



AMERICAN
BANKRUPTCY
INSTITUTE

2019 Alexander L. Paskay Memorial Bankruptcy Seminar

ABI Talks: The Most Important Bankruptcy Supreme Court Cases Ever

John B. Macdonald, Moderator

Akerman LLP; Jacksonville

John A. Anthony

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The Most Important Bankruptcy Supreme Court Cases Ever

The *Stern/Executive Benefits/Wellness* Trilogy

Luis E. Rivera II
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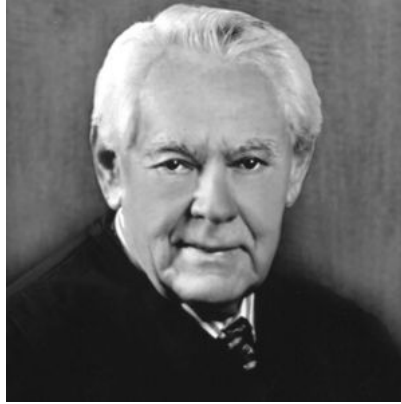


- *Stern v. Marshall*, 546 U.S. 462 (2011)
- *Executive Benefits Insurance Agency v. Arkinson*, 573 U.S. 25 (2014)
- *Wellness International Network, Limited v. Sharif*, 575 U.S. ____ (2015)

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28 U.S.C. § 157

(b)

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

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

* * *

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

(c)

(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

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Stern v. Marshall,
546 U.S. 462 (2011)

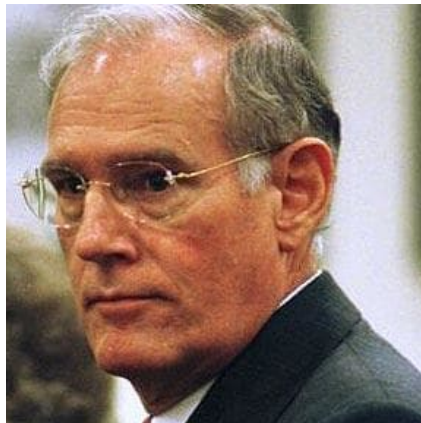
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Case 2:96-bk-12510-DS Doc 1-1 Filed 01/25/96 Entered 01/29/96 09:46:16
Main Document Page 1 of 4 ORIGINAL

United States Bankruptcy Court Central District of California Los Angeles Division		VOLUNTARY PETITION
IN RE: (Name of debtor) Marshall, Vickie Lynn		NAME OF JOINT DEBTOR (Spouse)
ALL OTHER NAMES used by debtor in the last 6 years See Attached Sheet		ALL OTHER NAMES used by joint debtor in the last 6 years
SOC. SEC./TAX I.D. NO. (if more than one, state all) 453-69-2845		SOC. SEC./TAX I.D. NO. (if more than one, state all)
STREET ADDRESS OF DEBTOR 200 N. Ashdale Los Angeles, CA 90045		STREET ADDRESS OF JOINT DEBTOR
COUNTY OF RESIDENCE/BUSINESS: Los Angeles		COUNTY OF RESIDENCE/BUSINESS:
MAILING ADDRESS OF DEBTOR		MAILING ADDRESS OF JOINT DEBTOR
LOCATION OF PRINCIPAL ASSETS OF BUSINESS DEBTOR		VERGE (Check one box) <input checked="" type="checkbox"/> Debtor has been domiciled or has had a residence, principal place of business, or principal assets in this District for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other District. <input type="checkbox"/> There is a bankruptcy case concerning debtor's affiliate, general partner, or partnership pending in this District.
INFORMATION REGARDING DEBTOR (Check applicable boxes)		
TYPE OF DEBTOR <input checked="" type="checkbox"/> Individual <input type="checkbox"/> Joint (Husband & Wife) <input type="checkbox"/> Partnership <input type="checkbox"/> Other		CHAPTER OR SECTION OF BANKRUPTCY CODE FOR PETITION <input type="checkbox"/> Chapter 7 <input checked="" type="checkbox"/> Chapter 11 <input type="checkbox"/> Chapter 13 <input type="checkbox"/> Chapter 9 <input type="checkbox"/> Chapter 12 <input type="checkbox"/> Sec. 304
NATURE OF DEBT <input checked="" type="checkbox"/> Non-Business/Consumer <input type="checkbox"/> Business - Complete ASB below		FILING FEE (Check one box) <input type="checkbox"/> Filing fee to be paid in installments <input checked="" type="checkbox"/> Filing fee attached
A. TYPE OF BUSINESS (Check one) <input type="checkbox"/> Farming <input type="checkbox"/> Transportation <input type="checkbox"/> Commodity Broker <input type="checkbox"/> Professional <input type="checkbox"/> Manufacturing <input type="checkbox"/> Construction <input type="checkbox"/> Retail/Wholesale <input type="checkbox"/> Mining <input type="checkbox"/> Real Estate <input type="checkbox"/> Railroad <input type="checkbox"/> Stockbroker <input type="checkbox"/> Other Business		NAME AND ADDRESS OF LAW FIRM OR ATTORNEY BIRGENHORN WEINBERG 21031 Ventura Boulevard Suite 905 Woodland Hills, CA 91364-2203 (818) 354-8822
B. BRIEFLY DESCRIBE NATURE OF BUSINESS		NAME(S) OF ATTORNEY(S) DESIGNATED TO REPRESENT DEBTOR Stephen F. Birgenhahn 60584

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FILED
MAR - 7 2006
CLERK U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

11 In Re 12 VICKIE LYNN MARSHALL, 13 14 E. FIERCE MARSHALL, 15 Plaintiff, 16 v. 17 VICKIE LYNN MARSHALL, 18 Defendant. 19 VICKIE LYNN MARSHALL, 20 Counter-Defendant, 21 v. 22 E. FIERCE MARSHALL, 23 Counter-Defendant. 24	CASE NO. SA CV 01-67 BDC (BANKRUPTCY CASE NO. LA 96-12510 SB; ADVERSARY CASE NO. AD 96-1324 SB) JUDGMENT
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JUDGMENT

Court of Appeals

First District of Texas

NO. 01-02-00114-CV

HOWARD STERN AS EXECUTOR OF THE ESTATE OF VICKIE LYNN
MARSHALL, Appellant

v.

ELAINE MARSHALL AS INDEPENDENT EXECUTRIX OF THE ESTATE OF
E. PIERCE MARSHALL, ROBERT MCINTYRE AS TEMPORARY
ADMINISTRATOR OF THE ESTATE OF J. HOWARD MARSHALL, II,
APPLICATION TO APPOINT ELAINE MARSHALL PENDING, IV
ELAINE MARSHALL AS TRUSTEE OF THE MARSHALL
GRANDCHILDREN'S TRUST FOR THE BENEFIT OF E. PIERCE
MARSHALL, JR., ELAINE MARSHALL AS TRUSTEE OF THE MARSHALL

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U.S. Const., Art. III, § 3

The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. *The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.*

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Executive Benefits Insurance
Agency v. Arkinson,
573 U.S. 25 (2014)

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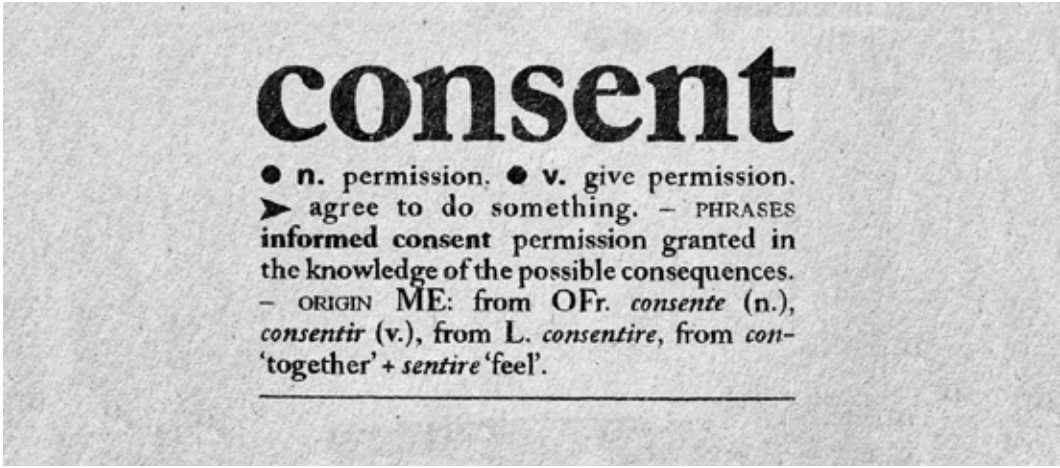
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Wellness International Network,
Limited v. Sharif,
575 U.S. ____ (2015)

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THE MOST IMPORTANT BANKRUPTCY SUPREME COURT CASE EVER

Baker Botts LLP v. Asarco, 135 S. Ct. 2158 (2015)



Presented By: Nicolette Corso Vilmos



The Court



- Opinion written by Justice Thomas on June 15, 2015.
- **Majority:** Justice Thomas delivered the opinion, with Justices Roberts, Scalia, Kennedy, and Alito joining, and Sotomayor joining all but part III B 2.
- **Dissent:** Justice Breyer delivered the dissent, with Justices Ginsberg and Kagan joining.

Facts of the case

- Baker Botts, LLP, along with other firms, was awarded approximately \$120 million in fees for representing Asarco, LLC in its Chapter 11 bankruptcy case, from which Asarco had emerged in 2009 with a reorganization plan that would pay its creditors in full.
- Baker Botts filed for a final fee request pursuant to §330(a)(1), which Asarco contested.
- The bankruptcy court awarded Baker Botts more than \$117 million to cover the fees in addition to \$5 million for expenses incurred defending the fee claims.
- The district court affirmed. The U.S. Court of Appeals for the Fifth Circuit held that the Bankruptcy Code did not allow the firms to recover \$5 million spent defending the fee request against Asarco's opposition.

11 U.S. Code § 330 - Compensation of officers

(a)(1)After notice to the parties in interest and the United State Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1103—

(A)reasonable compensation for actual, necessary services rendered by the trustee, examiner, ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person; and

(B)reimbursement for actual, necessary expenses.

Question Presented

- Does the Bankruptcy Code allow bankruptcy attorneys and other professionals to be awarded fees incurred in defending their fee requests?



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Decision

- 6-3 decision in favor of ASARCO
- The Supreme Court applied the so-called “*American Rule*” that each party must pay its own attorneys’ fees absent explicit statutory authority to the contrary.
- Section 330 of the Bankruptcy Code, which governs payment of fees to estate professionals, is not sufficiently “specific and explicit” to avoid the American Rule and therefore Baker Botts was not entitled to recover its fee defense costs.



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Significance



Where Do We Go From Here?

- 12 *amicus curiae* briefs were filed: 10 in favor of Baker Botts; 1 in favor of ASARCO; and 1 neutral.
- Changed the long standing right of estate professionals to be reimbursed by the estate for fees incurred in defending objections to their fees.
- Potential increase in meritless fee objections for strategic or tactical reasons.

Is There A Work Around?

- *In re Boomerang Tube, Inc.*, in the *Bankruptcy Court for the District of Delaware*.
- Official Committee of Unsecured Creditors entered into a retention agreement with its counsel expressly providing for the payment of fee defense costs and expenses to the extent that the counsel was successful in its fee defense. The U.S. Trustee objected to the proposed retention terms, contending that such arrangements were categorically precluded by ASARCO.
- Judge rejected each of the various arguments made to support the proposed fee shifting and found:
 - that section 328, while providing an exception to section 330, is not the type of “specific and explicit” authorization needed to overcome the limitations of the American Rule.
 - Parties still cannot, by contract, violate provisions of the Bankruptcy Code. Therefore, in order to utilize any contract exception, the contract would need to be consistent with the other provisions of the Code.
 - The estate could not be contractually bound by an agreement to which it was not a party.
 - the retention agreement provisions permitting compensation for services not rendered to the Committee, but rendered for the benefit of retained counsel, were not reasonable terms of employment.

Is There A Work Around?

- *In re Nortel Networks*, 2017 Bankr. LEXIS 674 (Bankr. D. Del. Mar. 8, 2017)
 - *Baker Botts* and *Boomerang Tube* did not apply to a fee dispute between an indenture trustee and certain bondholders, and permitted the trustee to recover its attorneys’ fees for defending against the challenge.
 - Bond indenture qualified as a contractual exception to the American Rule and it was an agreement directly between the debtor and the trustee.
 - Distinction- did not involve an estate professional under Section 328

Is There A Work Around?

- *In re Hungry Horse, LLC*, 574 B.R. 740 (Bankr. D.N.M. 2017)
 - Found that a fee defense provision in a retention agreement between a chapter 11 debtor and proposed debtor’s counsel to be “reasonable” within the meaning of Section 328.
 - Needs to be agreed to by the bankruptcy estate;
 - Extends to the creditors’ committee’s professionals, in order to “level the playing field.”
 - Sample language that could be acceptable under Section 328:
 - **Fee Defense.** The Client agrees to pay all reasonable legal fees and expenses incurred by the Firm, and also by any counsel retained by the unsecured creditors’ committee (if one is formed in the Client’s bankruptcy case) for successfully defending their respective fee applications. The bankruptcy court must approve all of such fees as reasonable. The Client will have no obligation to pay for any fees or expenses the Firm incurs defending fees that are not allowed.






Thank you!

**THE MOST IMPORTANT BANKRUPTCY SUPREME COURT
CASE EVER**

***TILL V. SCS CREDIT CORP.,*
541 U.S. 465, 124 S.CT. 1951 (2004)**

JORDI GUSO
BERGER SINGERMAN, LLP

FACTS

-  Debtors purchased a used truck for \$6,750.
-  Paid \$300 down and financed the balance of the purchase price pursuant to an installment sales contract that provided for the payment of:
 - 21% interest per annum, and
 - total payments of \$8,285.24 over 2.5 years.
-  One year later, the debtors defaulted and filed a joint petition for relief under Chapter 13.
-  As of the petition date, the debtors owed the lender \$4,894.89.
-  The parties agreed that the truck was worth \$4,000 thereby setting the amount of the lender's secured claim at \$4,000.

FACTS

- The debtors proposed a plan providing for the lender to:
 - retain its lien on the vehicle, and
 - receive deferred cash payments on account of the secured claim with interest at 9.5%.
- The debtors derived the interest by applying a “formula approach” which started with the risk free prime rate (8% at the time) and augmenting it by 1.5% to account for the risk of non-payment.
- The lender objected to the proposed plan treatment contending that it was entitled to interest at 21%, the rate the lender would obtain if it were to foreclose on the vehicle, sell the vehicle and re-invest the proceeds in new loans.



HOW WAS THE BANKRUPTCY COURT TO DETERMINE THE CRAMDOWN RATE OF INTEREST?

Historically courts used one of four approaches:

- “**Formula**”: start with a base rate, such as the prime rate, and then to increase it to account for any risk of nonpayment;
- “**Coerced Loan**”: set cramdown interest rate at the rate the creditor would have obtained if it had foreclosed on the loan, sold the collateral and reinvested the proceeds in loans of equivalent duration and risk;
- “**Presumptive Contract**”: begin with the prepetition contract rate, which creates a rebuttable presumption that either the secured creditor or the debtor can counter with persuasive evidence that a higher or lower rate should apply based upon current market conditions or market risks;
- “**Cost of Funds**”: begin with the rate that the creditor would have to pay to borrow the funds.



PROCEDURAL HISTORY

- The bankruptcy court in *Till* overruled the lender's objection and adopted the formula approach. The lender appealed.
- The District Court reversed reasoning that the Seventh Circuit required the Bankruptcy Court to set the cramdown interest rate at the level the creditor would have obtained if it had foreclosed on the loan, sold the collateral and reinvested the proceeds in loans of equivalent duration and risk. The debtors appealed.
- The majority opinion of the Seventh Circuit affirmed the District Court finding that for purposes of determining the cramdown interest rate, the Bankruptcy Court's inquiry should focus on the interest rate that the lender would obtain in making a new loan in the same industry to a debtor who is similarly situated, although not in bankruptcy, and added that the Bankruptcy Court should approximate the new loan rate by looking to the parties' prebankruptcy contract rate.



SUPREME COURT HOLDING

- A plurality of the Supreme Court⁽¹⁾ held that when determining the cramdown rate of interest under Section 1325(a)(5)(B)(ii), a bankruptcy court should use the formula-rate approach, rejecting the use of the coerced-loan rate method, the presumptive contract-rate method and the cost-of-funds rate method.
- After ascertaining the prime rate, the bankruptcy court should then adjust the prime rate upward after considering “the circumstances of the estate, the nature of the security and the duration and feasibility of the reorganization plan,” factors which the Supreme Court found to fall “squarely within the bankruptcy court’s area of expertise.” *Till*, 124 S. Ct. at 1961.
- The Supreme Court observed that the formula-rate approach is readily ascertainable, uncomplicated, involves less in litigation costs and focuses on insuring that the payments equal the required present value, rather than insuring that each creditor is made whole based on the individual circumstances of that creditor.

⁽¹⁾ Justice Stevens wrote the opinion, in which Justice Souter, Justice Ginsburg and Justice Beyer joined.



SUPREME COURT HOLDING

(CONTINUED)

- Justice Thomas concurred with the plurality's adoption of the formula-rate approach, but reasoned that Section 1325(a)(5)(B)(ii) does not require a debtor to compensate a secured creditor for the risk of non-payment. He observed that while there may be some risk of non-payment, the plain language of Section 1325(a)(5)(B)(ii) does not take this risk into account. Therefore, Justice Thomas concluded that "the appropriate risk-free rate should suffice." *Till*, 124 S.Ct. at 1966.
- Justice Scalia, joined by Justice Rehnquist, Justice O'Connor and Justice Kennedy, dissented. The dissent posits that the bankruptcy court should start with the contract rate between the parties which the court could revise on motion of either party.



SIGNIFICANCE



WHY IS A PLURALITY DECISION OF THE SUPREME COURT DETERMINING THE CRAMDOW INTEREST RATE IN CHAPTER 13 THE MOST IMPORTANT BANKRUPTCY CASE EVER?

- Look at the significance of a case not only by its holding or reasoning, but also by its progeny – that is, the jurisprudence that has evolved as a result of the ruling.
- *Till* has had a robust progeny. Trial courts and lower appellate courts have cited to *Till* hundreds of times.
- Notably, the courts have extended the rationale of *Till* outside of the Chapter 13 context and have applied it in the context of Chapter 11 reorganization.
- Footnote 14 of *Till*:
- “Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce. In the Chapter 13 context, by contrast, the absence of any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure.”



- In this context, many courts have applied the following analysis:
 - (1) is there an efficient market for comparable loans such that a market rate can be determined to cramdown the secured claim?
 - (2) if there is no efficient market, is the prime rate the appropriate risk-free rate to use as a base?
 - (3) what adjustment to the risk-free rate should the court use to compensate for the risk of default?

See, Momentive Performance Materials Inc. v. BOKF, NA (In re MPM Silicones, L.L.C.), 874 F.3d 787 (2d Cir. 2017); In re Am. HomePatient, Inc., 420 F.3d 559, 568 (6th Cir. 2005); In re 20 Bayard Views, LLC, 445 B.R. 83, 106 (Bankr. E.D.N.Y. 2011); In re Linda Vista Cinemas, L.L.C., 442 B.R. 724 (Bankr. D. Ariz. 2010); In re Nw. Timberline Enters., 348 B.R. 412 (Bankr. N.D. Tex. 2006).



- Notwithstanding, several bankruptcy courts have simply applied the formula-rate approach in Chapter 11 cases despite the Supreme Court's footnote in *Till* (see *In re Tex. Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (5th Cir. 2013); *In re Pamplico Highway Dev. LLC*, 468 B.R. 783, 792-95 (Bankr. D. S.C. 2012); *In re Vill. at Camp Bowie I, L.P.*, 454 B.R. 702,712-15 (Bankr. N.D. Tex. 2011); *In re Lilo Props., LLC*, 2011 WL 5509401 at *2 (Bankr. D. Vt. Nov. 4, 2011).



REMEMBER THE IMPACT OF *TILL* DURING THE FINANCIAL CRISIS?

- Debtors – including real estate investors who had obtained CMBS financing that faced looming maturities;
- No market for financing – efficient or otherwise;
- Chapter 11 provided the only relief available in an otherwise frozen market;
- Courts routinely applied the methodology in *Till* to set a cramdown rate giving debtors the opportunity to reorganize.



A Fraud By Any Other Name...

A Presentation on Bankruptcy Code §523(a)

Putting the Pieces Together

February 8, 2019



“Bankruptcy is intended to give debtors a fresh start, not a head start.”

-Honorable Alexander L. Paskay,
Chief Bankruptcy Judge Americus,
Middle District of Florida

Statute of 13 Elizabeth (1571)

II.
All Parties to such fraudulent Conveyances, putting the same in Effect, shall forfeit One Years Value of Land, and the whole Value of Goodes so conveyed;

AND be yt further enacted by thauthoriti aforesaid, That all and every the pōes to such fayned covenous or fraudulent Feoffement Gyfte Graunte Alienation Bargayne Conveyaunce Bondes Suites Judgements Executions and other Thynges before expressed, or beinge privy and knowynge of the same or any of them, w^{ch} at any tyme after the Tenth Daye of June next cōmyng shall wittingly and willingly put in ure swowe mayntaine justefie or defend the same or any of them, as true simple and done had or made bona fide and upon good consyderation, or shall alien or assigne any the Landes Tenementes Goodes Leases or other Thing^e before mentioned, to hym or them conveyed as is aforesaid, or anye parte thereof, shall incurre the Penaltie and Forfayture of one yeres value of the said Landes Tenementes & Heredytamentes Leases Rentes Comons or other Ffyttes of or oute of the same, and the whole value of the said Goodes and Cattalls, and also so muche Monye as are or shalbe conteyned in any suche covenous and fayned Bonde; the one Moitie whereof to be to the Queenes Ma^{ty}, her Heyres and Successors, and thother Moitye to the ptye or ptyes greaved by suche fayned and fraudulent Feoffement Gyfte Graunte Alyenation Bargayne Conveyaunce Bondes Suites Judgements Exccutions Leases Rentes Cōmunes Ffyttes Charg^e and other Thynges aforesaide; to be recovered in any of the Queenes Courtes of Record by Action of Debt Byll Playnt or Information, wherein none Essoyne Pfection or Wager of Lawe shalbe admitted for the Defendaunt or Defendauntes; and also beinge thereof lawfully convycted, shall suffer imprysōment for one halfe yere wthoute Baile or Maynepryse.

Half to the Crowne, and Half to the Party grieved.

The Six Badges of Fraud under the Statute of 13 Elizabeth (1571) were later specifically enumerated by the Court of Star Chamber in Twyne's Case (1601) 76 ER 809

United States Constitution, Article I, Section 8, Clause 4 (1789)

“To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;”

“The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.”

The Federalist No. 42 Publius
(James Madison)



Bankruptcy Act of 1898

§ 17. Debts Not Affected By a Discharge.-

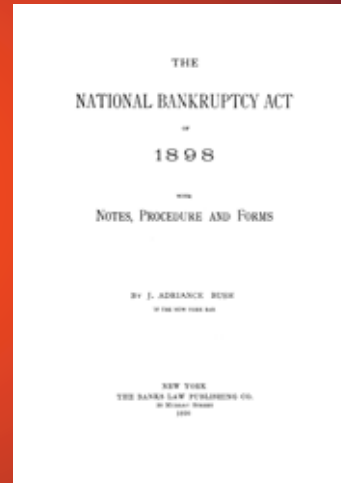
(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as

...

(2) Are judgments in actions for frauds, or obtaining property by false pretenses, or for willful and malicious injuries to the person or property of another;

...

(4) Were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity.



§523(a)(2) Exceptions to Discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -

...

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by -

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial situation;

(B) use of a statement in writing -

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

...

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

Grogan v. Garner, 498 U.S. 279 (1991)

- › This case established the foundation on which later Bankruptcy Code §523(a) cases were built on. The Court held that the bankruptcy system is only for the “honest but unfortunate debtor,” not the unfortunate and dishonest debtor. Accordingly, the Court was not going to interpret the Bankruptcy Code in such a way that would require a creditor to prove his fraud claim twice, imposing a higher standard the second time. On that basis, the Court concluded that a creditor needed only to establish the debtor’s fraud by a preponderance of the evidence rather than by clear and convincing evidence in order to except a debt from discharge under Bankruptcy Code §523(a).

Field v. Mans, 516 U.S. 59 (1995)

- › This case built on Grogan by lowering the bar that creditors needed to clear in order to except their debt for discharge on account of fraud under Bankruptcy Code §523(a)(2)(A). After Field, creditors only had to prove that their reliance on the debtor’s fraudulent misrepresentation was justifiable, not that it was reasonable as well. The Court based this decision on the standard of reliance required in state common law fraud actions. The Field opinion builds on the principles of Grogan by recognizing that not only was the bankruptcy system a balancing act, but also that creditors needed more protection in that system.

Cohen v. de la Cruz, 523 U.S. 213 (1998)

- › This case re-introduced the important role that state fraud statutes play in the Bankruptcy Code. The Court's holding allowed fraud creditors to except from discharge not only the compensatory damages awarded in their state action, but also their punitive damages. Most importantly was the Court's analysis of the phrase "to the extent obtained by fraud" in Bankruptcy Code §523(a)(2)(a). Relying heavily on Grogan and Fields, the Court held that the phrase "to the extent obtained by" does not limit the extent to which "any debt" is excepted from discharge. Given that the punitive damages would not have been awarded but for the debtor's underlying fraud, the damages were obtained as a result of the fraud. This opinion furthered the reach of Bankruptcy Code §523(a)(2)(a) and in the process started to put debtors on notice that bankruptcy could not always be their shield.

Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000)

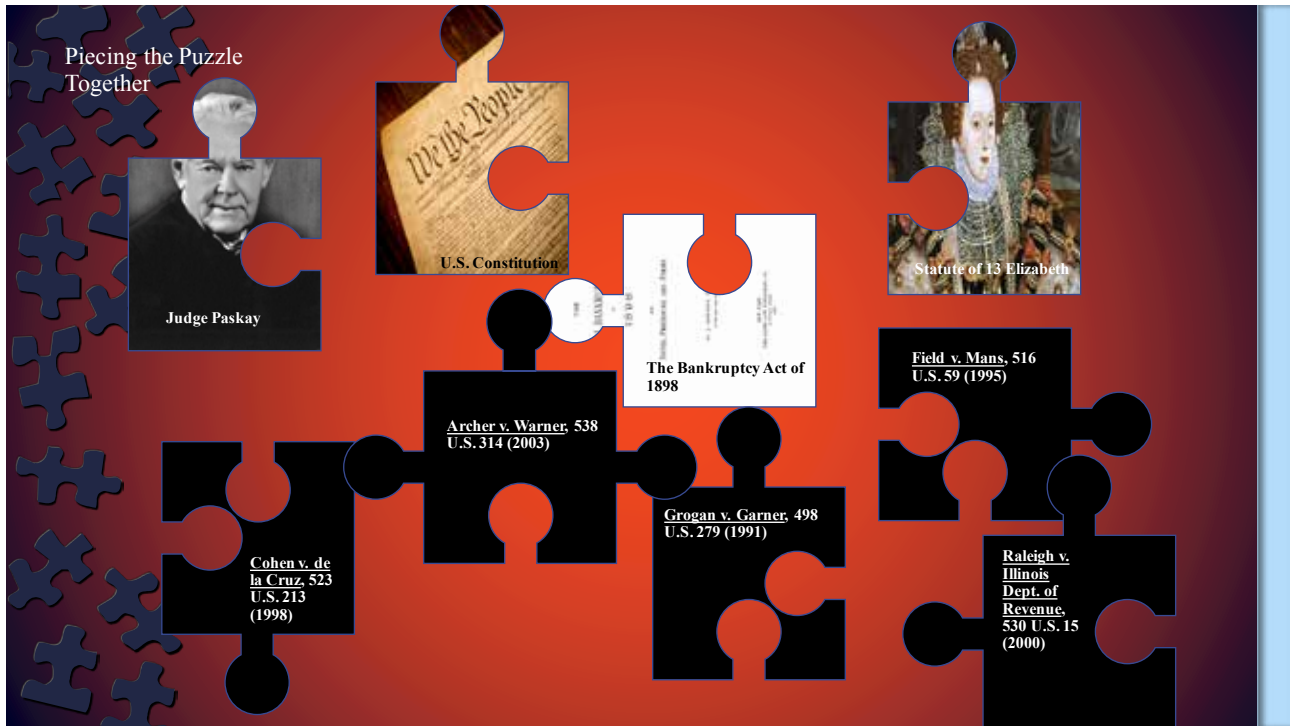
- › This case built on the respect shown to state law in Cohen to hold that the burden imposed by the state law claim under Illinois law is the same burden that will govern the claim in bankruptcy, absent a specific Bankruptcy Code provision to the contrary. The Court rejected the trustee's argument that simply because the debtor was in bankruptcy, the state tax creditor now had the burden of proof on its claim. Raleigh reminded bankruptcy courts across the country that they are not free in the name of "equity" to make wholesale substitution of underlying state law controlling the validity of creditor's entitlements.

Archer v. Warner, 538 U.S. 314 (2003)

- › This case put all the different pieces together showing that state law fraud is also bankruptcy fraud. The Court held that a debt that had been issued to settle a state law fraud claim constituted a debt obtained by fraud for purposes of Bankruptcy Code §523(a). Archer, combined with the four previous cases, demonstrates that regardless of its form, fraud is fraud, and debts obtained by that fraud are non-dischargeable under Bankruptcy Code §523(a).

Each of Our Considered Cases Was a Piece Putting The Puzzle Together

- › Grogan v. Garner, 498 U.S. 279 (1991) (creditors only need to prove fraud by a preponderance of the evidence)
- › Field v. Mans, 516 U.S. 59 (1995) (creditors only need to show justifiable reliance on the fraud)
- › Cohen v. de la Cruz, 523 U.S. 213 (1998) (a creditor's punitive damages awarded on account of fraud are non-dischargeable)
- › Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000) (creditors' claims are governed by state law absent a contrary Bankruptcy Code provision)
- › Archer v. Warner, 538 U.S. 314 (2003) (a creditor's fraud claim does not lose its character when converted to settlement)



Husky Intern. Electronics, Inc. v. Ritz, 136 S. Ct. 1581 (2016)



Facts

- › Husky International Electronics, Inc., sold its electrical components to Chrysalis Manufacturing Corp., and Chrysalis incurred a debt to Husky in return.
- › Rather than paying back creditors like Husky, Daniel Lee Ritz, the director of Chrysalis, carried out a fraudulent transfer scheme in which he moved large sums of Chrysalis's funds into three other companies.
- › Husky eventually filed suit against Ritz to hold him personally liable for Chrysalis' debt and Ritz subsequently filed for bankruptcy protection.
- › Husky next instituted adversary proceedings against Ritz in the bankruptcy court to again try to hold him personally liable and to prevent Ritz from discharging his debt to Husky. Husky contended that the Ritz's debt was non-dischargeable because fraudulent schemes constitute actual fraud under Bankruptcy Code §523(a)(2)(A).

Holding

- › “Fraud” for purposes of non-dischargeability under Bankruptcy Code §523(a)(2)(A) includes fraudulent transfers under the UFTA that do not involve misrepresentations to defrauded creditors.



Consequences

- › For debtors: the bankruptcy system is not your shield nor your sword.
- › For debtor’s lawyers: “assisting” your clients could make you liable for fraud yourself.
- › For America: underscores our nation’s commitment to rooting out fraud and to protecting fraud victims over dishonest debtors.



Of Course Lawyers Have a Role to Play



In Good Faith Estate Planning

Lawyers should carefully consider whether their services are being sought merely to camouflage fraudulent transfers.



Why Husky is the Most Important Bankruptcy Ever



We wish to thank the rest of our team

- › Andrew J. Ghekas, Esquire
- › Carter J. Wallace, Esquire
- › Jennifer N. Niro
- › Elizabeth M. Anthony

LOCAL LOAN CO. V. HUNT, 292 U.S. 234 (1934)

*The Most Important
Supreme Court Case Ever*

Presented by Monique D. Hayes

THE COURT

CHIEF JUSTICE
CHARLES EVANS
HUGHES

ASSOCIATE JUSTICES
WILLIS VAN DEVANTER
BENJAMIN N. CARDOZO
JAMES C. MCREYNOLDS
LOUIS D. BRANDEIS
PIERCE BUTLER
GEORGE SUTHERLAND
OWEN J. ROBERTS
HARLAN F. STONE



Charles Evan Hughes

Republican, N.Y.



*Benjamin N.
Cardozo*

Democrat, N.Y.



Louis D. Brandeis

Democrat, Mass.

ARI-TALKER © PASKAY, LLP



The Context

The Great Depression

In many ways, 1934 marked the turning point of the Great Depression in the United States. National unemployment decreased to 22 percent. Henry Ford reestablished the \$5 per minimum wage for nearly half of his 70,000 employees. However severe drought was affecting much of the American Heartland. And, urban unemployment and crime remained at historic levels. President Franklin D. Roosevelt's New Deal had been implemented to rejuvenate the national economy by providing funding for infrastructure and other public works projects. Congress enacted the Corporate Bankruptcy Act-which for the first time allowed corporate debtors to reorganize with the consent of two-thirds of their creditors. 1934 also saw the enactment of the Federal Farm Bankruptcy Act-with its moratorium on all farm mortgage foreclosures.

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22%

National Unemployment

\$1,600

Average Annual Wages



Gangsters & G-Men

1934 is also noted for the high profile crime sprees and the pursuit of outlaws by state and federal law enforcement. Notorious criminals of the day included:

- John Dillinger
- Bonnie & Clyde
- The Barker Gang
- Pretty Boy Floyd
- Baby Face Nelson



The Case

LOCAL LOAN CO. V. HUNT, 292 U.S. 234 (1934)

In *Local Loan v. Hunt*, the debtor granted a consumer loan company an assignment of his future wages in exchange for a \$300 loan. The following year, the debtor petitioned for bankruptcy relief and obtained a discharge. After the discharge was entered, the loan company brought action against the debtor's employer in state court to enforce the assignment. The debtor returned to the bankruptcy court seeking an injunction against the loan company continuing the state court action or any other effort to enforce the assignment. The bankruptcy court granted injunction relief to the debtor.

On appeal, the loan company challenged the bankruptcy court's authority to enjoin the state court action. The loan company further argued that even if the bankruptcy court had jurisdiction to issue the order, the assignment was effectively a lien and enforceable as determined by the state supreme court.

Considering the issues, the U.S. Supreme Court (Sutherland) held the injunction order was ancillary to the discharge order and bankruptcy court, as a court of equity, had jurisdiction to enter the relief.

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The Case Cont'n.

LOCAL LOAN CO. V. HUNT, 292 U.S. 234 (1934)

Noting applicable state law determining the assignment of future wages constitutes a lien on such future wages, the Supreme Court also considered lower federal court rulings determining such liens have no existence or, alternatively, are ineffective as against an adjudication and discharge in bankruptcy.

The Supreme Court reminded that "one of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'"

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The Honest But Unfortunate Debtor.

The Case Cont'n.

LOCAL LOAN CO. V. HUNT, 292 U.S. 234 (1934)

Reiterating the authority of the bankruptcy courts to enforce the purpose of the Bankruptcy Act, the Court held local rules (i.e. state court orders) subversive of the Bankruptcy Act's purpose of granting a fresh start cannot be accepted as controlling the action of a federal court.



ART: TALKER / PASKAY/SHI

**The Most Important Bankruptcy Supreme Court Cases Ever –
*Till v. SCS Credit Corp.***

Jordi Guso
Berger Singerman, LLP
Miami, FL

***Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951 (2004)**

I. Issue

Where a Chapter 13 plan proposes to cramdown a secured claim by paying the holder of the secured claim deferred cash payments, how is the Bankruptcy Court to determine that rate of interest to be paid so that the present value of the deferred cash payments to be received under the plan is no less than the allowed amount of the secured claim?

II. Statutory Context

11 U.S.C. § 1325(a)(5)(B)(ii).

III. Facts

On October 2, 1998, the debtors purchased a used truck for \$6,395 plus \$330.75 in fees and taxes. They made a \$300 down payment and financed the balance of the purchase price pursuant to an installment sales contract that provided for the payment of 21% interest per annum, requiring the debtors to make total payments of \$8,285.24 over 2.5 years to the lender. The loan was secured by a purchase money security interest in the truck.

One year later, the debtors defaulted on their payments to the lender and filed a joint petition for relief under Chapter 13. As of the petition date, the debtors owed the lender \$4,894.89. The parties agreed that the truck was worth \$4,000 thereby setting the amount of the lender's secured claim at \$4,000. The debtors then proposed a plan providing for the lender to (a) retain its lien on the vehicle, and (b) receive deferred cash payments on account of the secured claim with interest at 9.5%. The debtors derived the interest by applying a "formula approach" which started with the risk free prime rate (8% at the time) and augmenting it by 1.5% to account for the risk of non-payment. The lender objected to the proposed plan treatment contending that it was entitled to interest at 21%, the rate the lender would obtain if it were to foreclose on the vehicle, sell the vehicle and re-invest the proceeds in new loans. The Bankruptcy Court overruled the lender's objection and confirmed the proposed plan. The lender appealed.

The District Court reversed, reasoning that Seventh Circuit precedent required the Bankruptcy Court to set the cramdown interest rate at the level the creditor could have obtained if it had foreclosed on the loan, sold the vehicle and reinvested the proceeds in loans of equivalent duration and risk. The debtors appealed.

The majority opinion of the Seventh Circuit affirmed the District Court finding that for purposes of determining the cramdown interest rate, the Bankruptcy Court's inquiry should focus on the interest rate that the lender would obtain in making a new loan in the same industry to a debtor

who is similarly situated, although not in bankruptcy, and added that the Bankruptcy Court should approximate the new loan rate by looking to the parties' prebankruptcy contract rate. However, the Seventh Circuit also observed that because a loan to a bankrupt involves risks that may not be incurred in a new loan to a debtor not in default, the contract rate should only serve as the "presumptive cramdown rate" which the debtor or a creditor could challenge with evidence that a higher or lower rate should apply. The debtors appealed and the Supreme Court granted certiorari.

IV. Holding

A plurality of the Supreme Court¹ held that when determining the cramdown rate of interest under Section 1325(a)(5)(B)(ii), a bankruptcy court should use the formula-rate approach, rejecting the use of the coerced-loan rate method, the presumptive contract-rate method and the cost-of-funds rate method. The formula rate approach "begins by looking to the national prime rate...which reflects the financial markets' estimate of the amounts a commercial bank should charge a creditworthy commercial borrower to compensate it for the opportunity costs of the loan, risk of inflation and relatively slight risk of default." *Till*, 124 S. Ct. at 1961. After ascertaining the prime rate, the bankruptcy court should then adjust the prime rate upward after considering "the circumstances of the estate, the nature of the security and the duration and feasibility of the reorganization plan," factors which the Supreme Court found to fall "squarely within the bankruptcy court's area of expertise." *Id.* The Supreme Court observed that the formula-rate approach is readily ascertainable, uncomplicated, involves less in litigation costs and focuses on insuring that the payments equal the required present value, rather than insuring that each creditor is made whole based on the individual circumstances of that creditor.

Justice Thomas concurred with the plurality's adoption of the formula-rate approach, but reasoned that Section 1325(a)(5)(B)(ii) does not require a debtor to compensate a secured creditor for the risk of non-payment. The statute only requires the debtor to provide the secured creditor with property with a value, as of the effective date of the plan, that is not less than the allowed amount of the secured claim. He observed that while there may be some risk of non-payment, the plain language of Section 1325(a)(5)(B)(ii) does not take this risk into account. Therefore, Justice Thomas concluded that "the appropriate risk-free rate should suffice." *Till*, 124 S.Ct. at 1966.

Justice Scalia, joined by Justice Rehnquist, Justice O'Connor and Justice Kennedy, dissented. The dissent opined that the formula-rate approach undercompensates secured creditors for the risk of default because it starts with a prime rate – a rate that the dissent viewed as too low given the risk of default. The dissent posits that the bankruptcy court should start with the contract rate between the parties which the court could revise on motion of either party. In the view of the dissent, the contract rate more accurately assesses actual risk, its application should reduce disputes and provide a quick and reasonably accurate standard.

¹ Justice Stevens wrote the opinion, in which Justice Souter, Justice Ginsburg and Justice Beyer joined.

V. Significance

Till and its progeny go far beyond establishing the methodology to be used in setting the cramdown interest rate in Chapter 13 cases. As the plurality observed, the Bankruptcy Code contains numerous provisions that, like Section 1325(a)(5)(B)(ii), require a court to discount a stream of deferred payments to present value². Justice Stevens observed that “Congress likely intended for bankruptcy judges and trustee to follows essentially the same approach when choosing an appropriate interest rate under any of these provisions.” *Till*, 124 S.Ct. at 1959. This suggests that the formula-rate approach should be applied in other circumstances and in other chapters of the Bankruptcy Code. The Court also observed, however, that while there is no efficient market for subprime loans in consumer cases, there is a “free market” of willing lenders in the Chapter 11 context and highlighted as an example the availability of debtor-in-possession financing.

A number of courts have extended *Till* and applied its rationale to determine the cramdown rate of interest under a Chapter 11 plan of reorganization. In this context, the courts’ analysis is as follows:

- (1) is there an efficient market for comparable loans such that a market rate can be determined to cramdown the secured claim?
- (2) if there is no efficient market, is the prime rate the appropriate risk-free rate to use as a base?
- (3) what adjustment to the risk-free rate should the court use to compensate for the risk of default?

The approach proved particularly powerful for debtors during the recent financial crisis when there was no market for financing – efficient or otherwise. By rejecting the other approaches to determine the cramdown rate, *Till* has done much to enhance the prospects of an effective reorganization for both individual and corporate debtors.

² In footnote 10 of the opinion, the Court cited to the following provisions of the Bankruptcy Code: 11 U.S.C. § 1129(a)(7)(A)(ii) (requiring payment of property whose “value, as of the effective date of the plan” equals or exceeds the value of the creditor’s claim); §§ 1129(a)(7)(B), 1129(a)(9)(B)(i), 1129(a)(9)(C), 1129(b)(2)(A)(i)(II), 1129(b)(2)(B)(i), 1129(b)(2)(C)(i), 1173(a)(2), 1225(a)(4), 1225(a)(5)(B)(ii), 1228(b)(2), 1325(a)(4), 1228(b)(2).

**The Most Important Bankruptcy Supreme Court Cases Ever –
*Local Loan Co. v. Hunt***

Monique D. Hayes
Goldstein & McClintock, LLLP
Miami, FL

***Local Loan Co. v. Hunt*, 292 U.S. 234 (1934)**

I. THE COURT

The 1934 Supreme Court was led by Chief Justice Charles Evans Hughes. Associate Justices on the Court included Willis Van Devanter, Benjamin N. Cardozo, James C. McReynolds, Louis D. Brandeis, Pierce Butler, George Sutherland, Owen J. Roberts, and Harlan F. Stone.

II. THE CONTEXT

In many ways, 1934 marked the turning point of the Great Depression in the United States. National unemployment decreased to 22 percent. Henry Ford reestablished the \$5 per minimum wage for nearly half of his 70,000 employees. However, severe drought continued to affect much of the American Heartland. And, urban unemployment and crime remained at historic levels. President Franklin D. Roosevelt's New Deal had been implemented to rejuvenate the national economy by providing funding for infrastructure and other public works projects. Congress enacted the Corporate Bankruptcy Act-which for the first time allowed corporate debtors to reorganize with the consent of two-thirds of their creditors. 1934 also saw the enactment of the Federal Farm Bankruptcy Act-with its moratorium on all farm mortgage foreclosures.

1934 is also noted for high profile crime sprees and the pursuit of outlaws by state and federal law enforcement. Notorious criminals of the day included:

- John Dillinger
- Bonnie & Clyde
- The Barker Gang
- “Pretty Boy” Floyd
- “Baby Face” Nelson

That year, also saw the expansion of the Federal Bureau of Investigation (FBI) powers to pursue and capture such public enemies. And, Alcatraz Prison ("The Rock") was opened to house the most notorious.

III. THE CASE

In *Local Loan v. Hunt*, the debtor granted a consumer loan company an assignment of his future wages in exchange for a \$300 loan. 292 U.S. 234, 238 (1934). The following year, the debtor petitioned for bankruptcy relief and obtained a discharge. After the discharge was entered, the loan company brought action against the debtor's employer in state court to enforce the assignment. The debtor returned to the bankruptcy court seeking an injunction against the loan

company continuing the state court action or any other effort to enforce the assignment. The bankruptcy court granted injunction relief to the debtor. *Id.*

On appeal, the loan company challenged the bankruptcy court's authority to enjoin the state court action. The loan company further argued that even if the bankruptcy court had jurisdiction to issue the order, the assignment was effectively a lien and enforceable as determined by the state supreme court. *Id.* at 239.

Considering the issues, the U.S. Supreme Court (Sutherland) held that the injunction order was ancillary to the discharge order and the bankruptcy court, as a court of equity, had jurisdiction to enter the relief. *Id.*

After noting applicable state law determining the assignment of future wages constitutes a lien on such future wages, the Supreme Court also considered lower federal court rulings determining such liens have no existence or, alternatively, are ineffective as against an adjudication and discharge in bankruptcy. *Id.* at 242.

The Supreme Court reminded that "one of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'"

"This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." *Id.* at 244 (citing *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 554 (1915)).

Reiterating the authority of the bankruptcy courts to enforce the purpose of the Bankruptcy Act, the Court held local rules (i.e. state court orders) subversive of the Bankruptcy Act's purpose of granting a fresh start cannot be accepted as controlling the action of a federal court. *Id.* at 245.

**The Most Important Bankruptcy Supreme Court Cases Ever –
The *Stern/Executive Benefits/Wellness* Trilogy**

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GrayRobinson, P.A.
Fort Myers, FL

***Stern v. Marshall*, 546 U.S. 462 (2011)**

I. Issue

Whether a bankruptcy judge who did not enjoy the tenure and salary protections of Article III, Section 1, of the Constitution had authority under 28 U.S.C. § 157 and Article III of the Constitution to enter final judgment on a counterclaim filed by Vickie Lynn Marshall against Pierce Marshall.

II. Statutory Context

U.S. Const. Art. III, § 1; 28 U.S.C. § 157.

III. Facts

Vickie Lynn Marshall, who was known to the world as Playboy Playmate and celebrity Anna Nicole Smith (“Smith”), was the third wife of J. Howard Marshall II (“J. Howard”). Smith and J. Howard were married about a year when J. Howard died at the age of 89 years old. Although at the time of this death, J. Howard was one of the richest people in Texas, J. Howard did not include Smith in his will.

Prior to J. Howard’s death, Smith filed suit in Texas state probate court asserting that J. Howard’s son, Pierce Marshall (“Pierce”), had fraudulently induced J. Marshall to sign a living trust that did not provide for Smith. Pierce denied any fraudulent activity and defended the validity of the trust.

After J. Howard’s death, Smith filed a bankruptcy petition in the Central District of California. Pierce then instituted an adversary proceeding contending that Smith had defamed him by inducing her lawyers to tell members of the press that Pierce had engaged in fraud to gain control of his father’s estate. Pierce subsequently filed a proof of claim for the damages resulting from the alleged defamation. In turn, Smith filed a counterclaim in the adversary proceeding for tortious interference with the gift she expected from J. Howard.

In 1999 and 2000, the Bankruptcy Court granted summary judgment in favor of Smith on Pierce’s claim for defamation and awarded Smith over \$400 million in compensatory damages and \$25 million in punitive damages on Smith’s tortious interference counterclaim.

On appeal to the District Court, Pierce argued that the Bankruptcy Court lacked jurisdiction over Smith’s counterclaim because it was not a core proceeding under 28 U.S.C. § 157(b)(2)(C). The District Court agreed. Recognizing that to hold that any and all counterclaims are core would run afoul of the Supreme Court’s plurality opinion in *Northern Pipeline Constr. Co. v. Marathon*

Pipe Line Co., 458 U.S. 50, 79, n. 31 (1982), the District Court concluded Smith's counterclaim was not core. As a result, the District Court treated the Bankruptcy Court's judgment as proposed, rather than final, and engaged in an independent review of the record. Like the Bankruptcy Court, the District Court found that Pierce had tortiously interfered with Smith's expectancy of a gift from J. Howard and awarded Smith compensatory and punitive damages in excess of \$44 million each.

In the meantime, the Texas state probate court had conducted a jury trial on the merits of the parties' dispute and entered a judgment in Pierce's favor.

On appeal, the Court of Appeals reversed the District Court, holding that the District Court should have afforded preclusive effect to the Texas state probate court's judgment in Pierce's favor. The Court of Appeals reasoned that, because Smith's counterclaim was not properly a core proceeding arising in a case under Title 11, the Texas state probate court's judgment was the earliest final judgment entered on matters relevant to the proceeding.

IV. Holding

While Smith's counterclaim against Pierce was a "core proceeding" under the plain text of 28 U.S.C. § 157(b)(2)(C), and Section 157(b)(2)(C) permits a bankruptcy court to enter a final judgment on the counterclaim, Article III of the Constitution does not.

Article III, Section 1, of the Constitution requires that "[t]he judicial Power of the United States" be vested in one Supreme Court and "in such inferior Courts as the Congress may from time to time ordain and establish", and that the judges of these constitutional courts "hold their Offices during good Behaviour" and "receive for their Services[] a Compensation[] [that] shall not be diminished" during their tenure. These are "inseparable elements of the constitutional system of checks and balances" that "both defines the power and protects the independence of the Judicial Branch." *Northern Pipeline*, 458 U.S. at 58. Congress exceeded these limitations in 28 U.S.C. § 157(b)(2)(C) by authorizing bankruptcy judges to issue final judgments in all counterclaims.

V. Significance

While the *Stern* Court held the bankruptcy court lacked constitutional authority to enter final judgment on Smith's counterclaim against Pierce, the decision reinforces the plurality holding of *Northern Pipeline* that there is a category of cases involving "public rights" that Congress could constitutionally assign to a "legislative" court for resolution. This is the jurisdictional bedrock of our current bankruptcy system.

However, "core" cannot constitutionally be read as broadly as it had been. For a state law counterclaim to constitutionally fall within 28 U.S.C. § 157(b)(2)(C)'s grant of authority, resolution of the counterclaim must be a necessary part of ruling on a creditor's proof of claim.

Executive Benefits Ins. Agency v. Arkison, 573 U.S. 25 (2014)

I. Issue

Whether *Stern* claims – claims designated by 28 U.S.C. § 157(b)(2)(C) for final adjudication by the bankruptcy court, but constitutionally barred from being resolved in his manner – may proceed as non-core within the meaning of Section 157(c).

II. Statutory Context

U.S. Const. Art. III, § 1; 28 U.S.C. § 157.

III. Facts

Prior to 2006, Nicolas Paleveda and his wife owned and operated two companies—Aegis Retirement Income Services, Inc. (“ARIS”), and Bellingham Insurance Agency, Inc. (“BIA”).

By early 2006, BIA had become insolvent, and on January 31, 2006, the company ceased operation. The next day, Paleveda used BIA funds to incorporate Executive Benefits Insurance Agency, Inc. (“EBIA”). Thereafter, Paleveda initiated a scheme to transfer assets from BIA to EBIA.

In June 2006, BIA filed a voluntary petition under Chapter 7 of the Bankruptcy Code. In due course, the Chapter 7 Trustee filed a complaint against EBIA to recover the allegedly fraudulent conveyances of the property of the debtor. Ultimately, the Bankruptcy Court granted summary judgment in favor of the trustee on all of his claims, including the fraudulent conveyance claims.

EBIA appealed the Bankruptcy Court’s summary judgment against it to the District Court, who conducted *de novo* review, affirmed the Bankruptcy Court’s decision, and entered judgment for the trustee.

EBIA then appealed to the Court of Appeals. After EBIA filed its opening brief, the Supreme Court decided *Stern v. Marshall*, 546 U.S. 462 (2011). In light of *Stern*, EBIA moved to dismiss its appeal, contending that the Bankruptcy Court lacked constitutional authority to finally decide the trustee’s fraudulent conveyance claims.

The Court of Appeals denied EBIA’s motion to dismiss and affirmed the District Court. The court held that EBIA had impliedly consented to the Bankruptcy Court’s jurisdiction and, in any event, the Bankruptcy Court’s judgment could be treated as proposed findings of fact and conclusions of law, which received *de novo* review by the District Court.

IV. Holding

When, under *Stern*’s reasoning, the Constitution does not permit a bankruptcy court to enter final judgment on a related-to claim, the bankruptcy court should issue proposed findings of fact and conclusions of law to be reviewed *de novo* by the district court. The district court may then enter judgment on the claim.

V. Significance

The Court's decision in *Executive Benefits* provides guidance to the lower courts on how to handle *Stern* claims. Under 28 U.S.C. § 157(b), the bankruptcy courts "hear and determine" "core" claims and "enter appropriate orders and judgments" on them. 28 U.S.C. § 157(b)(1). A final judgment in a core proceeding is appealable to the district court, 28 U.S.C. § 158(a)(1), which reviews the judgment under traditional appellate standards. Fed. R. Bankr. P. 8013.

In "non-core" proceedings, the bankruptcy court is authorized to "hear [the] proceedings," and then "submit proposed findings of fact and conclusions of law to the district court. 28 U.S.C. § 157(c)(1). The district court must then review these proposed findings of fact and conclusions of law *de novo* and enter any appropriate final orders or judgments. *Id.* However, if all parties consent, 28 U.S.C. § 157(c) permits a bankruptcy judge "to hear and determine and to enter appropriate orders and judgments" as if the proceedings were core. 28 U.S.C. § 157(c)(2).

Some courts and parties argued *Stern* claims created a statutory "gap". A *Stern* claim cannot be constitutionally adjudicated to final judgment by the bankruptcy court. But, the proposed findings of fact and conclusions of law procedure do not apply to "core" claims. So, what were courts to do? The answer is that *Stern* claims are non-core claims within the scope of Section 157(c)(1) – "not . . . core" proceedings that are otherwise related to a case under title 11.

The Court's decision in *Executive Benefits* provides guidance to the lower courts on how to handle *Stern* claims. *Stern* claims are to be treated as "non-core" proceedings and adjudicated pursuant to 28 U.S.C. § 157(c)(1). The bankruptcy court is authorized to "hear [the] proceedings," and then "submit proposed findings of fact and conclusions of law to the district court. 28 U.S.C. § 157(c)(1). The district court must then review these proposed findings of fact and conclusions of law *de novo* and enter any appropriate final orders or judgments. *Id.*

Wellness Intern. Network, Ltd. v. Sharif, 575 U.S. ____ (2015)

I. Issue

Whether Article II permits bankruptcy courts to adjudicate *Stern* claims with the knowing and voluntary consent of the parties.

II. Statutory Context

U.S. Const. Art. III, § 1; 28 U.S.C. § 157.

III. Facts

Wellness International Network is a manufacturer of health and nutrition products. Sharif was one of Wellness' distributors. The relationship between Wellness and Sharif eventually soured, and Wellness obtained a judgment at the District Court against Sharif for, amongst other things, a \$650,000 attorneys fee sanction.

In February 2009, Sharif filed a voluntary petition under Chapter 7 of the Bankruptcy Code. After conducting Rule 2004 discovery, Wellness filed a complaint seeking, amongst other things, a declaratory judgment that the Soad Wattar Living Trust was Sharif's alter ego and that its assets should therefore be treated as part of Sharif's bankruptcy estate.

Sharif denied Wellness's allegations, but, in doing so, in his answer, he admitted that the adversary proceeding was a "core proceeding" under 28 U.S.C. § 157(b) and requested judgment in his favor from the Bankruptcy Court.

After a pattern of discovery evasion on the part of Sharif, the Bankruptcy Court issued a ruling finding that Sharif had violated the court's discovery order. As a sanction, the Bankruptcy Court denied Sharif's discharge and entered a default judgment against him in the adversary proceeding, including on the alter ego claim as to the Trust and its assets.

Sharif appealed to the District Court. Six weeks before Sharif filed his opening brief, the Supreme Court decided *Stern v. Marshall*, 546 U.S. 462 (2011). However, Sharif did not cite *Stern* in his opening brief. Rather, after the close of briefing, Sharif moved for leave to file a supplemental brief arguing the Bankruptcy Court's order should be treated as a report and recommendation. The District Court denied Sharif's motion as untimely and affirmed the Bankruptcy Court's judgment.

The Court of Appeals affirmed in part and reversed in part. Holding that a *Stern* objection could not be waived, the Court of Appeals ruled that the Bankruptcy Court lacked constitutional authority to enter final judgment on the alter ego claim.

IV. Holding

Article III of the Constitution is not violated when parties knowingly and voluntarily consent to adjudication by a bankruptcy judge.

V. Significance

In *Stern*, the Supreme Court told us that, despite being labeled by Congress as “core”, certain claims could not be constitutionally adjudicated in the manner established by 28 U.S.C. § 157(b). In *Executive Benefits*, the Supreme Court addressed the practical question of how the bankruptcy courts are to address these so-called *Stern* claims. Finally, in *Wellness International*, the Court applied a pragmatic approach to decide that Article III is not violated when the parties knowingly and voluntarily consent to adjudication of a *Stern* claim by a bankruptcy judge.

As Justice Sotomayor acknowledged in the majority opinion, the number of magistrate and bankruptcy judgeships exceeds the number of circuit and district judgeships, and, without the distinguished service of these judges, “the work of the federal court system would grind nearly to a halt.” 191 S. Ct. at 1938-39.

The Court in *Wellness International* makes a practical assessment of the situation and concludes that allowing bankruptcy litigants to waive the right to adjudication of *Stern* claims by an Article III tribunal does not usurp the constitutional prerogatives of Article III courts. Bankruptcy judges, like magistrate judges, are appointed by and subject to removal by Article III judges. Bankruptcy judges “serve as judicial officers of the United States district court” and the district court retains the power to withdraw the reference *sua sponte* or at the request of a party.

The Court also emphasizes that entitlement to an Article III judge is a personal right and may be waived. This is not the situation where an objecting defendant is being forced to litigate involuntarily before a non-Article III court.

Finally, it is important to point out that the Court in *Wellness International* did not require the knowing and voluntary consent be express. Implied consent is sufficient. The majority points out that nothing in the Constitution requires that consent be express.

Paskay Seminar Case Summaries

Grogan v. Garner, 498 U.S. 279 (1991)

1. **Facts:** After a jury trial in United States District Court, Grogan received an award of damages on his common law fraud claim, his breach of fiduciary duty claim, and for Garner's violation of section 10(b) of the Securities Exchange Act of 1934. Garner subsequently filed for bankruptcy and alleged that he was entitled to a new trial on the fraud issue for purposes of determining the dischargeability of Grogan's debt under Bankruptcy Code § 523(a).
2. **Argument for the Creditor:** The debtor's fresh start does not outweigh the interest in having fraud victims fully compensated. Further, because a preponderance of the evidence standard governs some of the claims involved in Bankruptcy Code § 523(a), it is fair to infer that Congress intended the same standard to apply to all the discharge exceptions.
3. **Argument for the Debtor:** Garner contended he was entitled to a new trial on the fraud issue because the bankruptcy court required a clear and convincing standard of proof whereas the district court had only required a preponderance of the evidence standard. He and the lower court reasoned that the higher standard had been applied pre-Bankruptcy Code and that Congress' silence meant they did not wish to change the law. He also argued that the "fresh start" policy of bankruptcy necessitated a favorable standard towards the debtor.
4. **Holding:** The preponderance of the evidence standard of proof rather than the clear and convincing evidence applies when a creditor is trying to prove that his claim is a debt obtained by the debtor's fraud for purposes the non-dischargeability exception in Bankruptcy Code § 523(a). Garner was not entitled to a new trial because Grogan had already proven the fraud by a preponderance of the evidence.
5. **Why it Matters:** This opinion relieved those creditors who had already proved the debtor's fraud by clear and convincing evidence the extra higher burden of having to prove the fraud again in bankruptcy court. This opinion also matters because it rejected the idea that the debtor should always be the favored party in the bankruptcy system, especially when the debtor is dishonest.

Field v. Mans, 516 U.S. 59 (1995)

1. **Facts:** The Fields sold real estate to Mans who had personally guaranteed a promissory note for the debt secured by a second mortgage on the real estate. The mortgage had a clause that called for the Fields' consent for any conveyance of the encumbered real estate during the mortgage term. Mans subsequently sold the real estate to a newly formed partnership without consent and then sent two different letters to the Fields asking them to waive their rights to the due on sale clause. Neither letter discussed the conveyance. Mans later declared bankruptcy and the Fields alleged that their debt on the note was non-dischargeable because Mans's letters constituted fraud which the Fields relied on to their detriment. The court held that the Field's reliance on the letters was unreasonable and hence their debt did not meet the fraud exemption requirements in Bankruptcy Code § 523(a).
2. **Argument for the Creditor:** The Fields argued that the standard by which to judge their reliance on Mans's letters was by no standard at all. They reasoned that Congress added

an element of reasonable reliance to Bankruptcy Code § 523(a)(2)(B) and that Congress' silence regarding Bankruptcy Code § 523(a)(2)(A) at the same time meant that Congress did not intend for there to be any standard at all, just mere reliance.

3. **Argument for the Debtor:** Some form of reliance is required at the very least. Common law terms like actual fraud imply the elements that the common law has defined them to include. Congress did not need to specifically include those elements in order for them to imply that the standard was the same as that of common law fraud actions.
4. **Holding:** Bankruptcy Code § 523(a)(2)(A) does require more than mere reliance but that reliance need only be justifiable, not reasonable based on the standard of reliance in common law fraud actions.
5. **Why it Matters:** This case built on Grogan by again lowering the bar that creditors needed to clear in order to except their debt from discharge on account of fraud under Bankruptcy Code § 523(a)(2)(A). After Field, creditors only had to prove their reliance on the debtor's fraudulent misrepresentation was justifiable, not that it was reasonable. Furthermore, this opinion built on the principle of Grogan by recognizing that not only was the bankruptcy system a balancing act, but also that creditors needed more protection in that system, especially against debtors' frauds.

Cohen v. de la Cruz, 523 U.S. 213 (1998)

1. **Facts:** Tenant creditors obtained a state court judgment against their landlord that included treble damages, attorney's fees, and costs under the New Jersey Consumer Fraud Act. The landlord had been charging his tenants rents in excess of the levels permitted under a rent control ordinance. The landlord subsequently declared bankruptcy in the hopes of discharging the non-compensatory damage elements of the state court judgment.
2. **Argument for the Creditor:** The term "debt for" should be given an expansive reading. In addition, the Bankruptcy Code has a broad meaning of that phrase in parallel provisions, such as Bankruptcy Code § 523(a)(7) where it was interpreted to encompass debts arising from a fine, penalty, or forfeiture. In Black's Law Dictionary and American Heritage Dictionary, "debt for" is synonymous with "debt with respect to" and "debt by reason of." This reading of the term "debt for" is in keeping with the history of the fraud exception, which had held that punitive damages clearly fit in the category of judgements in actions for fraud. Lastly, the general policy of giving debtors a fresh start does not take precedence over allowing the victims of fraud to be made whole.
3. **Argument for the Debtor:** The debtor contended that Bankruptcy Code § 523(a)(2)(A) excepts from discharge only the value of the money, property, services, or credit the debtor obtained by fraud, and that thus, a "debt for" money obtained by fraud is necessarily limited to the value of the money actually received by the debtor. Here, the debtor only actually received the excess rent on account of the fraud.
4. **Holding:** "Debt obtained by fraud" is not limited only to what the debtor actually received from the fraud, and therefore the entire state court judgment based on the New Jersey Consumer Fraud Act was debt obtained by fraud and non-dischargeable.
5. **Why it Matters:** This opinion furthered the reach of Bankruptcy Code § 523(a)(2)(a) and in the process started to put debtors on notice that bankruptcy could not always be their shield. Fraudsters were subsequently prevented from using bankruptcy to lessen the impact of state court judgements and the ruling has allowed victims of fraud to be made more whole in the bankruptcy process ever since.

Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000)

1. **Facts:** The Illinois State Department of Revenue issued a notice of liability for the debtor's failure to state taxes on his purchase of an airplane because the seller had failed to remit the tax. Illinois also had a law that held the principal liable for the willing failure to pay the tax of his company. The Illinois law also shifted the burden of proof to the taxpayer-principal to prove that he was either not responsible for the failure to pay or that he had not willfully evaded the payment. The principal-debtor was in bankruptcy once the State discovered the failure to pay the tax.
2. **Argument for the Creditor:** The State argued that the burden of proof should not change just because the debtor is in bankruptcy. The Bankruptcy Code is silent as to the burden and therefore the burden does not change.
3. **Argument for the Debtor:** The Court should follow pre-Bankruptcy Code practice and put the burden on the taxing authorities, even where that would shift the original burden under the state statute. Further, the trustee argued that "allowance" of claims is a federal matter, not a state matter. Lastly, the trustee argued that because taxing authorities enjoy priority over other creditors, they should have to demonstrate the validity of their claims at a higher standard.
4. **Holding:** In the absence of modification expressed in the Bankruptcy Code, the burden of proof on a tax claim in bankruptcy remains where the substantive tax law puts it.
5. **Why it Matters:** Raleigh reminded bankruptcy courts across the country that those courts are not free in the name of "equity" to make wholesale substitution of underlying state law controlling the validity of creditor's entitlements. Where the Bankruptcy Code is silent, state law must be respected.

Archer v. Warner, 538 U.S. 314 (2003)

1. **Facts:** The Warners sold their manufacturing company to the Archers and in the process made fraudulent misrepresentations to the Archers concerning the company. In response, the Archers sued the Warners and the two parties eventually settled the suit. After the Warners failed to make the first settlement payment due on a \$100,000 note, the Archers sued the Warners on the note. The Archers then declared bankruptcy and tried to discharge the entire \$100,000.
2. **Argument for the Creditor:** The Archers argued that conversion of their debt into the settlement agreement did not change the debt's essential character of being "obtained by fraud." They reasoned that the mere fact that a conscientious creditor has reduced his claim of fraud to settlement should not bar him from asserting that it is non-dischargeable under Bankruptcy Code § 523(a). The fact that in this case the claim was reduced to settlement and not to a stipulation or consent decree should not be a bar either.
3. **Argument for the Debtor:** The settlement agreement converted the state law claim for fraud into one for failure to pay a debt. The Archers were barred by res judicata from pursuing their fraud claim in bankruptcy court after they settled the fraud claim in state court.
4. **Holding:** The settlement agreement did not bar the Archers from showing that their claim was a debt obtained by fraud under Bankruptcy Code § 523(a)(2)(A).
5. **Why it Matters:** Holding otherwise would have allowed fraudsters to settle claims against their creditors quickly in state court litigation, renege on their promises by failing to pay the required settlement payments, and then have the whole debt discharged anyway in

bankruptcy. Archer, combined with the four previous cases, demonstrates that regardless of its form, fraud is fraud, and debts obtained by that fraud are non-dischargeable under Bankruptcy Code § 523(a).

Husky Intern. Electronics, Inc. v. Ritz, 136 S. Ct. 1581 (2016)

1. **Facts:** Husky International Electronics, Inc. (“Husky”) sold its electronic products to Chrysalis Manufacturing Corp (“Chrysalis”) and Chrysalis incurred a debt to Husky in return. The acting director of Chrysalis during the operative period, Daniel Ritz (“Ritz”), transferred assets out of Chrysalis that could have been used to pay creditors like Husky. When Chrysalis could not satisfy its obligations to Husky, Husky filed suit against Ritz seeking to hold him personally liable for Chrysalis’ debt under a Texas law that allowed creditors to hold shareholders liable for corporate debt when an intercompany transfer constitutes actual fraud. A few months after Husky initiated the suit, Ritz filed for Ch. 7 bankruptcy protection. Husky then filed an adversarial proceeding in the bankruptcy court attempting to hold Ritz personally liable for the Chrysalis debt. Husky further argued that the intercompany transfer constituted “actual fraud” under Bankruptcy Code § 523(a)(2)(A) and that therefore, the debt was non-dischargeable. The District Court and later the Fifth Circuit both held that Ritz did not commit “actual fraud” on the grounds that though Ritz’s asset transfers may have hindered Husky’s ability to recover its debt, Ritz did not make the necessary misrepresentations to Husky regarding those assets. Thus, those courts argued, no “actual fraud” occurred. Husky then appealed the Fifth Circuit decision to the Supreme Court.
2. **Argument for the Creditor:** Husky argued that the “obtained by fraud” requirement should be read broadly to include any debts traceable to fraud, including those incurred by fraudulent conveyances. This argument was based on the history of fraudulent conveyance statutes that dictate that a fraudulent conveyance is a form of “actual fraud.” Further, there is no requirement that a creditor rely on a debtor’s fraudulent misrepresentation at the inception of the credit relationship because there is nothing in the text of Bankruptcy Code § 523(a)(2)(A) supporting that notion. Lastly, Bankruptcy Code § 523(a)(2)(A) is a tailored remedy for behavior connected to specific debts, and is not subsumed by broader provisions of the Bankruptcy Code such as § 523(a)(4), § 523(a)(6), or § 727(a)(2).
3. **Argument for the Debtor:** Ritz conceded that fraudulent conveyances are a form of “actual fraud” but contended that the use of that phrase in Bankruptcy Code § 523(a)(2)(A) meant something else. Namely, Ritz argued that holding fraudulent conveyances as a form of “actual fraud” under Bankruptcy Code § 523(a)(2)(A) would render Bankruptcy Code § 523(a)(4) and Bankruptcy Code § 523(a)(6) duplicative. He also contended that holding fraudulent conveyances as a form of “actual fraud” would make Bankruptcy Code § 727(a)(2) redundant as well. Ritz further reasoned that the relevant debt had to actually be “obtained by fraud” and that fraudulent conveyances cannot be used to obtain debt because they function instead to hide valuables that a debtor already possesses. Lastly, Ritz argued that because there was no direct reliance on a misrepresentation at the inception of the credit relationship, the requirements for Bankruptcy Code § 523(a)(2)(A) had not been met.
4. **Holding:** The Court held that “actual fraud” for purposes of Bankruptcy Code § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a misrepresentation to the creditor.

5. **Why it Matters:** Before Husky, debtors had the ability to make fraudulent transfers out of debtor-controlled entities pre-filing without facing any ramifications themselves post-filing. After Husky, these debtors were put on red alert that they would no longer be able to use bankruptcy to wipe out the debts their fraudulent transfers have created. Bankruptcy was not their shield from their creditors nor their sword to discharge their fraud-incurred debts. Debtors' lawyers and estate planning were also put on notice that certain activities they had engaged in in the past could now be considered fraud. While we acknowledge that giving debtors a fresh start is one goal of the bankruptcy process, that goal should still never be wielded in the name of perpetuating fraud.