent is whether the grantor “intended a complete transfer—whether the grantor parted with dominion over the instrument with the intention of relinquishing all dominion over it and of making it presently operative as a conveyance of the title to the land.” *Id.* “Delivery of deed may be made so as to pass title even though the grantor retains possession of the deed.” *O’Mohundro v. Mattingly*, 353 S.W.2d 786, 792 (Mo. 1962); *see also Pollock v. Brown*, 569 S.W.2d 724, 734 (Mo. 1978) (holding that delivery may be made even if the grantor maintains custody of the deed).

4. Delivery to a Third Person

“The distinctive feature of an escrow is the delivery of a deed to a third person to await the performance of some condition, whereupon the deed is to be delivered to the grantee and the title is to pass.” *Morris v. Davis*, 334 Mo. 411, 66 S.W.2d 883, 888 (1933). If the grantor, with the intent to make a complete transfer, delivers a deed to an escrow agent subject to a condition precedent for the conveyance of the deed and the passing of title to the grantee, it will not constitute delivery until the condition is performed. *Hammack v. Coffelt Land Title, Inc.*, 348 S.W.3d 75, 81 (Mo. Ct. App. 2011) (citing *Morris v. Davis*, 66 S.W.2d 883, 888 (Mo. 1933)); *see also Pipes v. Sevier*, 694 S.W.2d 918, 926 (Mo. Ct. App. 1985) (holding that “[a] delivery to a third party, to be held by that party for delivery to the grantee . . . operates as a valid delivery when there is no reservation in the deed nor any right of control over the instrument retained by the grantor.”). Where a grantor in a deed deposits it with a third person to receive and hold until a condition precedent is met, the deed in the hands of the custodian has the same effect “as if it had been manually delivered by the grantor to the grantee.” *Pipes*, 694 S.W.2d at 926. Lastly, “[i]t has long been the law in Missouri that the delivery of a deed by the grantor to a third person with unconditional instructions that it be held by him and delivered to the grantee upon the

grantor's death is a valid delivery[] if there is no reservation by the grantor of dominion over the deed." *Turner v. Mallernee*, 640 S.W.2d 517, 521 (Mo. Ct. App. 1982).

a. Recording

Recording a deed creates a rebuttable presumption of its delivery. *Grueter v. Wetekamp*, 172 S.W.3d 822, 825 (Mo. Ct. App. 2005) (citing *Wilkie v. Elmore*, 395 S.W.2d 168, 172 (Mo. 1965) (holding that the law presumes that a recorded deed has been delivered)). Furthermore, recordation establishes a prima facie case of delivery. *LeMehaute*, 585 S.W.2d at 279. Notably, however, a party does not take title upon recordation, but rather it takes title upon delivery. *La Near v. CitiMortgage, Inc.*, 364 S.W.3d 236, 241 (Mo. Ct. App. 2012). Also, "[a] deed is valid between the parties to the transaction regardless of whether it is recorded." *Newton v. Wimsatt*, 791 S.W.2d 823, 829 (Mo. Ct. App. 1990).

5. Necessity of acceptance by the grantee

Acceptance by the grantee is presumed. In the absence of evidence showing a rejection, acceptance is presumed where the transfer of an interest is beneficial to the grantee. *Clark v. Skinner*, 334 Mo. 1190, 70 S.W.2d 1094, 1099 (1934). "The acceptance may be after the death of the grantor and may be proven by the circumstances." *Id.* In the absence of clear, cogent, and convincing evidence to rebut the presumption of acceptance, a deed should not be set aside. *Pollock v. Brown*, 569 S.W.2d 724, 734 (Mo. 1978).

III. Effect of the Code: Surrender and vesting under §§ 1322(b)(9), 1325(a)(5)(A) and (C), and 1327

A. Vesting, § 1322(b)(9).

A debtor may control the vesting of estate property through the chapter 13 plan. If the debtor is proposing a surrender of the property, it presumably remains property of the estate until confirmation. Under § 1327(b) property of the estate reverts in the debtor upon confirmation of the chapter 13 plan, "[e]xcept as otherwise provided in the plan or the order confirming the plan." Section 1322(b)(9) in turn provides:

Subject to [§ 1322(a) and (c)], the plan may –

* * *

(9) provide for the vesting of property of the estate, on confirmation of the plan *or at a later time*, in the debtor *or in any other entity*. [Emphasis added.]

Thus, the debtor might try to provide for vesting, or transfer, of surrendered property to third parties such as the mortgage creditor upon confirmation. *In re Fisher*, 203 B.R. 958, 961 (N.D. Ill. 1997) (Section 1327(b) should be read to confer property rights beyond possession if the vesting provision is to have any effect); *In re Rosa*, 495 B.R. 522, 524 (Bankr. D. Hawaii 2013) (plain meaning of vesting in § 1322(b)(9) includes a present transfer of ownership).

B. *Creditor's failure to accept or reject, § 1325(a)(5)(A).*

The effectiveness of using vesting under § 1322(b)(9) may be limited. In one published decision, the bankruptcy court confirmed a plan vesting title to the surrendered property in the secured creditor (over the chapter 13 trustee's objection). *See In re Rosa*, 495 B.R. 522 (Bankr. D. Haw. 2013). Even that case turned on the secured creditor's failure to object to its plan treatment, despite having received proper notice of the plan, and by that creditor's silence and inaction, acceptance of the plan was inferred. *See* 495 B.R. at 524-25. The bankruptcy court emphasized that vesting alone was insufficient and also required the secured creditor's acceptance under § 1325(a)(5)(A). *Id.* at 524.

The debtor's nonstandard plan language in *Rosa* provided:

All collateral surrendered for Class 3 claims is surrendered in full satisfaction of the underlying claim. Pursuant to §§ 1322(b)(8) and (9), title to the property located at 91-1849 Luahoana Street, Ewa Beach, Hawaii 96707, shall vest in City National Bank/OCWEN Loan Service upon confirmation, and the Confirmation Order shall constitute a deed of conveyance of the property when recorded at the Bureau of Conveyances. All secured claims secured by the Debtor's property in Ewa Beach will be paid by surrender of the collateral and foreclosure of the security interests. 495 B.R. at 523.

1. Failing to object is acceptance.

The majority of courts hold that a secured creditor's failure to timely object to confirmation/plan treatment is deemed an acceptance and secured creditor is bound by the confirmed plan under § 1327(a), so vesting language coupled with "acceptance" may effectuate the transfer of title to surrendered property. If the debtor is relying upon the secured creditor's silence and inaction, it is imperative that the creditor be given proper notice and service of the plan. *See e.g., In re Flynn*, 402 B.R. 437 (B.A.P. 1st Cir. 2009) (adopting Third Circuit view); *In re Szostek*, 886 F.2d 1405 (3d Cir. 1989) (because creditor had not filed a timely objection the creditor satisfied § 1325(a)(5)(A) by accepting the plan); *In re Andrews*, 49 F.3d 1404 (9th Cir. 1995) (absence of secured creditor objection deemed to satisfy § 1325(a)(5)(A)'s requirement of acceptance); *In re Chappell*, 984 F.2d 775 (7th Cir. 1993) (citing general rule that the failure to raise an objection at the confirmation hearing precludes subsequent attack on the plan or any provision therein); *In re Bateman*, 331 F.3d 821 (11th Cir. 2003) (noting generally that § 1327(a) gives *res judicata* effect to a confirmed chapter 13 plan and the binding effect extends to any issue necessarily determined by the confirmation order, including compliance with § 1325); *Shaw v. Aurgroup Fin. Credit Union*, 552 F.3d 447 (6th Cir. 2009) (if a secured creditor fails to object to confirmation it will be bound by the confirmed plan's treatment of its secured claim under § 1325(a)(5)).

- a. The 10th Circuit has adopted this view: *In re Jones*, 530 F.3d 1284, 1291 (10th Cir. 2008) (failure of secured creditor to timely object to confirmation binds it to confirmed plan's treatment of

claim); *In re Talbot*, 124 F.3d 1201, 1209 n. 10 (10th Cir. 1997); *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263 (10th Cir. 1988) (chapter 11 case – failure to object constitutes acceptance).

- b. Judge Federman and Judge Koger, likewise, adopted this view. See *In re Carter*, 390 B.R. 648, 651 (Bankr. W.D. Mo. 2008); *In re Basham*, 167 B.R. 903, 905-05 (Bankr. W.D. Mo. 1994).

C. *Surrender over a creditor’s objection.*

Most courts refuse to compel the secured creditor to accept title to the “surrendered” collateral over its objection. For instance, in *In re Tyler*, Case No. 09-60916, *Order Denying Motion to Quit Claim Property to Lender or to City* (Doc. #61) (Bankr. W.D. Mo. Sept. 30, 2009), the Chapter 13 plan provided for the surrender of property to the secured lender. But the lender did not foreclose on the property. So, the debtor asked the court to order the secured creditor to accept a quit claim deed, and the creditor objected, arguing that it could not be forced to foreclose or otherwise take title to the property. Judge Federman agreed with the secured creditors, and concluded that there is “no authority, under either Missouri law or bankruptcy law, to” force the secured lender to take title property through surrender or abandonment. *Id.* The court reasoned that conveyances of land in Missouri are generally made by deed, and acceptance is necessary to the validity of the deed. *Id.* at 3. Moreover, because Missouri has adopted the “lien theory” on mortgages, the debtor “remains the owner of the property until a secured creditor becomes the owner by either accepting a deed from the [d]ebtor or foreclosing.” *Id.* at 3-4. Similarly, in *In re Service*, 155 B.R. 512 (Bankr. E.D. Mo. 1993), Judge Schermer held that surrender does not compel the secured creditor to accept title to the collateral and that the debtors could not compel (by a Motion to Enforce Plan Terms and to Order Abandonment of Real Property) the creditor to accept their surrender of collateral and exercise its rights to foreclose and take title to real estate. Nor could they compel abandonment of the surrendered property to a creditor that had no possessory interest in it. See also *In re Koeller*, 170 B.R. 1019 (Bankr. W.D. Mo. 1994) (Koger, J.) (Chapter 7 debtor cannot compel secured creditor to accept surrender of, or take title to, its collateral); *Hancock v. Chase Bank USA, N.A. (In re Hancock)*, Adv. No. 07-4071-13-abf, *Order (i) Granting Plaintiff Leave to File Amended Complaint; (ii) Granting Motions to Dismiss First, Second, and Third Causes of Action of the First Amended Complaint; (iii) Denying Motions to Dismiss Fourth Cause of Action; and (iv) Denying as Moot the Motion by the Law Offices of Mark Alan Bertsch to Quash Service of Process* (Doc. #98) (Bankr. W.D. Mo. Dec. 17, 2009) (Federman, J.). These and similar decisions have implications for form or model plans. In another case, Judge Schermer rejected debtor’s request to alter the model plan with different vesting language from the Model Plan approved by the Bankruptcy Court in the Eastern District of Missouri notwithstanding § 1322(b)(9), finding that debtor failed to show her substantive rights had been infringed. See *In re McIntosh*, 2012 WL 6005761 (Bankr. E.D. Mo. Nov. 30, 2012).

In *Arsenault v. JP Morgan Chase Bank, N.A. (In re Arsenault)*, 456 B.R. 627, 630 (Bankr. S.D. Ga. 2011), the court concluded that the debtor’s surrender under her plan did not obligate the lender to effectuate a transfer of title to itself:

As a matter of law, given the undisputed facts of this case the act of “surrender” does not obligate Chase to transfer title out of Debtors’ names. “Consistently with the general principle that surrender of encumbered property leaves the secured creditor in control of the exercise of its remedies, a plan cannot require a secured creditor to accept a surrender of property or take possession of or title to it through repossession or foreclosure.” [citations omitted.]

Even the surrender provisions found in 11 U.S.C. § 521 do not affirmatively require the creditor to accept possession of the collateral.

A Massachusetts judge has held to the contrary in approving a post-confirmation modified plan that provided for investment real property located in Rhode Island to be surrendered in satisfaction of the creditor’s claim and foreclosure of lien over the objection of the creditor. The modification provided that, pursuant to § 1322(b)(8) and (9), title to the property would vest in the named secured creditor upon confirmation of the modified plan and that the confirmation order shall constitute a deed of conveyance of such real property which may be recorded in the register of deeds by the debtor. In addition to arguing that it could not be compelled to accept title to the property, the secured creditor argued that vesting of title in the creditor precluded it from conducting a foreclosure sale under state law and the inability to foreclose or wipe out the junior liens, depriving the creditor of its state law contract rights. The modification was approved. *See In re Gerardi*, No. 1:10-bk-19028 (Bankr. D. Mass. July 24, 2014) (Feeney, J.). Stay tuned . . . the creditor has appealed to the BAP, Case No. 14-50 (1st Cir. BAP Aug. 6, 2014).

Note: it is not apparent from the *Gerardi* amended plan that junior liens existed on the investment property; there were residential leases of the property that were rejected under the plan. If junior liens do exist, it may require the debtor to strip off wholly unsecured junior liens in the plan. Failing that, the ability to convey title through vesting language may be limited to property on which there is only a single lien thus eliminating the need to foreclose other liens and conduct a foreclosure sale. Judge Feeney did not issue a written memorandum but confirmed the plan “for reasons stated on the record,” to which the authors lack access. Thus, we can only speculate how the Massachusetts court got around the fact that the secured creditor failed to accept the plan modification. See § 1329(b)(1) (incorporating complying with § 1325(a) into the modification confirmation requirements).

In re Perry, 2012 WL 4795675 (Bankr. E.D.N.C. Oct. 9, 2012), is an example of a court stretching its authority in an attempt to free the Chapter 13 the debtor of her obligations to pay ad valorem taxes. There the court, without much analysis as to its ability to do so, gave the secured creditor 60 days to commence a foreclosure proceeding and, failing that, authorized the debtor to execute, deliver, and record a quitclaim deed of the property to the creditor. *Id.* at *2.

IV. Selling the Property under § 363(f) and § 1303

A third possibility exists for a debtor to rid himself of title to property secured to a creditor by selling it to a third party.

A. *Sections 363 and 1303.*

Section 1303 of the Code gives the debtor the authority, exclusive of the trustee, the right and power after notice and hearing to use, sell, or lease *property of the estate* – including the right to sell property outside the ordinary course of business, § 363(b), and free and clear of liens, § 363(f). A Kansas judge has held that a chapter 7 debtor may not sell mortgaged property that is claimed exempt because it is no longer property of the estate if it is claimed exempt. *Nazar v. Carmichael (In re Carmichael)*, 439 B.R. 884, 889-90 (Bankr. D. Kan. 2010) (citing *In re Penniston*, 206 B.R. 948 (Bankr. D. Minn. 1997) holding that § 363 is inapplicable to sales of exempt property). Yet Kansas chapter 13 debtors sell their homesteads all the time, but the statutory provisions for sales free and clear do not apply when those residences have been exempted and are no longer property of the estate.

1. Anti-modification under § 1322(b)(2).

If the property to be sold is the debtor’s residence, does selling it under the chapter 13 plan run afoul of the anti-modification provision in § 1322(b)(2)? Judge Lundin suggests that the surrender (and even moving out) of a principal residence must occur prior to the filing of the bankruptcy petition to ensure that the anti-modification provision does not come into play. See Keith M. Lundin & William H. Brown, CHAPTER 13 BANKRUPTCY, 4TH Ed., § 102.1 at ¶s 22-24, Sec. Rev. Oct. 20, 2010, www.Ch13online.com. Most courts after *Nobleman* hold that the sale of a debtor’s residence does not violate the anti-modification provision. *Id.* at § 102.1[31] and cases cited in n. 65.

B. *Sales free and clear: § 363(f).*

In order to sell property of the estate free and clear of the mortgagee’s interest, one of the five conditions enumerated in § 363(f) must be satisfied. Those conditions are: (1) applicable nonbankruptcy law permits the sale of property free and clear of the interest; (2) the secured creditor consents; (3) the property sells at a price that is greater than the aggregate value of all liens against the property; (4) the interest is in bona fide dispute; or (5) the entity (mortgagee or creditor) could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest. Under § 363(k) the mortgagee is protected from an insufficient sales price by the ability to credit bid its claim, unless the court for cause orders otherwise.

1. § 363(f)(2) consent.

A properly noticed creditor’s silence may be viewed as implied consent sufficient to satisfy the consent requirement for approving a sale under § 363(f)(2). See *BAC Home Loans Servicing LP v. Grassi*, No. EP 11-010, 2011 WL 6096509 (B.A.P. 1st Cir. Nov. 21, 2011) (unpublished).

2. § 363(f)(3) price greater than aggregate value of liens.

The viability of satisfying this condition is obviously dependent upon a number of factors, including the current real estate market, the number and amount of claims secured by the property, the length of time to expose the property to the market, and whether debtor has equity in the property. The majority of home mortgages we encounter may make satisfying (f)(3)

difficult. This would still probably require some pre-sale planning and leg work to find a potential buyer by private sale, rather than a public auction, in order to attain a price in excess of the liens. Then again, if the secured creditor sits back and does nothing, they can be stuck with the sale. See *In re Canonigo*, 276 B.R. 257 (Bankr. N.D. Cal. 2002) (chapter 13 case; “aggregate value of all liens” refers not to the value of the collateral but the face amount of claims that the liens secure, although there is a split of authority on this issue); *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 41 (9th Cir. B.A.P. 2008) (accord, chapter 11 case). But see contra *In re Boston Generating, LLC*, 440 B.R. 302 (Bankr. S.D.N.Y. 2010) (chapter 11 case). In *In re WK Lang Holdings, LLC*, 2013 WL 6579172 (Bankr. D. Kan. Dec. 11, 2013), a chapter 11 case, Judge Nugent concluded that the better view was that value of all liens referred to the value of the collateral, rather than the amount of the claims. Our research uncovered no Tenth Circuit authority on this issue in either a chapter 13 or a chapter 11 case.

3. § 363(f)(5) compulsion to accept money satisfaction.

Very little case law regarding (f)(5) exists in the context of chapter 13. Most of the cases arise in chapter 11 sales by the debtor in possession. No published Tenth Circuit authority under § 363(f)(5) exists in a chapter 13 case. Judge Nugent approved a sale under § 363(f)(5) in a chapter 11 case, *WK Lang Holdings, LLC, supra*.

Some courts distinguish (f)(5)’s differing language of “interest” compared to (f)(3)’s use of “lien.” The first issue then is whether an “interest” under (f)(5) includes a lien. In *Canonigo, supra*, a chapter 13 case, the bankruptcy court concluded that (f)(5) does not apply to a lien. But in *Clear Channel, supra*, a chapter 11 case, the court held that the term “interest” in subsection (f)(5) includes a lien. Most courts follow the *Clear Channel* interpretation. See e.g., *In re Mundy Ranch, Inc.*, 484 B.R. 416 (Bankr. D. N.M. 2012) (chapter 11 case; “interest” in (f)(5) should be construed expansively while the type of “interest” in (f)(3) is limited to liens); *In re Telluride Income Growth, L.P.*, 364 B.R. 390, (10th Cir. BAP 2007) (involuntary chapter 7 case; “The Code makes it clear that a lien is an interest by providing in § 363(f)(3) conditions for a sale free and clear “if such interest is a lien” and noting the trend that “interest” in property is not limited to *in rem* interests such as liens”).

In *In re Gulf States Steel, Inc. of Alabama*, 285 B.R. 497, 508 (Bankr. N.D. Ala. 2002), a chapter 11 case, the court explained that § 363(f)(5) requires a showing that some mechanism exists to address extinguishing the lien without paying in full. It refers to a legal or equitable proceeding “in which the nondebtor could be compelled to take less than the value of the claim secured by the interest.” In *Boston Generating, supra* at 333, the bankruptcy court held that judicial and nonjudicial foreclosure under state law qualified as such a “legal or equitable process” because junior lienholders could be compelled to accept general unsecured claims to extent sale proceeds are insufficient to pay their claims in full. The bankruptcy court in *In re Jolan, Inc.*, 403 B.R. 866, 869-70 (Bankr. W.D. Wash. 2009) identified several “legal or equitable proceedings” where a lienholder’s interest could be cleared: Article 9 default remedies under the UCC permitting a senior lienholder to dispose of collateral, a receiver’s authority to sell free and clear, personal property and real property tax sales, a federal tax lien sale, and judicial and nonjudicial foreclosure sales.

The Tenth Circuit BAP in an unpublished chapter 11 decision, recognized chapter 11 cram down as a legal or equitable proceeding under § 363(f)(5), citing Collier's bankruptcy treatise. *See Compass Bank v. Investment Co. of the Southwest, Inc. (In re Investment Co. of the Southwest, Inc.)*, 302 B.R. 112 [Table] (B.A.P. 10th Cir. Dec. 8, 2003).

See generally Keith M. Lundin & William H. Brown, CHAPTER 13 BANKRUPTCY, 4TH Ed., § 102.1, Sec. Rev. Oct. 20, 2010, www.Ch13online.com addressing surrender or sale of collateral as a means of providing for secured claims.

V. Invoking “Equity” to Preserve the Code’s Fresh Start Policy, § 105(a)

Some courts have considered the equities between the debtor and secured creditor when a debtor attempts to surrender property that the secured creditor doesn't want and can't be compelled to take title, repossess, or pursue state law foreclosure rights upon.

In *Pratt v. GMAC (In re Pratt)*, 462 F.3d 14 (1st Cir. 2006), a chapter 7 case, the debtors intended to surrender their inoperable car to the creditor rather than redeem or reaffirm. After they received their discharge the creditor refused to take possession of the vehicle and foreclose its security interest in the vehicle or release its lien unless they were paid in full. The Circuit Court of Appeals found that the creditor's actions had the practical effect of preventing surrender and coercing debtors into paying the prepetition debt in violation of the discharge injunction. Under these circumstances, the court concluded that the Bankruptcy Code preempted the creditor's rights under state law. Where the refusal to exercise state law rights prevents relief under the Code they may be overridden to ensure that the debtors receive their fresh start. *See also Bessette v. Avco Fin. Servs., Inc.*, 230 F.3d 439, 445 (1st Cir. 2000) (Section 105 empowers bankruptcy court to address violations of the § 524 discharge injunction). *But see In re Canning*, 706 F.3d 64 (1st Cir. 2013) (refusing to foreclose or release lien after debtor's surrender and inviting a short sale, does not violate the discharge injunction; property did not pose undue burden on debtors after their discharge; distinguishing *Pratt*).

In *Pigg v. BAC Home Loans Servicing LP (In re Pigg)*, 453 B.R. 728 (Bankr. M.D. Tenn. 2011), the bankruptcy court held that debtor suffered a “legislated wrong” without a remedy and equity required a remedy that would prevent eradication of debtor's fresh start due to the nondischargeability of homeowners' association fees. In *Pigg*, also a chapter 7 case, the debtor filed an adversary proceeding seeking to compel mortgagee to accept deed in lieu or to commence foreclosure proceeding to stop the accrual of homeowners' association fees for debtor's flood-damaged condo that debtor had vacated and surrendered. The mortgagee took possession of and secured the condo and maintained insurance on it after its surrender but the HOA fees continued to accrue. Because the creditor took possession, the HOA lien had priority over the creditor under the Master Deed and Bylaws. The value of the condo exceeded the amount of HOA fees and unpaid property taxes. Court invoked § 105(a) to set aside the discharge and chapter 7 trustee's report of no distribution, and reappointed the chapter 7 trustee and directed him to sell the condo providing for distribution of proceeds to administrative expenses, the HOA claim, and the lienholders. The Court held that mortgagee and HOA were deemed to consent to trustee's sale by their inaction despite third party investor's interest in acquiring the condo and debtor's offer of deed in lieu of foreclosure (junior lienholder offered to release its lien if the senior lienholder accepted the deed in lieu) and therefore, the sale was free

and clear of liens under § 363(f)(2). The bankruptcy court noted that it could not declare the post-petition HOA fees dischargeable in contravention of § 523(a)(16) but it could stop the accrual of HOA fees. The HOA's claim would be paid, the lienholders would receive the same as if it had foreclosed upon the property, and the debtor would receive a fresh start.

Other courts disagree. In *In re Fristoe*, 2012 WL 4483891 (Bankr. D. Utah 2012) (Thurman, J.), a Utah bankruptcy court disagreed with *Pigg* and concluded that § 105(a) did not empower the bankruptcy court to sanction the lender for not foreclosing on the property nor to order the trustee to sell the property. Rather, equitable relief is limited to that which is consistent with the Code. *See also Arsenault*, 456 B.R. 627 (§ 105(a) could not be used to require transfer of title and absolve debtors of third-party obligations that were incidents of ownership).

These cases suggest that in order to prevail on the equity argument, debtors must show that the creditor's inaction rises to the level of coercing the debtor to pay the discharged debt or impedes the debtor's ability to reorganize. The sufficiency of the proof will depend upon the particular facts of the case and factors such as the value of the underlying collateral. *See In re Canning*, 706 F.3d 64 (1st Cir. 2013) (Bankruptcy law can't alter a secured creditor's state law rights unless those rights are used to coerce payment of a discharged debt). If the collateral is virtually worthless and unlikely to appreciate in value over time, is there a valid business justification for the secured creditor's inaction?

VI. Conclusion

As a matter of state law, a chapter 13 debtor plan could effectuate a transfer of title to property it is surrendering to the mortgagee by indicating his intent to surrender the property and executing and recording a quitclaim deed to the mortgagee upon confirmation (and noting such in the plan). If the mortgagee fails to object to confirmation and expressly disclaim acceptance of the deed, the mortgagee should be precluded from "undoing" the transfer. Of course, proper notice of the plan, and even the recorded deed, should be given to the mortgagee. If the lender objects, that is likely fatal to the forced "take back" as a matter of bankruptcy law.