# 2018 Midwestern Bankruptcy Institute

## ABI Talks

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PLENARY SESSION

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# MIDWEST BANKRUPTCY INSTITUTE

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## *Student Loan Considerations and Dischargeability Actions*

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## I. BASICS

**A. Find out who has loans, type of loans & how much**

- **NSLDS - National Student Loan Data System**
- **Federally Funded or Private Loans**
- **Capitalized Interest & Collection Costs if Defaulted**

**B. Repayment/Administrative Discharge Options (without adversary)**

- **Ford/ICRP**
  - **4 options**
- **IBR - Less loans qualify (defaulted, PLUS)**
- **PAYE and REPAYE**
- **TPD**
- **Closed school**
- **Fraud**
- **Teacher or Public Service Loan Forgiveness**

C. **Service of Summons and Complaint --**

- **Not to payment box**
- **Corporate service to officer, registered agent, etc.**
- **Government has special rules**
- **Guarantor has separate right to notice**
- **If nobody is engaging, default judgment will likely not stand**

D. **Loans change hands upon filing bankruptcy or AP**

E. **Substitute, Intervene or Add**

- **In everyone's best interest**

F. **Basic Procedure - 3-4 months, up to a year**

- **Complaint**
- **Answer**
- **Schedule set by Court; RPPM Scheduling Order**
- **Discovery - written; depositions**
- **Telephone pretrial; formal PTC and complete PTO**
- **Witness and Exhibit Lists & exchange of exhibits**
- **Trial – 2 hours to days**

G. **Discovery issues --**

- **Plaintiff/debtor's Burden of Proof**
- **Creditor entitled to information but also, plaintiff needs it, too**
- **If I asked for it and you don't produce it --**
  **How meet burden?**
  **Objection at trial**

- **Medical records --**
  - **If you are claiming physical/mental limitations --**
    - **Better have the records**
  - **Person to testify (?)**

**H. Trial Issues**

- **Totality of the Circumstances Test:**
  - **Past, present and reasonably reliable future resources**
  - **Reasonable, necessary living expenses**
  - **Any other relevant facts**
  - **Will reasonable future resources allow payment of student loans and a minimal standard of living**
- ***Brunner* Test**
  - **Current Income and Expenses**
  - **Likely to Continue for Significant Portion of Repayment Period**
  - **Good Faith Efforts to Repay**
- **Proper foundation**
- **Hearsay & other evidentiary rules**
- **Exhibits marked**
- **Exhibit index**
- **Witnesses listed**
- **When is undue hardship determined**
  - **Bankruptcy filed**
  - **Adversary filed**
  - **Trial held**
- **Partial discharge**
  - **Loan by loan**
  - **Just pick an amount**

## I. Miscellaneous

- AWG
  - Administrative Wage Garnishment
    - lender can just issue

- Discharge by declaration in Chapter 13
  - *United Student Aid Funds v. Espinoza,* 559 U.S. 260, 270, 130 S. Ct. 1367, 176 L. Ed. 2d 158 (2010)

- PLUS loans --
  - Parent takes out loan for child
  - Not co-signer
  - Just parent's loan
  - No REPAYE, PAYE, IBR, but can ICRP (if consolidated)

- Defaulted loans –
  - No REPAYE, PAYE, IBR, but can ICRP (if rehabilitation)

- Post Petition debt --
  - If do REPAYE, PAYE, IBR or ICRP = new loan
    - post petition

- Private loans --
  - No REPAYE, PAYE, IBR or ICRP
  - More flexible on repayment options; direct negotiation

- Proof of claim v. Debt
  - Since non-dischargeable debt,
    just because object to POC ≠discharge

- Ripeness in Chapter 13
  - -- File AP 6 months into a 5 year plan = ripe?
  - -- Undue hardship as of when?
    - * file bankruptcy, AP filed, decision

- **Tax Consequences**
  - -- **Discharge/Forgiveness**
    - **Now by AP = none**
    - **At conclusion of Income Dependent Repayment Plan = who knows**
    - **Solubility determined with student loan still in debt column**
      - -- **before forgiveness**

## II. FACTORS RELEVANT TO A STUDENT LOAN ADVERSARY

### A. Personal

1. Age
2. Married
3. Single
4. Medical Conditions/Disabilities (Pre-existing)
5. Parents living
6. Children
7. Disabled/Special Needs Children

### B. Education/College

1. Where
2. When
3. Degree

### C. Loans:

1. When
2. How much initially disbursed
3. Interest rates
4. Current balance
5. Consolidated = New loan
6. Amount paid
7. Deferments or Forbearances
8. Defaulted

**D. Employment:**

1. Where
2. How long
3. Number of hours worked
4. Benefits
5. Spouse employed (same issues)

**E. Income:**

1. Gross wages
2. Monthly net
3. Overtime or bonus pay
4. Yearly pay increases
5. Advancement potential
6. SSI and SSA income
7. Spouse, paramour or adult children in household's income
8. Bank Accounts
9. Tax Refunds
10. Alimony
11. Unearned income
12. Retirement or investments - access, how close to need

**F. Expenses:**

1. Compare Schedule J and Interrogatory responses
2. Any anticipated or significant change in expenses
3. Are claimed medical bills paid by medical card
4. Elements
   - A. Rent or mortgage payments;
   - B. Home maintenance;
   - C Electricity;
   - D. Heat;
   - E. Water;
   - F. Telephone;
   - G. Transportation;
   - H. Insurance;
   - I. Groceries;
   - J. Meals outside of household;
   - K. Laundry and dry cleaning;
   - L. Recreation or entertainment;
   - M. Medicine;
   - N. Medical or dental:
   - O. Clothing;
   - P. Child care;
   - Q. Charitable contributions; and
   - R. Other necessities or expenditures not specified above, and specify the category and amount.

**G. Test for Undue Hardship**

A. *The Totality of the Circumstances or Brunner Test*

This standard requires borrowers to demonstrate repayment would cause an undue hardship as they are incapable of "paying the student loans in question while still maintaining a minimal standard of living."

B. In determining whether a borrower meets this burden, courts will consider a number of factors, including:

(1) the debtor's past, present, and reasonably reliable future financial resources;

(2) a calculation of the debtor's and her dependent's reasonable necessary living expenses;

(3) good faith efforts to repay the debt; and/or

(4) any other relevant facts and circumstances surrounding each particular bankruptcy case.

C. Potential additional factors are:

- total present and future incapacity to pay debts for reasons not within the control of the debtor;
- whether the debtor has made a good faith effort to negotiate a deferment or forbearance of payment;
- whether the hardship will be long-term;
- whether the debtor has made payments on the student loan;
- whether there is permanent or long-term disability of the debtor;
- the ability of the debtor to obtain gainful employment in the area of the study;
- whether the debtor has made a good faith effort to maximize income and minimize expenses;
- whether the dominant purpose of the bankruptcy petition was to discharge the student loan; and
- the ration of student loan debt to total indebtedness.

**H. Repayment Options for Federally Funded**

[Contact holder of loan to confirm eligibility]
REPAYE - Revised Pay As You Earn
PAYE - Pay As You Earn
IBRP - Income Based Repayment Plan
ICRP - Income Contingent Repayment Plan
William Ford - 4 options
- Standard
- Graduated
  - Stair steps
  - Each payment
- Extended

**<u>http://studentaid.ed.gov/repay-loans/understand/plans</u>**

**I. Case Law**

**1. Totality of Circumstances Jurisdiction**

*Walker v. Sallie Mae Serv. Corp.* (*In re Walker*), 650 F.3d 1227, 1231 (8th Cir. 2011)

*Educational Credit Management Corporation v. Jesperson*, 571 F.3d 775, 779 (8th Cir. 2009)

*Reynolds v. Penn. Higher Educ. Assistance Agency (In re Reynolds)*, 425 F.3d 526, 531 (8th Cir. 2005)

*Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549 (8th Cir. 2003)

*Andrews v. S.D. Student Loan Assistance Corp. (In re Andrews)*, 661 F.2d 702 (8th Cir. 1981)

*In re Hurst*, 553 B.R. 133, Case No. 15-6031 (B.A.P. 8th Cir. 2016)

*Nielsen v. ACS, Inc.* (*In re Nielsen*), 473 B.R. 755, 759-60 (B.A.P. 8th Cir. 2012), *aff'd* 502 Fed. App'x 634 (8th Cir. 2013)

*Andresen v. Neb. Student Loan Program, Inc.* (*In re Andresen*), 232 B.R. 127, 130 (B.A.P. 8th Cir. 1999)

*In re Abney*, 540 B.R. 681 (Bankr. W.D. Mo 2015)

**2. *Brunner* Jurisdiction**

*Roe v. College Access Network*, 295 Fed. Appx. 927 (10th Cir. 2008).

*In Re Mersmann*, 505 F.3d 1033 (10th Cir. 2007).

*Alderete v. Educational Credit Management Corp.* (*In re Alderete*), 412 F.3d 1200 (10th Cir. 2005).

*Educational Credit Management Corp v. Polleys*, 356 F.3d 1302 (10th Cir. 2004).

*Azwar v. Texas Guaranteed Student Loan Corp.*, 326 B.R. 165 (B.A.P. 10th 2005).

*Innes v. Kansas*, 284 B.R. 496 (D. Kan. 2002).

*Buckland v. Educational Credit Management Corp.*, 424 BR. 883 (Bankr. Kan. 2010).

*In Re Schwaiger*, 361 B.R. 181 (Bankr. Kan. 2007).

*Mandala v. Educational Credit Management Corp.*, 310 B.R. 213 (Bankr. D. Kan. 2004).

*In Re Brunner*, 46 B.R. 752, 756 (S.D.N.Y. 1985) aff'd 831 F. 2d 395 (2nd Cir. 1987).

**J. Administrative Options -**

False Certification of Student Eligibility -
**https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation**

Unpaid Refund -
**https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation**

Teacher Loan Forgiveness -
**https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation**

Public Service Loan Forgiveness -
**https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation**

Total & Permanent Disability -
**https://studentaid.ed.gov/sa/repay-loans/understand/plans**

Closed School -
**https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/closed-school**

Death -
**https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation#death-discharge**

## 4. What are the differences between the income-driven plans?

The chart below compares the major features of the income-driven plans. The terms and conditions summarized in the chart are discussed in detail in separate sections of this document. *See* ***Eligible Borrowers, Eligible Loans, Monthly Payment Amount***, and ***Repayment Period & Loan Forgiveness*** in this document.

| Feature | REPAYE Plan | PAYE Plan | IBR Plan | ICR Plan |
|---|---|---|---|---|
| **Eligible Borrowers** | Direct Loan borrowers | Direct Loan borrowers<br>**Note:** This plan is limited to new borrowers on or after October 1, 2007, who received a Direct Loan disbursement on or after October 1, 2011. | Direct Loan and FFEL borrowers<br>**Note:** Some terms and conditions differ depending on when you received your federal student loans. | Direct Loan borrowers |
| **Eligible Loans** | All Direct Loan types *except* Parent PLUS Loans and consolidation loans that repaid Parent PLUS Loans | All Direct Loan types *except* Parent PLUS Loans and consolidation loans that repaid Parent PLUS Loans | All Direct Loan and FFEL Program loan types *except* Parent PLUS Loans and consolidation loans that repaid Parent PLUS Loans | All Direct Loan types *except* Parent PLUS Loans.<br>Consolidation loans made after July 1, 2006, that repaid Parent PLUS Loans may be repaid under ICR |
| **Income Requirement to Enter Plan** | None | Your income must be low compared to your eligible federal student loan debt | Your income must be low compared to your eligible federal student loan debt | None |
| **Requirement to Recertify Income and Family Size** | Annually | Annually | Annually | Annually |
| **Monthly Payment** | Generally 10 percent of your discretionary income | Generally 10 percent of your discretionary income | Generally<br>• 10 percent of your discretionary income (if you're a new borrower on or after July 1, 2014), or<br>• 15 percent of your discretionary income (if you're not a new | The lesser of<br>• 20 percent of your discretionary income or<br>• what you would pay on a repayment plan with a fixed payment over the course of 12 |

| Feature | REPAYE Plan | PAYE Plan | IBR Plan | ICR Plan |
|---|---|---|---|---|
| | | | borrower) | years, adjusted according to your income |
| **Cap on Payment Amount** | None (may be higher than the 10-year Standard Repayment Plan amount) | Never more than what you would have paid under the Standard Repayment Plan with a 10-year repayment period, based on what you owed when you entered the PAYE Plan | Never more than what you would have paid under the Standard Repayment Plan with a 10-year repayment period, based on what you owed when you entered the IBR Plan | None (may be higher than the 10-year Standard Repayment Plan amount) |
| **Married Borrowers** | Payment is generally based on the combined income and loan debt of you and your spouse, regardless of whether you file a joint or separate federal income tax return<br>If you file a separate return and you are separated from your spouse or are unable to reasonably access your spouse's income, only your income and loan debt is used | Payment is based on the combined income and loan debt of you and your spouse only if you file a joint federal income tax return<br>Only your income is considered if you file a separate return from your spouse | Payment is based on the combined income and loan debt of you and your spouse only if you file a joint federal income tax return<br>Only your income is considered if you file a separate return from your spouse | Payment is based on the combined income and loan debt of you and your spouse only if you file a joint federal income tax return, or if you and your spouse choose to jointly repay under the plan<br>Only your income is considered if you file a separate return from your spouse and do not choose the joint repayment option |
| **Repayment Period & Loan Forgiveness** | Any outstanding balance is forgiven after<br>• 20 years of qualifying repayment if all loans you're repaying under the plan were received for undergraduate study, or<br>• 25 years of qualifying | Any outstanding balance is forgiven after 20 years of qualifying repayment | Any outstanding balance is forgiven after<br>• 20 years of qualifying repayment (if you're a new borrower on or after July 1, 2014), or<br>• 25 years of qualifying repayment (if you're not a new | Any outstanding balance is forgiven after 25 years of qualifying repayment |

| Feature | REPAYE Plan | PAYE Plan | IBR Plan | ICR Plan |
|---|---|---|---|---|
| | repayment if any loans you're repaying under the plan were received for graduate or professional study | | borrower) | |
| **Interest Benefit** | If your monthly payment doesn't cover the full amount of interest that accrues, the government pays<br>• the full amount of the difference on your subsidized loans for the first three years, and half of the difference after the first three years, and<br>• half of the difference on your unsubsidized loans during all periods | If your monthly payment doesn't cover the full amount of interest that accrues on your subsidized loans, the government pays the difference for the first three years | If your monthly payment doesn't cover the full amount of interest that accrues on your subsidized loans, the government pays the difference for the first three years | No interest benefit; if your monthly payment doesn't cover the full amount of interest that accrues on your loans, you're still responsible for paying the interest |
| **Interest Capitalization When Payment Doesn't Cover All Interest** | If your monthly payment is less than the amount of interest that accrues, any unpaid interest is capitalized (added to your loan principal balance) if<br>• you are removed from the plan for failing to recertify your income by the annual deadline, or<br>• you voluntarily leave | If your monthly payment is less than the amount of interest that accrues, any unpaid interest is capitalized (added to your loan principal balance) if<br>• you no longer qualify to make payments that are based on your income or<br>• you leave the plan | If your monthly payment is less than the amount of interest that accrues, any unpaid interest is capitalized (added to your loan principal balance) if<br>• you no longer qualify to make payments based on income or<br>• you leave the plan<br>There is no limit on the amount of unpaid interest that may be | If your monthly payment is less than the amount of interest that accrues, any unpaid interest is capitalized (added to your loan principal balance) annually<br>When your monthly payment is less than the amount of interest that accrues, the amount of unpaid interest that is capitalized |

| Feature | REPAYE Plan | PAYE Plan | IBR Plan | ICR Plan |
|---|---|---|---|---|
| | the plan<br>There is no limit on the amount of unpaid interest that may be capitalized under these conditions | The amount of unpaid interest that may be capitalized if you no longer qualify to make payments that are based on your income is limited to 10 percent of your original loan principal balance at the time you entered the PAYE Plan | capitalized under these conditions | annually is limited to 10 percent of your original loan principal balance at the time you entered the ICR Plan |
| **Leaving the Plan** | If you choose to leave this plan, you may change to any other repayment plan for which you are eligible | If you choose to leave this plan, you may change to any other repayment plan for which you are eligible | If you choose to leave this plan, you will be placed on the Standard Repayment Plan. If you want to change from the Standard Repayment Plan to a different repayment plan, you must first make at least one payment under the Standard Repayment Plan, or one payment under a reduced-payment forbearance (you may request a reduced-payment forbearance if you can't afford the Standard Repayment Plan payment) | If you choose to leave this plan, you may change to any other repayment plan for which you are eligible |

5. Is there a maximum income limit to qualify for an income-driven repayment plan?

No. There is an income eligibility requirement for the PAYE and IBR plans, but it is not based on a particular income level. Rather, it compares your income to the amount of your eligible federal student loan debt. There is no income eligibility requirement for the REPAYE or ICR plans. See ***Eligible Borrowers***, below, for more information.

6. How can I learn more?

Contact your loan servicer. Find your loan servicer's contact information at **StudentAid.gov/log-in**, or contact the Federal Student Aid Information Center (FSAIC) at 1-800-4-FED-AID (1-800-433-3243); (TTY: 1-800-730-8913).

**MEDIATION HANDOUT**

**MIDWESTERN BANKRUPTCY INSTITUTE**
**OCTOBER 12, 2018**

Mediation is the most common form of alternative dispute resolution utilized in the bankruptcy context. Unlike arbitration, which may be compelled pursuant to an arbitration clause, mediation generally is not compelled pursuant to a contract. Nevertheless, the bankruptcy court may compel parties to participate in mediation, even if those parties do not consent. However, unlike an arbitration determination, which is usually binding, a mediation result is binding only if the parties agree to the mediated terms. It is like leading a horse to water but not being able to make the horse drink the water.

The Alternative Dispute Resolution Act of 1998, 28 U.S.C. §§ 651–58 (2012), requires each district court to authorize and devise its own ADR program. The ADR Act applies to civil proceedings filed in district courts and to adversary proceedings filed in bankruptcy courts. 28 U.S.C. § 651(b) (2012). In addition to the ADR Act, the bankruptcy court may rely on several sources of authority to require parties to mediate a dispute: (i) its inherent authority to manage its own docket, (ii) its authority under Bankruptcy Code § 105(a), (iii) its authority under Bankruptcy Code § 105(d), (iv) local bankruptcy rules, and (v) Federal Rule of Bankruptcy Procedure 7016.

***Inherent Authority to Manage the Docket**.* Federal courts "have the inherent authority to manage their dockets and courtrooms with a view toward the efficient and expedient resolution of cases." *Dietz v. Bouldin*, 136 S.Ct. 1885, 1892 (2016); *see Zerger & Mauer LLP v. City of Greenwood*, 751 F.3d 928, 931 (8th Cir. 2014) (noting that "all courts have inherent authority to 'manage their own affairs so as to achieve the orderly and expeditious disposition of cases'" (quoting *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43 (1991)). So, if the bankruptcy court believes a case could be efficiently and expediently resolved through mediation, the court has the authority to refer such matter to mediation as an act of managing its docket.

***Section 105(a).*** Bankruptcy Code § 105(a) provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C § 105(a). While it is unlikely that a mediation order could be strictly "necessary," a court may consider a mediation order"appropriate to carry out the provisions" of the Bankruptcy Code. The bankruptcy court thus has the authority to enter an order for mediation, if doing so would be appropriate.

***Section 105(d).*** Bankruptcy Code § 105(d) provides that the court, on its own motion or on the motion of a party, "(1) shall hold such status conferences as

are necessary to further the expeditious and economical resolution of the case; and (2) unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, may issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically . . . ." Section 105(d) also lists examples of the types of orders that may be entered pursuant to § 105(d)(2). *See* § 105(d)(2)(A)–(B). Although an order for mediation is not one of the types of orders enumerated, that list is not exclusive. As mediation could constitute a "condition" that the court "deems appropriate to ensure that the case is handled expeditiously and economically," § 105(d) appears to provide the court with authority to enter a mediation order.

***Local Rules.*** Many bankruptcy courts have their own local rules governing case procedures and case management. Some have detailed rules regarding mediation; others have less complex or formalized procedures, and arrange mediations on a case-by-case basis. However, when local rules address mediation, they often cover basic ground rules, for example: who may be selected as mediator, how the mediator may be paid, whether mediation automatically stays the litigation of the matter, and requirements regarding the filing of the mediator's report. In addition, the local bankruptcy rules may establish confidentiality expectations, such as whether mediation interactions and disclosures constitute conduct and communications made in compromise negotiations for purposes of Federal Rule of Evidence 408. It is important for practitioners to be familiar with a particular court's approach and procedures regarding mediation.

Two examples of highly formalized and detailed mediation procedures are those in the U.S. Bankruptcy Court for the Southern District of New York and the U.S. Bankruptcy Court for the District of Delaware—courts with particularly high-volume bankruptcy filings. The U.S. Bankruptcy Court for the Southern District of New York has an eleven-page alternative dispute resolution procedures manual, entitled "Procedures Governing Mediation of Matters and the Use of Early Neutral Evaluation and Mediation/Voluntary Arbitration in Bankruptcy Cases and Adversary Proceedings." The manual is available on the court's website, http://www.nysb.uscourts.gov/mediators, where there is also a mediator register with mediator "bio pages," mediators' application form, and mediators' final report form.

The U.S. Bankruptcy Court for the District of Delaware has a General Order, which applies to all adversary proceedings, including a claim for relief to avoid a preferential transfer and other proceedings that the court may designate. The General Order is available on the court's website, http://www.deb.uscourts.gov/mediation-information. The General Order, as amended, requires that "[n]o later than one hundred twenty (120) days after an answer or other responsive pleading is filed the parties shall file a Stipulation Regarding Appointment of Mediator . . . . If the parties fail to [do so] no later than ten (10) days after the deadline, the court will enter an order, without further notice

or hearing, selecting and appointing a mediator for the adversary proceeding." On its website, the Delaware court also provides detailed information related to bankruptcy mediations, including official forms and a mediator registry.

However, even with these formal guidelines and official forms, it still may be necessary or appropriate to further modify or tailor the mediation process in specific cases. For example, in the Chapter 11 case of *In re Exide Technologies*, Case No. 13-11482, ECF No. 4360 (signed June 30, 2015 and entered on docket July 1, 2015), the U.S. Bankruptcy Court for the District of Delaware entered an "Order Establishing Streamlined Procedures Governing Associated Adversary Proceedings Pursuant to 11 U.S.C. §§ 547 and 550." The order includes more than four pages of specific procedures regarding the "mediation process," including where the mediation will be held and when, how costs will be borne, from which list the mediator may be chosen, the scope of the mediator's authority (including the authority to create additional procedures), a calendar for position statements, and consequences for failing to comply with the order and its deadlines.

Mediation is a well-accepted and often-used practice in the U.S. Bankruptcy Courts for the District of Kansas and the Western District of Missouri. The judges in both districts have wide and varied mediation experience, mediating matters in bankruptcy cases pending before the other judges in their own district, in the other district, and elsewhere. In the District of Kansas, D. Kan. Rule 16.3 and LBR 9019.2 set forth the standard rules and procedures for mediations, and Standing Order No. 17-2 establishes a one-year pilot program (calendar year 2018) that subsidizes the mediation expenses of litigants who otherwise cannot afford mediation.

While there are no local bankruptcy rules on mediation in bankruptcy cases in the Western District of Missouri, mediation is just as common. In addition to mediating matters arising in bankruptcy cases, the Western District of Missouri bankruptcy judges serve in the mediator pool of the Mediation and Assessment Program ("MAP") of the U.S. District Court for the Western District of Missouri.[1] The Western District bankruptcy judges generally do not order parties to mediate without their consent; however, a judge may suggest that a particular matter appears suited for mediation. If the parties agree to mediation, they recommend a mediator to the court—often another bankruptcy judge from the Western District of Missouri, the District of Kansas, or the Eastern District of Missouri. The name of the proposed mediator then is submitted to the court for approval. After approval, the parties generally work out the schedule and logistics with the mediator; depending on the circumstances, the parties may submit to the court a proposed order regarding the mediation process. After the mediation, the mediator will

[1] Although the Western District bankruptcy judges serve in the mediator pool, MAP does not offer mediation services in bankruptcy disputes. However, MAP's procedures, policies, and forms offer guidance on mediation issues. MAP is described in detail on the website of the U.S. District Court for the Western District of Missouri at http://www.mow.uscourts.gov/district/map.

submit a report to the court formally advising if the mediation was successful in reaching settlement.

***Federal Rule of Bankruptcy Procedure 7016.*** Federal Rule of Bankruptcy Procedure ("Rule") 7016 incorporates Federal Rule of Civil Procedure ("FRCP") 16 to apply in adversary proceedings. FRCP 16(a) provides that the court may schedule a pretrial conference for "such purposes as . . . (1) expediting disposition of the action; (2) establishing early and continuing control so that the case will not be protracted because of lack of management; . . . and (5) facilitating settlement." In addition, FRCP 16(c)(2)(I) provides that, at a pretrial conference, the court may consider and take appropriate action on various matters, including "settling the case and using special procedures to assist in resolving the dispute when authority by statue or local rule." So, if a local rule permits mediation, a directive for mediation appears to be authorized under FRCP 16(c)(2)(I) as part of the pre-trial conference process. But even if there is no local rule providing for mediation, it appears that mediation also can be directed under the broad language of FRCP 16(c)(2)(P), which provides that the court may consider and take action on "facilitating in other ways the just, speedy, and inexpensive disposition of the action."

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It is worth observing that not all courts embrace mediation as an effective method of docket management and dispute resolution—in particular, where estate assets will be used to pay for the mediator. A notable example of this is the recent case of *In re Cody W. Smith*, 524 B.R. 689 (Bankr. S.D. Tex. 2015) ("*Smith*").

In *Smith*, the trustee arranged for a retired bankruptcy judge to mediate an ongoing dispute in the case before Judge Bohm. Judge Bohm had previously served on the bench with the former judge, and conducted numerous conferences with the former judge in his capacity as a mediator. *Id.* at 693. However, the trustee did not seek any authority from the bankruptcy court to mediate the dispute or to retain the mediation services of the former judge. *Id.* In fact, the bankruptcy court learned of the planned mediation for the first time only when a motion to toll deadlines mentioned the mediation. *Id.* At the hearing on the motion to toll deadlines, the court inquired as to whether the trustee planned to use estate assets to pay for mediator's fee and for the trustee's counsel's fees, and the trustee confirmed that this was his plan. *Id.* The court then orally denied the motion to toll deadlines and directed the parties to not proceed with the scheduled mediation, because they had not first obtained court approval of the mediation. *Id.*

Next, Judge Bohm observed that the court is not required to rubberstamp-approve mediation upon an agreed request, but instead is charged with determining whether mediation is appropriate. *Id.* at 702. He recognized at least ten factors that courts should consider in assessing whether to approve a mediation request:

(1) the subject matter of the dispute;
(2) the amount of discovery completed;
(3) the amount of time the attorneys have spent discussing settlement with their respective clients and whether the lines of communication with the clients have been open;
(4) the amount of time the attorneys have spent discussing settlement with opposing counsel, whether the lines of communication have been open, and whether any progress has been made towards a resolution;
(5) the actual courtroom experience of the attorneys in adducing testimony and introducing exhibits;
(6) whether the attorneys have explained the mediation process to their respective clients and reviewed with them the costs of mediation versus the costs of simply going forward with the scheduled hearing or trial;
(7) the name, qualifications, and fee of the proposed mediator;
(8) the estimated cost for each client of the mediation (i.e., the client's share of the mediator's fee, the attorney's fees for representing the client in the mediation, and any travel or other associated costs);
(9) the percentage of the estimated cost to the estate (i.e. the estate's portion of the mediator's fee, plus attorneys' fees associated with the mediation, plus costs of lodging and travel, if any) to the actual amount of cash presently in the estate; and,
(10) whether any of the parties are opposed to mediation because they want their day in court as soon as possible.

*Id.* at 704.

But the most striking part of the *Smith* order is the pointed criticism of the increasingly widespread use of mediation. Judge Bohm charged that mediation deprives a litigant of his or her “day in court” and the satisfaction of vindication by a judicial tribunal. *Id.* at 705–06. He accused inexperienced attorneys of being afraid to going to trial, and thus instead counseling clients to mediate. *Id.* at 703. He observed that pursuing mediation “promotes deception of clients and erodes a fundamental premise of the American legal system: the development of lawyers who know how to examine witnesses and introduce evidence in the courtroom.” *Id*. at 703. However, Judge Bohm did not lay the problem entirely at the feet of timid attorney. He also complained about the complicity of judges who are “too lazy or too scared to adjudicate the dispute on the merits.” *Id.* at 704. Last, Judge Bohm rejected the contention that settlement by mediation was preferable in certain circumstances to a clear determination of a winner-and-loser, as made at a trial:

> The final factor to consider is the importance of having a hearing (or trial) so that one party will win and the other will lose. The losing party, by learning a hard lesson in the courtroom—including how unpleasant it can be to undergo cross-examination by opposing counsel—may stop behaving in the manner that created the dispute

> in the first place. However, if that same party does not lose in the courtroom, but rather settles at a mediation (without the embarrassment and sting that can come with a courtroom loss), the party is more likely to continue the same behavior and foment future disputes similar to the one that has settled in mediation. Thus, in certain instances, it is appropriate for a court to deny mediation in the interest of pushing a "winner take all" scenario.

Id. at 704. Judge Bohm summarized his unambiguous feelings about mediation: "the undersigned judge does not belong to the school of 'mediation romantics' who believe that mediation best resolves all disputes and leaves all the parties walking away with warm and fuzzy feelings towards one another." *Id.* at 705.

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While the court has the authority to direct the parties to mediate, it cannot force parties to accept terms proposed in mediation, or punish a party for refusing to settle. It should be noted, however, that a court can sanction a party who does not participate in mediation in good faith. *Spradlin v. Richard*, 572 Fed. Appx. 420, 428-29 (6th Cir. 2014); *Negron v. Woodhull Hosp.*, 173 Fed. Appx. 77, 78-79 (2d Cir. 2006); *Lucas Auto. Eng'g, Inc. v. Bridgestone/Firestone, Inc.*, 275 F.3d 762, 769 (9th Cir. 2001). The problems is: what constitutes good faith "can at times be an inherently vague and subjective notion which would be difficult, if not impossible, to reasonably and logically enforce in practice," *Procaps S.A. v. Patheon Inc.,* 2015 WL 3539737, at *1 (S.D. Fla. June 4, 2015)("*Procaps*"), thus making the appropriateness of sanctions difficult to determine. However, the *Procaps* court did list examples of objectively bad faith behavior for which sanctions can be imposed: (1) not attending a court-ordered mediation, (2) not having a representative with sufficient settlement authority attend the mediation, (3) failing to submit a court-required written mediation summary, (4) leaving a mediation after a few minutes (or some other inadequate amount of time), and (5) failing to timely give notice before mediation that it did not intend to make a settlement offer at a mediation. *Id.*

**VIRTUAL CURRENCY HANDOUT**

**MIDWESTERN BANKRUPTCY INSTITUTE**
**OCTOBER 12, 2018**

## I. Introduction

When people speak of virtual currency, Bitcoin, the Blockchain, ICOs, etc., they usually are speaking of things identifiable in three different buckets:

- **Virtual currency (also referred to as cryptocurrency)**: A virtual currency is a digital currency that uses cryptography for security. A virtual currency is difficult to counterfeit because of this security feature. A defining feature of virtual currency and arguably its most endearing allure is its organic nature; it is not issued by any central authority, rendering it theoretically immune to government interference or manipulation.

- **Blockchain**: A Blockchain is a digitized, decentralized, public ledger of all cryptocurrency transactions. Constantly growing 'completed' blocks (the most recent transactions) are recorded and added to it in chronological order, it allows market participants to keep track of digital currency transactions without central recordkeeping. Each node (a computer connected to the network) gets a copy of the Blockchain, which is downloaded automatically.

- **Initial Coin Offerings (ICOs):** An unregulated means by which funds are raised for a new cryptocurrency venture. An ICO is used by startups to bypass the rigorous and regulated capital-raising process required by venture capitalists or banks. In an ICO campaign, a percentage of the cryptocurrency is sold to early backers of the project in exchange for legal tender or other cryptocurrencies, but usually for Bitcoin.[1]

Here are some of the aspects and terms of virtual currency that may be referenced when discussing the holding and storage of virtual currency:

- **Public key–**a public portion of your address that when linked with the private key allows the owner to establish that he owns the cryptocurrency. The public key will be seen on the Blockchain.

- **Private key–**a secret number that allows you to complete a cryptocurrency transaction. Here is a sample private key:

[1] Definitions from Investopedia: www.Investopedia.com/terms

- **Storage**–Either on the web, any computer or what is referred to as cold storage. There are potential security issues with all of them, including vulnerability to hacking and if you lose your storage medium (such as your USB drive).

- **Exchanges–**Use a digital wallet or account to store a person's cryptocurrency.

## II. Regulatory/IRS Treatment of Virtual Currency

- **CFTC/SEC Joint Senate Testimony.** SEC Chairman Jay Clayton stated at one point that he has yet to see an ICO that was not a security. He did not elaborate on this point, however, or clearly define what constitutes an ICO. He also admitted it does not have jurisdiction to regulate spot prices of commodities (e.g., the trading of cryptocurrencies themselves) but they can regulate derivatives, such as the futures instrument currently trading. CFTC Chairman Christopher Giancarlo responded to a question about the intrinsic value of cryptocurrencies stating that economists have acknowledged that the resources put into cryptocurrency mining are arguably a price floor.

- **IRS Notice 2014-21**: While the IRS acknowledged that virtual currency could operate like real currency, it is not designated as legal tender even though it acts as a "convertible virtual currency" that can be converted to other currencies, such as U.S. Dollars. Because the IRS concluded that virtual currencies are more akin to property, the IRS applied traditionally understood tax rules to the use of virtual currencies. Under this notice, taxpayers are required to pay any tax resulting from the gain or loss on a sale or exchange of virtual currency. Furthermore, if a taxpayer is paid in virtual currency, the taxpayer must "include the fair market value of the virtual currency, measured in U.S. dollars…." The taxpayer would then also owe taxes when the virtual currency is spent or otherwise converted into currency. The onus is on the taxpayer to keep good records.

## III. Bankruptcy Topics in Virtual Currency

Because many virtual currency issues are novel, many questions remain unanswered. However, several key topics have been addressed and are discussed below.

- **Should virtual currency holdings be disclosed?** Yes. The broad language of Section 541 of the Bankruptcy Code defines "property fo the estate" to include "all legal or equitable interests of the debtor in property as the of the commencement of the case." Therefore, debtors must disclose their virtual currency holdings.

- **Is virtual currency "currency" or a "commodity"?** No published decisions, but In re HashFast Technologies addressed it. "The court does not need to decide whether bitcoin is currency or commodities for fraudulent transfer provisions of the Bankruptcy Code. Rather, it is sufficient to determine that, despite defendant's arguments to the contrary, bitcoin are not United States Dollars." Does this signal perhaps more like a commodity than currency?

- **Why does it matter?** If virtual currency is deemed to be a commodity, it may qualify for protection against the automatic stay and the right to avoid fraudulent transfers. If deemed a currency, then agreements to exchange virtual currency for cash could be considered "swap agreements" under the Bankruptcy Code.

- **How are virtual currencies valued?** Virtual currencies have no intrinsic value and are valued merely at what people will pay. The volatility with virtual currencies is a hindrance to valuation, and most people follow Coindesks Bitcoin Price Index and other virtual currency price indices that uses weighted averages across the exchanges.

- **Can virtual currency be used to pay creditors?** Likely yes. And the timing of liquidation is key for the maximum return of investment and the greater potential for creditor relief. Ordinarily, liquidation by a trustee is done swiftly, especially in a Chapter 11 plan. But with the rise and fall of prices, it may be advisable to hold virtual currency and liquidate at a later time.

## IV. Final Thought

- **HODL**–The intentionally misspelled word *hodl* has its roots in a December 2013 post on the Bitcoin Talk forum, "I AM HODLING"; when the author, GameKyuubi, couldn't be bothered to fix his typo about holding on to bitcoin during a volatile period, the online community instantly turned it into a verb: To hodl and "hold on for dear life."