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2018 Central States Bankruptcy Workshop

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Kelly Daley

Burford Capital LLC; New York

Eric L. Johnson

Spencer Fane LLP; Kansas City, Mo.

Ronald R. Peterson

Jenner & Block; Chicago

Hon. Phillip J. Shefferly

U.S. Bankruptcy Court (E.D. Mich.); Detroit

Hon. Eugene R. Wedoff (ret.)

Oak Park, Ill.

Litigation finance for bankruptcy, insolvency & restructuring

American Bankruptcy Institute:

25th Annual Central States Bankruptcy Workshop

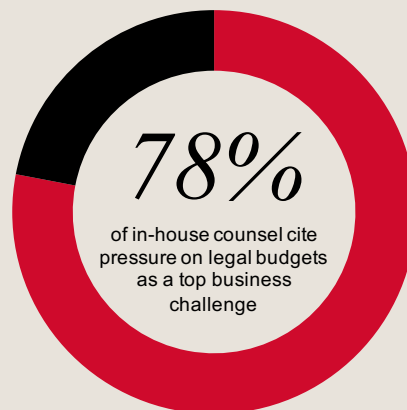
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Litigation finance defined

How companies from start-ups to the Fortune 500 are using litigation finance

- Value of litigation and arbitration claims is used to obtain financing
- Used by companies to
 - Fund legal fees or expenses
 - Finance portfolios of litigation
 - Transfer or share risk in matters
 - Monetize litigation assets at beginning of a case, or after judgment or appeal
 - Secure corporate debt facilities
 - Finance, sell, or collect uncollected judgments
 - Secure litigation-related insurance and risk solutions
 - Trace assets and enforce judgments against litigation debtors



2017 Litigation Finance Survey

Litigation finance in bankruptcy

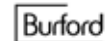
We work with debtors, creditors, law firms and insolvency professionals

- Burford helps debtors, creditors, law firms and insolvency professionals pursue meritorious claims and causes of action that are the property of debtor estates, creditors' committees or individual creditors
- These claims and causes of action are often valuable assets with a substantial basis for recovery, yet unlocking their value may be impossible without an injection of capital from an outside source



2017 Litigation Finance Survey

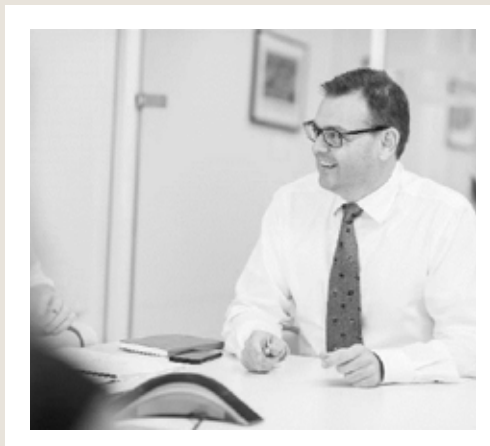
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Litigation finance in bankruptcy

Areas for investment

- Fund the pursuit of claims and causes of action by or on behalf of debtor estates
- Finance litigation trusts
- Finance for creditors
- Purchase litigation claims



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Finance claims held by the debtor

Non-recourse capital to fund the pursuit of high-value litigation claims

- Provide funding to debtor estates to hire counsel of choice with the economic arrangement determined to be the most beneficial to the debtor/creditors
- Pay legal and professional fees and expenses (e.g., discovery, expert witnesses, and other professional services)
- In certain instances, pay administrative expenses
- Make distributions to creditors
- Benefits
 - Provide the prospect of an immediate liquidity event for creditors and/or the acceleration of creditor recoveries
 - Inject capital where capital is otherwise difficult to come by
 - Enable claims to be prosecuted and value to be realized
 - Reduce risk for estates and creditors

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Finance litigation trusts

Non-recourse capital helps increase litigation trust recoveries

- Provide funding to litigation trusts with high-value claims
- Well suited to litigation trusts with multiple matters of varying levels of risk and duration
- If litigation trust fails to generate recoveries, financial burden remains with Burford, not the trust beneficiaries
- Pricing can be negotiated by portfolio, but tied to recoveries
- Benefits
 - Obviate need for the bankruptcy estate to seed the trust
 - Increase upfront cash recoveries for creditors upon confirmation
 - Accelerated and more efficient recoveries for creditors and estate beneficiaries
 - Estate capital can be used to fund administrative expenses

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Finance creditors

Non-recourse funding to creditors with high-value litigation assets

- Provide capital for litigation brought by creditors' committee
- Inter-creditor disputes
- Purchase claims from creditors that may have liquidity constraints or are in wind-down
- Benefits
 - Inject capital where creditor is experiencing litigation fatigue or has reached credit limits
 - Accelerate monetization for creditor
 - Reduce risk for creditors
 - Allow professionals working for creditors who are not able to bill their fees through an estate to get paid

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Purchase or manage litigation claims

Monetize high-value litigation claims

- Burford purchases a litigation claim outright, or the right to manage litigation of the claim
- Provides cash up front for the claim and takes on the management and expense of litigation
- Estate or trust can retain a “back-end” interest in any recovery
- Benefits
 - Provide the prospect of an immediate liquidity event for creditors and/or the acceleration of creditor recoveries
 - Distributions can be made sooner
 - Eliminate risk for debtor estates and creditors

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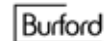


Disclosure and approval requirements

Complying with the Bankruptcy Code

- Funding for the debtor or pre-plan confirmation will generally need to be disclosed and approved by the court
 - In some instances, litigation funding may be granted administrative expense status
 - Funding will typically be reviewed by the bankruptcy court under a broad standard of reasonableness
- Approval for post-confirmation funding will depend on the scope of the authority of the Trustee
 - Even if it does not require court approval, it will almost certainly need approval by the key creditors

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Case study: MagCorp

- For 13 years, MagCorp had been embroiled in litigation against its former parent company
- Following the appeal of a \$213 million judgment in its favor, MagCorp's bankruptcy trustee arranged the sale at public auction of an interest in the right to receive litigation recoveries from the judgment
- The \$26.2 million sale enabled the estate to liquidate a portion of a contingent asset, hedge against appellate risk and guarantee a minimum recovery to MagCorp's creditors
- Won Financial Times' "Most Innovative Bankruptcy" award for 2017

“

Bankruptcy is ideally suited to capitalize on the benefits that can be provided by litigation finance.

Nicholas Kajon, Attorney for MagCorp. and Co-Chair of Stevens & Lee's Bankruptcy and Financial Restructuring Department

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Investment criteria

How we evaluate opportunities

- We consider type of matter, merits, counsel, jurisdiction, capital requirements and damages
- Clients, firms and Burford get the best value when the amount needed is at least \$2 million
- Damages must be sufficient to support return for debtor estate/creditors, lawyers and Burford
- Our average investment is \$10 million+ and we have created \$200 million facilities



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Funder relationship

Burford acts as a passive provider of corporate finance

- No interference with lawyer/client relationship or obligations
 - Burford has no control over litigation strategy or settlement decisions
- Consideration of confidential and privileged information
 - Case law confirming work product protection applies to funder communications and documents
 - We're vigilant in managing diligence to avoid risking waiver of protected communications
- Reporting requirements for investments
 - Burford requires regular reporting of significant case developments
 - We may offer case-related advice but have no decision-making authority
- Investment process:
 - NDA
 - Initial case review
 - Due diligence
 - Ethical compliance
 - Investment approval
 - Negotiation of definitive documents

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Who we are

More than eighty-five people—litigators, investment bankers and veterans of the world's top law firms and corporations.



Christopher P. Bogart
Chief Executive Officer
Former EVP & General Counsel,
Time Warner Inc.



Jonathan T. Molot
Chief Investment Officer
Professor of Law,
Georgetown University



Sir Peter Middleton GCB
Chairman
Former Chairman,
Barclays



Hugh Steven Wilson
Vice Chairman
Former Senior Partner,
Latham & Watkins



Aviva O. Will
Senior Managing Director
Former Assistant General
Counsel, Time Warner Inc.



Craig Arnott
Managing Director
Former Barrister & Partner,
Fried Frank



Emily O. Slater
Managing Director
Former Senior Litigator,
Debevoise & Plimpton



Justin Daniels
IP Principal
Former Partner,
Proskauer Rose



Ernie Getto
Managing Director
Former Senior Partner,
Latham & Watkins



Peter Benzian
Managing Director
Former Senior Partner,
Latham & Watkins



Elizabeth O'Connell, CFA
Chief Financial Officer
Former Director,
Credit Suisse



Christy Searl
Director
Former Senior Vice President,
Lahman Brothers



Christopher Catalano
Director
Former Vice President,
JPMorgan Chase



John Lazar
Director
Former Litigator,
Cravath, Swaine & Moore



Daniel Hall
Director
Former Director,
Focus Ltd.



Michael Rodman
Director
Former Director,
Focus Ltd.



Robert Martorana
Vice President
Former Executive Director,
US Legal Support

Kelly M. Daley

Vice President

kdaley@burfordcapital.com

+1 312 778 6182

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AMERICAN BANKRUPTCY INSTITUTE JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

Feature

BY ANDREW C. HELMAN AND JEREMY R. FISCHER

The Missing Page of the Playbook

"Blocking Directors" Can't Escape Fiduciary Duty



Andrew C. Helman
Marcus Clegg
Portland, Maine



Jeremy R. Fischer
Drummond Woodsum
Portland, Maine,
and Manchester, N.H.

Andrew Helman is an attorney with Marcus Clegg in Portland, Maine. Jeremy Fischer is the leader of Drummond Woodsum's Bankruptcy, Restructuring and Creditors' Rights Practice Group and is based in the firm's Portland, Maine, and Manchester, N.H., offices.

As every commercial bankruptcy practitioner knows, a voluntary petition must be properly authorized by a company's governing body, otherwise it will be vulnerable to dismissal. This requirement is so important that evidence of such authorization is generally filed in support of a voluntary petition, as is required by the local bankruptcy rules in several districts.¹

However, for so-called "bankruptcy-remote" companies, it can be difficult — if not impossible — to obtain all of the necessary consents due to governance provisions that often grant control (or veto power) over the decision to file for bankruptcy to lender-controlled directors (called the "blocking directors"). These companies typically require unanimous director consent, or the consent of the blocking director, to authorize filing a bankruptcy petition.

While there is nothing inherently improper about lender-controlled directors, a recent decision by the U.S. Bankruptcy Court for the Northern District of Illinois in *In re Lake Michigan Beach Pottawattamie Resort LLC*² serves as a cautionary tale. In this case, the bankruptcy court refused to dismiss a voluntary petition that was admittedly filed without the approval of a blocking director. The court held that provisions in the governance documents granting the blocking director with complete self-interested veto power over bankruptcy filings were unenforceable because they relieved the blocking director of fiduciary duties to the company and its members.

Background

The facts of *Lake Michigan Beach* fit within a familiar framework: a troubled borrower making

concessions to a lender in connection with a workout. Prior to the bankruptcy, Lake Michigan Beach Pottawattamie Resort LLC (the debtor) granted a mortgage and other security to BCL-Bridge Funding LLC (the lender) to secure a \$1.34 million loan and a \$500,000 line of credit.³ Its collateral included a vacation resort with seasonal rentals and undeveloped land.⁴

A few months after the original financing transaction, the debtor defaulted on its monetary obligations to the lender. To avoid foreclosure, the debtor entered into a forbearance agreement in which it stipulated to a default and promised to (and did) amend its operating agreement so that the lender became a "special member" of the debtor, without any economic interest but "with the right to approve or disapprove of any" bankruptcy filing.⁵ In other words, the lender became a blocking director. As the court observed,

when exercising its rights under the [amended operating agreement], [the lender] is not obligated to consider any interests or desires other than its own and has "no duty or obligation to give any consideration to any interest of or factors affecting the Company or the Members."⁶

Shortly thereafter, the debtor defaulted again, and the lender started foreclosure proceedings.⁷ Predictably, the day before a foreclosure sale, the debtor filed a chapter 11 petition, which prevented the foreclosure sale and led to the lender's motion to dismiss in which it contended that the petition was an "unauthorized filing."⁸ The following facts appear to have been uncontested:

³ *Id.* at 903.

⁴ *Id.* The collateral also included some nondebtor property.

⁵ *Id.* at 904. While it might be more accurate to say that the lender became a "blocking member" of the debtor, the term "blocking director" is widely used.

⁶ *Id.*

⁷ *Id.*

⁸ The lender also argued that the petition was a bad-faith filing. In the absence of the "unauthorized filing" argument, the bad-faith issue "could have been handled summarily" because such motions are routine. The court rejected these arguments. *Id.* at 905.

Attached to the Debtor's petition is a consent to file [for] bankruptcy signed by four members of the Debtor. A signature on behalf of [the lender], as the Special Member, was not included. The Debtor agrees that [the lender] has not consented to the Debtor's bankruptcy petition and that this case was filed on the eve of the foreclosure sale.⁹

In response, the debtor argued that the blocking-director provision in its operating agreement was "void as against public policy because it amounts to a prohibition of the Debtor's right to exercise its right to bankruptcy relief and, alternatively, is not valid under Michigan law."¹⁰

The Court's Decision

The bankruptcy court ultimately agreed with the debtor that a complete self-interested veto power over a bankruptcy filing was unenforceable under Michigan and federal bankruptcy law. Thus, the court denied the lender's motion to dismiss.

The court reviewed the provision of the operating agreement requiring unanimous director consent to authorize a bankruptcy filing under Michigan law to see if it actually prohibited the bankruptcy filing. As the court pointedly observed, "if the operating agreement, as amended, does not prohibit the filing as effectuated, then the argument with respect to the validity of the provision is unfounded."¹¹ While Michigan law generally calls for "a vote of the majority in interest of the members entitled to vote" on a given issue, it also allows "for operating agreements to override the default majority of interests requirement set forth in section 450.4502(8)."¹² Thus, the unanimous-consent provision of the operating agreement was not inherently invalid, and the debtor's bankruptcy petition was presumptively unauthorized because it lacked the lender's consent.

However, the court then considered whether the blocking-director provisions were void as a matter of public policy under state or federal law. The court acknowledged the tension between two competing public policies: on the one hand, protecting the fundamental, federal right to invoke bankruptcy protection (which the court characterized as including rights "so seminally important that they were specifically authorized under the Constitution"), and on the other hand, respecting "corporate formalities and state corporate law ... in commencing a bankruptcy case."¹³ For example, while outright prohibitions against bankruptcy filings in corporate governance documents have uniformly been rejected as being contrary to public policy, that is not the case for governance provisions creating bankruptcy remote corporate structures, even though they are aimed at reaching the same result, with one caveat: Blocking directors must be required to act in the best interests of the business they govern.¹⁴ Thus:

Even though the blocking director structure ... impairs or in operation denies a bankruptcy right ... [i]t has

built into it a saving grace: the blocking director must always adhere to his or her general fiduciary duties to the debtor in fulfilling the role.... The essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties and there in some circumstances vote in favor of a bankruptcy filing, even if not in the best interests of the creditor that they were chosen by.¹⁵

Blocking directors serve a valuable purpose by providing a lender additional influence over a troubled borrower, but a lender cannot make an end-run around the Bankruptcy Code by trying to relieve blocking directors of their state law fiduciary duties.

Unfortunately for the lender, its "playbook was ... missing this page."¹⁶ Specifically, Article 12.4(iv) of the debtor's operating agreement eliminated the fiduciary duties owed to the debtor and its members by the lender in its capacity as a blocking director:

Notwithstanding anything provided in the Agreement (or other provision of law or equity) to the contrary, in exercising its rights under this Section, *the Special Member shall be entitled to consider only such interests and factors as it desires, including its own interests*, and shall to the fullest extent permitted by applicable law, have *no duty or obligation to give any consideration to any interests of or factors affecting the Company or the Members.*¹⁷

The bankruptcy court ruled that this provision was "unenforceable, both as a matter of Michigan corporate governance and bankruptcy law."¹⁸ Importantly, "[b]y excluding the Debtor's interests from consideration by [the lender] ... thereby allowing [it] to consider only its own best interests, the Third Amendment also expressly eliminates the only redeeming factor that permits the blocking director ... construct."¹⁹ As a result, the provision of the debtor's operating agreement requiring the blocking director's consent to a bankruptcy filing was unenforceable, the consent of all remaining directors to the filing was sufficient, and the lender's motion to dismiss was denied.

Analysis

Following this decision, the playbook should now be clear for lenders looking to block borrowers from filing for bankruptcy. While outright prohibitions against bankruptcy filings in corporate governance documents will not withstand

⁹ *Id.* at 904.

¹⁰ *Id.* at 905.

¹¹ *Id.* at 909.

¹² *Id.* at 910 (quoting Mich. Comp. Laws Ann. § 450.4502(8)), 911.

¹³ *Id.* at 911-12 (citing, *inter alia*, *Gen. Growth Props. Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009), and *NNN 123 N. Wacker LLC*, 510 B.R. 854 (Bankr. N.D. Ill. 2014)).

¹⁴ *Id.* at 912 ("[C]ommon wisdom dictates that the corporate control documents should not include an absolute prohibition against bankruptcy filing.") (citing *Trans World Airlines Inc.*, 261 B.R. 103 (Bankr. D. Del. 2001), and *In re Tru Block Concrete Prods. Inc.*, 27 B.R. 486 (Bankr. S.D. Cal. 1983)).

¹⁵ *Id.* See also *Gen. Growth Props.*, 409 B.R. at 64 ("[I]f [the] Movants believed that an 'independent' manager can serve on a board solely for the purpose of voting 'no' to a bankruptcy filing because of the desires of a secured creditor, they were mistaken."); *In re Kingston Sq. Assocs.*, 214 B.R. 713, 735-36 (Bankr. S.D.N.Y. 1997) (blocking director "completely ignored the limited partners' plight in the face of foreclosure actions instituted by the group which placed him on the boards of directors of these and other companies and saw to it that he was paid fees").

¹⁶ *Lake Michigan Beach*, 547 B.R. at 913.

¹⁷ *Id.* at 914 (quoting Article 12.4(iv) of debtor's operating agreement) (emphasis added).

¹⁸ *Id.*

¹⁹ *Id.*

scrutiny, blocking directors can be used to exert influence, provided they do not eliminate directors' fiduciary duties to the companies they govern. In fact, in *Lake Michigan Beach*, the debtor's own bankruptcy-remote structure might have been respected had the lender not overreached by eliminating its state law fiduciary duties to the debtor.

This decision should remind debtors that they are not powerless against blocking directors' intransigence. If a blocking director ignores an existential threat to a company's continued operations (such as foreclosure of substantially all of the company's core assets), then the debtor may have state law breach-of-fiduciary-duty claims. This is the trade-off for bankruptcy-remote structures. While such claims may not be a quick fix to a director's intransigence, the fact that fiduciary duties cannot be contracted around to eliminate the right to file for bankruptcy may avoid the problem in the first place.

Conclusion

The court's decision provides clear guidance for debtors and lenders considering governance provisions aimed at making a business "bankruptcy remote."²⁰ Blocking directors serve a valuable purpose by providing a lender additional influence over a troubled borrower, but a lender cannot make an end-run around the Bankruptcy Code by trying to relieve blocking directors of their state law fiduciary duties. **abi**

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²⁰ The decision was recently followed in a case involving a "golden shareholder" with blocking rights akin to *Lake Michigan Beach*. *In re Intervention Energy Holdings LLC*, Case No. 16-11247, Opinion, D.E. 69 (Bankr. D. Del. June 3, 2016).

AMERICAN BANKRUPTCY INSTITUTE

JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

Feature

BY ERIC L. JOHNSON AND MARK G. STINGLEY¹

Intervention Energy Holdings

Good Public Policy, or Unnecessary Intrusion into State Law?



Eric L. Johnson
Spencer Fane LLP
Kansas City, Mo.



Mark G. Stingley
Bryan Cave LLP
Kansas City, Mo.

Provisions purporting to restrain a debtor's ability to file for bankruptcy and prohibitions against the same are nothing new on the bankruptcy landscape. However, such prohibitions have not stopped lenders in their quests to form truly bankruptcy-remote entities. While much of the recent case law on this issue has been rooted in traditional state law concepts,² the U.S. Bankruptcy Court for the District of Delaware in *Intervention Energy Holdings LLC*³ recently rejected the "golden share" method of restricting bankruptcy filings solely on the grounds that such a method violates federal public policy. This ruling highlights the delicate tension between state corporate and federal bankruptcy law and begs the following question: Did the decision demonstrate good public policy or an unnecessary intrusion into state law?

zational documents to require unanimous shareholder consent to approve a bankruptcy filing.⁷ Lenders would then be granted a share in exchange for forbearance,⁸ which gave lenders veto power over any proposed bankruptcy filing.

Limits on Contracting Away Bankruptcy Rights

Any debtor may file for bankruptcy by filing a petition with the bankruptcy court,⁹ but a business entity must have the authority to properly file a voluntary petition.¹⁰ Whether a business entity has authority to act is a question of state law.¹¹ A filing without corporate authority is invalid and must be dismissed.¹² Therefore, a bankruptcy court must look to state substantive law to determine whether a business has the proper authorization to file a voluntary bankruptcy petition.

Generally, creditors and debtors cannot agree to prohibit a bankruptcy filing through a pre-petition agreement. Indeed, a debtor may not contract away the right to a discharge in bankruptcy for public policy reasons.¹³ Creditors cannot require debtors to sign pre-petition waivers because "[t]he Bankruptcy Code pre-empts the private right to contract around its essential provisions[.]"¹⁴ Debtors cannot waive the right to file for bankruptcy because it would undermine the purpose of the Bankruptcy Code.¹⁵

A Brief History of the Golden Share

A "golden share" gives an owner veto power over certain actions that a business can take. The British government first used the golden-share concept in the 1980s⁴ by selling state-held firms and retaining a share that would allow the government to outvote all shareholders.⁵ The same concept was then adopted by banks to make their debtors more bankruptcy-remote. Lenders asked for golden shares in order to make the possibility of bankruptcy less likely⁶ by requiring the borrower to amend organi-

Eric Johnson is a partner at Spencer Fane LLP in Kansas City, Mo., and serves as membership relations director for ABI's Bankruptcy Litigation Committee. Mark Stingley is Global Head of the Bankruptcy, Restructuring and Creditors' Rights Client Service Group of Bryan Cave LLP in Kansas City, Mo., and serves on ABI's Executive Committee.

¹ The authors thank Hillary Martel and William Easley for their assistance in researching and writing this article. In addition, Mr. Stingley, an adjunct professor at the University of Missouri at Kansas City School of Law, is co-editor of *How Secure Are You? Secured Creditors in Commercial and Consumer Bankruptcies* (ABI 2016), available for purchase in the ABI Bookstore at abi.org/bookstore.

² See, e.g., *In re Lake Mich. Beach Pottawattamie Resort LLC*, 547 B.R. 899 (Bankr. N.D. Ill. 2016); *DB Capital Holdings LLC v. Aspen HH Ventures LLC* (*In re DB Capital Holdings LLC*), No. CO-10-6, 2010 Bankr. LEXIS 4176 (B.A.P. 10th Cir. Dec. 6, 2010).

³ *In re Intervention Energy Holdings LLC*, No. 16-11247 (KJC), 2016 Bankr. LEXIS 2241 (Bankr. D. Del. June 3, 2016).

⁴ Christine O'Grady Putek, Comment, "Limited But Not Lost: A Comment on the ECJ's Golden Share Decisions," 72 *Fordham L. Rev.* 2219, 2221 (2004).

⁵ *Id.*

⁶ Michael H. Torkin and Douglas P. Bartner, "Major Legal and Financial Factors Impacting Chapter 11 Restructuring in 2011," *Bankruptcy and Financial Restructuring Law 2011: Top Lawyers on Trends and Key Strategies for the Upcoming Year* (Thomson Reuters/Aspatore eds., 2011), available at 2011 WL 586140 at *7.

⁷ See *id.*

⁸ See *id.*

⁹ See 11 U.S.C. § 301(a).

¹⁰ *In re Real Homes LLC*, 352 B.R. 221, 225 (Bankr. D. Idaho 2005).

¹¹ *Id.*

¹² See *Hager v. Gibson*, 108 F.3d 35, 38 (4th Cir. 1997) (citing *Price v. Gurney*, 324 U.S. 100, 106 (1945)).

¹³ *Klingman v. Levinson*, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987).

¹⁴ *In re Pease*, 195 B.R. 431, 435 (Bankr. D. Neb. 1996).

¹⁵ *Bank of China v. Huang* (*In re Huang*), 275 F.3d 1173, 1177 (9th Cir. 2002), but see *DB Capital*, 2010 LEXIS 4176 at *10.

Fiduciary Obligations of Members and Managers of an LLC

Controlling members of a limited liability company (LLC) owe fiduciary duties of care and loyalty under Delaware law, unless otherwise agreed. The Delaware LLC Act states that “in any case not provided for in this chapter, the rules of law and equity, including ... fiduciary duties ... shall govern.”¹⁶ This means that a member or manager of an LLC can have fiduciary duties depending on their role in the LLC and the LLC agreement.¹⁷ A member or manager owes fiduciary duties when they are active in the management of the business.¹⁸ However, even if a member or manager owes fiduciary duties, the LLC agreement can still limit or eliminate fiduciary duties.¹⁹ The Delaware LLC Act gives members broad discretion in formulating the LLC and organizing the relationships between members or managers,²⁰ and members or managers of an LLC will owe fiduciary duties unless the agreement unambiguously states otherwise.²¹ Therefore, members or managers will owe fiduciary duties if they take an active role in the LLC and the operating agreement does not state otherwise.

Both LLC members and managers who are active in a business and corporate directors have the fiduciary duties of loyalty and care. The duty of loyalty imposes an affirmative obligation on members or managers to protect the interests of the business and act in good faith.²² A member or manager of an LLC breaches his/her duty of care when acting with gross negligence.²³ When an entity is insolvent, creditors have derivative standing to enforce fiduciary duties.²⁴

DB Capital Holdings LLC

In *DB Capital Holdings LLC*, the Bankruptcy Appellate Panel (BAP) for the Tenth Circuit considered, on appeal, whether members of an LLC could contract away their rights to file for bankruptcy.²⁵ The debtor was a Colorado manager-managed LLC where the manager had no ownership interest in the debtor.²⁶ Under the operating agreement, the rights and powers given to the manager pertained only to managing the affairs of the debtor in the ordinary course.²⁷ The debtor’s operating agreement was subsequently amended to include, among other things, a complete bar from filing for bankruptcy.²⁸ There is no indication that the operating agreement was amended at a time when the debtor was experiencing financial difficulty.

Several years after the amendment, the debtor fell on troubled financial times, which ultimately caused the manager to file chapter 11 on the debtor’s behalf. One of the members filed a motion to dismiss, arguing, in part, that

the operating agreement prohibited the filing of a bankruptcy case.²⁹ The manager argued that such a provision should be invalidated on public policy grounds because the provision was included at the lender’s behest. The bankruptcy court ultimately dismissed the case, and the manager appealed.³⁰

In affirming the bankruptcy court’s ruling, the BAP first noted that it could find no law that would prohibit members of an LLC from agreeing among themselves to file for bankruptcy. Further, the BAP found that there was no evidence indicating that the lender coerced the provision. For this reason, the BAP declined to opine whether such a provision could be unenforceable if coerced by a lender.³¹ Finally, the BAP found that the dismissal was warranted — even if the amendment was disregarded — reasoning that the manager had taken an unauthorized action under the original agreement because bankruptcy was not in the ordinary course of business.³²

Lake Michigan Beach Pottawattamie Resort LLC

In *Lake Michigan*, a Michigan LLC was in default of its obligations to its lender and entered into a forbearance agreement. As part of the forbearance agreement, the debtor amended its operating agreement to incorporate a golden share concept under which its lender would become a fifth “special” member with the right to approve or disapprove any “material” action, including the right to file for bankruptcy. As a special member, the lender would have no rights in profits or losses, distributions, or tax consequences, and would not have any duties to the debtor or the other members.³³

The debtor ultimately filed for chapter 11 without the lender’s consent, and the lender sought to dismiss the case.³⁴ The bankruptcy court denied the motion to dismiss and, in addition to addressing public policy concerns, found that the amendment to the operating agreement was void under Michigan law because the special member was not required to consider the debtor’s interests.³⁵

Intervention Energy Holdings LLC

In *Intervention Energy Holdings*, the Delaware bankruptcy court invalidated a golden-share provision solely on grounds that it violated federal public policy. The debtors, which were Delaware LLCs, entered into a note purchase agreement with their lender. The debtors failed to comply with the agreement terms, and the lender declared default. The parties negotiated a forbearance agreement that was conditioned on (1) allowing the lender to become a member with one common unit and (2) amending the operating agreement to require the approval of each holder of common units before any voluntary bankruptcy filing. The debtors amended their operating agreement accordingly and

16 6 Del. Code Ann. § 18-1104 (2013).

17 *Feeley v. NHAOCG LLC*, 62 A.3d 649, 662-63 (Del. Ch. 2012).

18 *Id.*

19 *See id.*; 6 Del. Code Ann. § 18-1101(e).

20 *Elf Atochem N. Am. Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999).

21 *Bay Ctr. Apartments Owner LLC v. Emery Bay PKI LLC*, No. 3658-VCS, 2009 WL 1124451, at *8 (Del. Ch. April 20, 2009).

22 *See, e.g., Guth v. Loft Inc.*, 5 A.2d 503, 510 (Del. 1939); *Auriga Capital Corp. v. Gatz Properties LLC*, 40 A.3d 839, 843 (Del. Ch. 2012); *Feeley*, 62 A.3d at 664 (citing *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006)).

23 *Auriga Capital*, 40 A.3d at 876.

24 *N. Am. Catholic Educ. Programming Found. Inc. v. Gheewalla*, 930 A.2d 92, 101-02 (Del. 2007).

25 2010 Bankr. LEXIS 4176, at *7.

26 *Id.* at *1.

27 *Id.* at *13, 14.

28 *Id.* at *3.

29 *Id.* at *6.

30 *Id.*

31 *Id.* at *10.

32 *See id.* at *10-19.

33 *Lake Mich.*, 547 B.R. at 903-04.

34 *Id.* at 904, 905.

35 *Id.* at 914. For a more-detailed analysis of the *Lake Michigan* case, see Andrew C. Helman and Jeremy R. Fischer, “The Missing Page of the Playbook: ‘Blocking Directors’ Can’t Escape Fiduciary Duty,” XXXV *ABI Journal* 8, 12, 58-59, August 2016, available at abi.org/abi-journal.

issued a single common unit to the lender in exchange for a \$1 capital contribution.³⁶

The debtors ultimately sought chapter 11 protection with the consent of all unit-holders except the lender. The lender filed a motion to dismiss the bankruptcy — arguing, in part, that the debtors lacked authority to file for bankruptcy.³⁷ The lender warned that if the bankruptcy court declared the agreement as void, it would cause confusion in regard to the breadth of an LLC’s right to contract.³⁸ Conversely, the debtors argued that if the provision was enforced, debtor/creditor relationships would dramatically change and future lenders would demand similar provisions in future transactions.³⁹

Ultimately, the court concluded that the debtors did possess the necessary authority to commence their chapter 11 proceedings without the lender’s consent. In doing so, the court found that the amendment was an absolute waiver of the LLC’s right to file for bankruptcy and was void as being against federal public policy.⁴⁰ Although the above-described decisions appear to represent two opposing viewpoints with respect to golden-share provisions, it is important to consider the nuances of the cases to better understand the significance of a court’s sole reliance on federal public policy in evaluating such provisions.

Good Public Policy or Unnecessary Intrusion on State Law?

Both *DB Capital* and *Intervention Energy* discuss whether members can ultimately contract away their ability to file for bankruptcy, but the cases are distinct in several ways. In *Intervention Energy*, the anti-bankruptcy provision was clearly added at the lender’s behest and as part of a forbearance agreement. In *DB Capital*, the anti-bankruptcy provision appears to have been inserted several years before the debtor began experiencing financial difficulty. Further, the BAP in *DB Capital* found that there was ultimately no evidence that the provision was inserted at the lender’s behest, and specifically reserved the issue of whether such a provision could be invalidated if it had been coerced by a lender.

More importantly, the BAP found that dismissal was warranted on traditional state law grounds because the manager was acting outside the scope of his authority, even if the challenged provision was disregarded. The *Lake Michigan* decision was similarly grounded in state law (*i.e.*, the prohibition of the eliminating fiduciary duties under Michigan law). Since Delaware law allows for such elimination of fiduciary duties, the bankruptcy court in *Intervention Energy* likely could not rely on a similar rationale in reaching its decisions. Since it found that such a provision was void against federal public policy, the bankruptcy court in *Intervention Energy* did not address the role of state law in limiting the scope of an LLC member’s freedom of contract, which would have likely been a question of first impression under Delaware LLC law.⁴¹ The court’s refusal to ground its decision in traditional notions of state law is what makes the decision so notable.

While the bankruptcy court in *Intervention Energy* was presented with an extreme set of facts, the decision also raises several thorny questions that future courts will need to resolve. For example, would the outcome be different if the requirement of unanimous consent to file for bankruptcy existed at the time of creation and the creditor subsequently purchased one share from another member for fair value? In addition, would it be a different outcome if filing for bankruptcy required unanimous consent and an existing member was also a creditor?⁴² Finally, *Intervention Energy* could be used for the proposition that any provision denying a business entity the ability to file for bankruptcy is invalid for federal public policy purposes:

The federal public policy to be guarded here is to assure access to the right of a person, including a business entity, to seek federal bankruptcy relief as authorized by the Constitution and enacted by Congress. It is beyond cavil that a state cannot deny to an individual such a right. I agree with those courts that hold the same applies to a “corporate” or business entity, in this case an LLC.⁴³

Such an interpretation could have a profound impact on the internal corporate affairs of a struggling company where there is a good-faith dispute among its owners as to whether bankruptcy is appropriate.

Conclusion

It is well established that whether a business entity is authorized to file for bankruptcy is a matter generally left for state law. As such, when evaluating provisions concerning whether a business entity has the requisite authority to file, courts should first look to state law. Further, courts should be wary of relying on or expanding the *Intervention Energy* decision beyond its facts. Doing so creates a very slippery slope from good public policy to an unnecessary intrusion into state law. **abi**

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³⁶ *Intervention Energy*, 2016 Bankr. LEXIS 2241, at *5.

³⁷ *Id.* at *1-2.

³⁸ *Id.* at *14-15.

³⁹ *Id.* at *15.

⁴⁰ *Id.* at *17-18.

⁴¹ *See id.* at *10.

⁴² *See, e.g., In re Global Ship Sys. LLC*, 391 B.R. 193, 203 (Bankr. S.D. Ga. 2007) (finding that since lender was also an equityholder, it had “the unquestioned right to prevent, by withholding consent, a voluntary bankruptcy case”).

⁴³ *Intervention Energy*, 2016 Bankr. LEXIS 2241, at *17 (footnotes omitted).

25th Annual Central States Bankruptcy Workshop

**Remote Control:
Is a Bankruptcy Remote Company Truly Possible?
Materials**

Presented by:¹

Eric L. Johnson
Spencer Fane LLP
1000 Walnut St., Suite 1400
Kansas City, Missouri 64106
816-292-8267
ejohnson@spencerfane.com

¹ **DISCLAIMER:** These written materials and presentation made by the presenter is intended for educational and discussion purposes only. The presenter is involved in case regarding the various issues addressed in these materials and presentation. Any view or opinion expressed during the course of the presentation or in the materials are not intended to be attributable to the clients of the presenters or the presenters' respective firms, and are not intended to bind any of the presenters, their firms, or their clients to any position they may or may not take in those cases or in future cases.

I. Bankruptcy Remote Entities

A. Bankruptcy Remote Definition.

The Southern District of New York, in the seminal case of *In re General Growth Properties*, provides a good definition of a bankruptcy remote entity:

Sometimes referred to as a ‘single-purpose entity’ or ‘bankruptcy remote entity,’ an SPE has been described by one commentator as ‘an entity, formed concurrently with, or immediately prior to, the closing of a financing transaction, one purpose of which is to isolate the financial assets from the potential bankruptcy estate of the original entity, the borrower or originator.’ David B. Stratton, *Special-Purpose Entities and Authority to File Bankruptcy*, 23–2 Am. Bankr. Inst. J. 36 (March 2004). ‘Bankruptcy-remote structures are devices that reduce the risk that a borrower will file bankruptcy or, if bankruptcy is filed, ensure the creditor procedural advantages in the proceedings.’ Michael T. Madison, et. al., *The Law of Real Estate Financing*, § 13:38 (2008).

In re General Growth Properties, Inc., 409 B.R. 43, 49 n. 15 (Bankr. S.D. N.Y. 2009). In addition to various separateness provisions, two techniques that are frequently used in connection with a bankruptcy remote entities are the use of “blocking directors” and/or “golden shares”. Additionally, “Bad Boy guarantees” are also frequently used in connection with special purpose entities.

B. Blocking Directors

A blocking director has been described as follows:

A blocking director is the lynchpin that holds together a bankruptcy remote special purpose entity.... In such instances, a business enterprise creates an entity that has assets but limited or no operations and may not, but for unanimous consent of its directors, file for bankruptcy, *Gen. Growth*, 409 B.R. at 49, and that entity acts as the borrower and often the guarantor of the loan. Actions of a similar nature to bankruptcy are likewise prohibited. The organizational documents of the entity provide that the prohibited actions may not be taken if a specific director’s seat is vacant, and that director is nominated by the secured creditor. Last, the organizational documents of the entity provide that these prohibitions may not be altered but for unanimous consent of the directors (again, with an inability to act if the secured creditor’s nominee’s seat is vacant).

The import of such a structure is readily apparent. One specific director, chosen by the secured creditor, may withhold its vote and thus block, hence the name, a

voluntary bankruptcy petition. Further, given the limited operations, an involuntary petition against the entity is highly unlikely.

In re Lake Michigan Beach Pottawattamie Resort LLC, 547 B.R. 899, 911 (Bankr. D. Ill. 2016).

Use of Blocking Directors can be limited because several courts have found that such directors cannot abandon their fiduciary duties. *See, e.g., id.* at 913 (“The essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor that they were chosen by.”). *See also Gen. Growth*, 409 B.R. at 64-65; Andrew C. Helman and Jeremy R. Fischer, “The Missing Page of the Playbook: ‘Blocking Directors’ Can’t Escape Fiduciary Duty,” XXXV *ABI Journal* 8, 12, 58-59, Aug. 2016.

C. Golden Share

A “golden share” is a mechanism that provides a party a veto action over various activities of a company. *See* Eric L. Johnson and Mark G. Stingley, “Intervention Energy Holdings: Good Public Policy, or Unnecessary Intrusion into State Law?” XXXV *ABI Journal* 11, 20, 76-78, Nov. 2016. In a golden share scenario, the lender negotiates an amendment to corporate formation documents. As part of that amendment, the lender or lender controlled affiliate will be issued a minimal interest in company. The corporate bylaws or operating agreement will require unanimous consent to undertake material activities including the filing of bankruptcy. The result will be that the lender will have a veto right on the company’s ability to file bankruptcy. *See id.* at 20.

D. Bad Boy Guarantees

A “Bad Boy Guarantee” has been described as follows:

These types of agreements are often known as “bad boy guarantees” and are “frequently required by lenders providing financing to special purpose entities,

often in real estate transactions, to permit the lender to pursue the individual controlling the special purpose borrower for actions that undermine the value of the lender's collateral." *CP III Rincon Towers, Inc. v. Cohen*, 666 Fed.Appx. 46, 49 n.1 (2d Cir. 2016). "Thus, unlike a payment guarantee, which is triggered when a borrower fails to pay an amount when due, a bad boy guarantee is triggered when one of the enumerated bad acts occurs." *Nexbank, SSB v. Soffer*, No. 652072/13, 2014 N.Y. Misc. LEXIS 2462, at *6, 2014 WL 2451357 (N.Y. Sup. Ct. May 30, 2014), *aff'd*, 11 N.Y.S.3d 135 (N.Y. App. Div. 2015).

Sand Capital VI LLC v. Dickler Eyeglasses, 2017 WL 3008277 at *4 (N.D. Ill. July 14, 2017).

One of the triggers frequently used for a Bad Boy Guarantee is the filing of bankruptcy of the principal borrower. See Richard J. Corbi, "New York State Court Enforces "Bad Boy" Guaranty Provisions," XXXI *ABI Journal* 11, 32-33, 94, Dec/Jan 2013; *In re South Side House, LLC*, 470 B.R. 659, 676 (Bankr. E.D. N.Y. 2012) ("And New York law permits the enforcement of agreements that impose liability on guarantors when a borrower files for bankruptcy."); Mark A. Cody and Mark G. Douglas, "A Brief Guide to Automatic Stay Waivers, Bankruptcy Remoteness, and Bad Boy Guarantees," *Jones Day Publications*, July/Aug. 2016² (identifying several cases where guarantees were found to be enforceable).

II. Federal Public Policy vs. State Law Corporate Governance

Courts have also long held that restrictions on an individual's right to file bankruptcy should be rejected for public policy reasons. See, e.g., *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1177 (9th Cir. 2002) ("This prohibition of prepetition waiver has to be the law; otherwise, astute creditors would routinely require their debtors to waive."). Several courts have expanded this restriction to corporate entities:

The federal public policy to be guarded here is to assure access to the right of a person, including a business entity, to seek federal bankruptcy relief as authorized by the Constitution and enacted by Congress. It is beyond cavil that a state cannot deny to an individual such a right. I agree with those courts that hold the same applies to a "corporate" or business entity, in this case an LLC.

² <http://www.jonesday.com/A-Brief-Guide-to-Automatic-Stay-Waivers-Bankruptcy-Remoteness-and-Bad-Boy-Guarantees-08-08-2016/#>

In re Intervention Energy Holdings, LLC, 553 B.R. 258, 264 (Bankr. D. Del. 2016)(footnotes omitted)(citing *Lake Michigan Beach Pottawattamie Resort*, 547 B.R. at 912; *In re Bay Club Partners-472, LLC*, 2014 WL 1796688, at *4-5 (Bankr. D. Or. May 6, 2014); *In re Shady Grove Tech Ctr. Assocs. Ltd. P'ship*, 216 B.R. 386, 390 (Bankr. D. Md. 1998) *supplemented*, 227 B.R. 422 (Bankr. D. Md. 1998)). *See also In re Lexington Hospitality Group, LLC*, 577 B.R. 676, 684-86 (Bankr. E.D. Ken. 2017).

However, whether a company as the authority to file bankruptcy has generally been a matter left to state law. *See In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701 (E.D. Ark. 2017). “The Supreme Court long ago instructed that if a court ‘finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition. It is not enough that those who seek to speak for the corporation may have the right to obtain that authority.’” *Id.* at 706 (quoting *Price v. Gurney*, 324 U.S. 100, 106 (1945)). Thus, a tension exists between two longstanding bankruptcy policies. *See* Eric L. Johnson and Mark G. Stingley, “Intervention Energy Holdings: Good Public Policy, or Unnecessary Intrusion into State Law?” XXXV ABI Journal 11, 20, 76-78, Nov. 2016.

III. Case Examples

In addressing the tension between the competing policies related to bankruptcy remote companies, courts have reached varying conclusions. While the following list is not exhaustive, the identified cases demonstrate the issues that courts grapple with when faced with various bankruptcy remote provisions.

A. *In re Global Ship Systems, LLC*, 391 B.R. 193 (Bankr. S.D. Ga. 2007).

The debtor was a Georgia LLC. The bankruptcy court dismissed an involuntary case where the involuntary petition was a subterfuge for a voluntary petition that was otherwise

prohibited. As part of its financing, the lender was given a Class B equity interest in the debtor. The debtor needed the consent of the Class B equity to file bankruptcy. This consent right survived even after the loan was paid. The bankruptcy court found that a waiver to file bankruptcy violates public policy, but when a creditor is wearing two hats both as a lender and equity holder, it has the unquestioned right to prevent a bankruptcy filing.

B. *In re General Growth Properties, Inc.*, 409 B.R. 43 (Bankr. S.D. N.Y. 2009).

General Growth Properties, Inc. (“GGP”) was a real estate investment trust and was the parent of approximately 750 wholly owned subsidiaries and affiliates. GGP had an elaborate and complex corporate structure holding many of its real estate projects in special purpose entities (“SPEs”). The SPEs’ documentation generally contained various restrictions, separateness covenants, and required the appointment of one or more independent directors or managers. As part of the 2008 financial crisis, the debtors had to begin contemplating Chapter 11 restructuring as several of its loans were going into default.

Several lenders filed motions to dismiss the bankruptcy case asserting that several of the SPEs’ cases were filed in bad faith. The bankruptcy court denied the motions to dismiss finding, in part:

However, if Movants believed that an “independent” manager can serve on a board solely for the purpose of voting “no” to a bankruptcy filing because of the desires of a secured creditor, they were mistaken. As the Delaware cases stress, directors and managers owe their duties to the corporation and, ordinarily, to the shareholders. Seen from the perspective of the Group, the filings were unquestionably not premature.

Gen. Growth, 409 B.R. at 64-65.

C. *DB Capital Holdings, LLC*, 463 B.R. 142 (table), 2010 WL 4925811 (10th Cir. BAP, Dec. 6, 2010).

The debtor was a Colorado manager-managed LLC where the manager had no ownership in the debtor. The manager could only manage the debtor’s ordinary course affairs. The debtor’s

operating agreement was amended to include a complete bar from filing bankruptcy. The debtor fell on hard times and the manager filed Chapter 11 bankruptcy. One of the members filed a motion to dismiss arguing that the manager lacked the requisite authority. The bankruptcy court dismissed case and manager appealed.

The Tenth Circuit Bankruptcy Appellate Panel (“BAP”) affirmed the bankruptcy court. The BAP could find no law that would prohibit members from agreeing amongst themselves restricting the LLC’s ability to file bankruptcy. The BAP found no evidence that the debtor’s lender coerced the provision. Further, the BAP refused to opine on the result if the lender did coerce a provision. The BAP found that the dismissal was warranted because filing bankruptcy is outside the ordinary course affairs of the debtor and manager had no authority.

D. *In re Bay Club Partners -472, LLC, Case No. 14-30394, 2014 1796688, at *4-5 (Bankr. D. Or. May 6, 2014).*

The debtor was an Oregon LLC. In connection with its financing, the debtor’s operating agreement contained various special purpose entity provisions including an absolute prohibition on the filing of bankruptcy unless the financing was paid in full. The debtor filed for Chapter 11 bankruptcy. The lender filed a motion to dismiss asserting that the filing was not authorized. Without going into Oregon state law, the bankruptcy court found that the prohibition violated federal public policy.

E. *In re Lake Michigan Beach Pottawattamie Resort LLC, 547 B.R. 899 (Bankr. D. Ill. 2016).*

The debtor was a Michigan LLC. The debtor defaulted on loan obligations and entered into a forbearance agreement with its lender. The debtor was required to amend its operating agreement to establish that lender would become “special member”. The special member would have right to approve or disapprove of any “material” action including filing bankruptcy. The special member had no rights in profits or losses and would not have any fiduciary duties to the

debtor. The debtor filed bankruptcy without the special member's consent, and the lender sought to dismiss.

The motion to dismiss was denied on public policy grounds. First, the bankruptcy court recognized that absolute prohibitions against filing bankruptcy are considered "bad form." Second, the bankruptcy court found that the amendment was not a complete prohibition, rather it provided for a blocking director. However, the bankruptcy court found that the amendment to operating agreement was void under Michigan law because the special member was not required to consider the interests of the company.

F. *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016).

The debtor was Delaware LLCs. The debtor defaulted on loan obligations and entered into a forbearance agreement with its lender. The debtor's operating agreement was amended to give lender one common unit for \$1.00 capital contribution. The operating agreement was amended to require unanimous consent of all common unit holders in order to file bankruptcy.

The debtor filed for Chapter 11 bankruptcy. The lender's motion to dismiss was denied by bankruptcy court. The bankruptcy court found that the amendment to the operating agreement was determined to be void as against federal public policy:

A provision in a limited liability company governance document obtained by contract, the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC's decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy. Under the undisputed facts before me, to characterize the Consent Provision here as anything but an absolute waiver by the LLC of its right to seek federal bankruptcy relief would directly contradict the unequivocal intention of [lender] to reserve for itself the decision of whether the LLC should seek federal bankruptcy relief. Federal courts have consistently refused to enforce waivers of federal bankruptcy rights. I now join them, and conclude that the Debtors possessed the necessary authority to commence their chapter 11 proceedings.

Intervention Energy Holdings, 553 B.R. at 264-65.

G. *In re Tara Retail Group, LLC*, Case No. 17-bk-57, 2017 WL 1788428, at *2 (Bankr. N.D. WV May 4, 2017), appeal *dism'd* 2017 WL 283015 (N.D. WV June 30, 2017).

The debtor was a Georgia LLC. The debtor could not file bankruptcy without the unanimous consent of its members. Also, while the loan was outstanding, the debtor was to be managed by a single purpose entity with no ownership in the debtor. Further, there was to be an independent director who serves either as a manager of the debtor or board member of the single purpose entity. The debtor was prohibited from filing bankruptcy without unanimous consent of its board of directors and managers, including the independent director.

The debtor ultimately filed Chapter 11 bankruptcy. On the eve of bankruptcy, the debtor reached out to the independent director seeking his consent. He stated that he needed at least a week to consider the filing. The debtor then removed the single purpose entity as a manager, appointed two new managers, and filed bankruptcy.

The lender sought to dismiss the bankruptcy case. The bankruptcy court denied the motion to dismiss on the basis that the independent director acquiesced to the bankruptcy filing under Georgia law, thereby ratifying the filing. It did not have to reach the question of whether such provisions were valid for public policy reasons.

H. *In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701 (E.D. Ark. 2017).

The debtor was an Arkansas limited partnership with three partners. The general partner, tasked with managing the operations of the debtor, filed bankruptcy without the consent of the debtor's limited partners. The limited partners sought to dismiss the bankruptcy filing. The bankruptcy court dismissed the bankruptcy case finding lack of proper authority.

On appeal, the district court affirmed the bankruptcy court. It distinguished several of the golden share/blocking director cases because the owners of the debtor did not delegate the right

to veto a bankruptcy to a creditor. Rather, the owners kept the right to decide whether a bankruptcy should be filed.

I. *In re Lexington Hospitality Group, LLC, 577 B.R. 676 (Bankr. E.D. Ky. 2017).*

The debtor was a Kentucky LLC, which was manager managed. At its formation, the debtor had a sole initial member. Its initial operating agreement the initial member was the manager (the “Company Manager”). The original operating agreement was silent on the company’s ability to file bankruptcy. As part of receiving additional financing, the operating agreement was amended to admit a new member (a company owned and controlled by the lender) and that company was given a 30% share in the debtor. In addition to the lender’s company, two other members were each given a 5% share in the debtor.

The amendments also required the additional of “independent manager”, who must approve a filing of bankruptcy, but only if 75% of the members approve. The agreement requires the independent member to consider the interests of the company and the creditors in making the decision. The agreement also purports to eliminate all fiduciary duties of the independent manager. The amended agreement also contains a provision that all members vote affirmatively for the plan.

As part of forbearance, additional interests were transferred to the lender’s created company to hold the LLC interests bringing its ownership to 50% with provisions that would transfer an additional 1%. The Company Manager ultimately caused the debtor to file Chapter 11 bankruptcy without the independent director’s approval or a membership vote. The lender filed a motion to dismiss relying upon the bankruptcy restrictions in the operating agreement.

The lender’s motion to dismiss was denied by bankruptcy court. The bankruptcy court found that the amendments to the operating agreement were determined to be void as against

federal public policy. Further, the court found that the independent director provisions were merely a pretense in light of the absolute blocking provisions that were included.

J. *In re Franchise Services of North America, Inc.*, Case No. 1702316EE (Bankr. S.D. Miss. Dec. 18, 2017), certified for direct appeal to the Fifth Circuit by *In re Franchise Services of North America, Inc.*, Case No. 1702316EE, 2018 WL 485959 (Bankr. S.D. Miss. Jan. 17, 2018), on appeal *Franchise Services of North America, Inc. v. United States Trustee, et al.*, No. 18-60093, 2018 WL 2325909 (5th Cir. May 22, 2018).

The debtor was a Delaware corporation. The debtor's certificate of incorporation provided that it could not file for bankruptcy without the written consent or affirmative vote by a majority of both its preferred stock holders and common stock holders, each voting as a class. The debtor has only one preferred stock holder. The debtor filed for bankruptcy without obtaining shareholder approval.

The bankruptcy court dismissed the petition. After going through the recent cases on blocking directors and golden shares, the bankruptcy court dismissed the motion of the creditor asserting a golden share provision finding that it was void against public policy. However, the bankruptcy court upheld the preferred shareholder right since it was not a creditor (although it was a subsidiary of a creditor).

The bankruptcy court certified the following questions for direct appeal to the Fifth Circuit:

1. Is a provision, typically called a blocking provision or a golden share, which gives a party (whether a creditor or an equity holder) the ability to prevent a corporation from filing bankruptcy valid and enforceable or is the provision contrary to federal public policy?
2. If a party is both a creditor and an equity holder of the debtor and holds a blocking provision or a golden share, is the blocking provision or golden share valid and enforceable or is the provision contrary to federal public policy?
3. Under Delaware law, may a certificate of incorporation contain a blocking provision/golden share? If the answer to that question is yes, does Delaware law

impose on the holder of the provision a fiduciary duty to exercise such provision in the best interests of the corporation?

Franchise Services, 2018 WL 485959 at *6-7.

On February 8, 2018, the Fifth Circuit granted leave for an expedited direct appeal. See *Franchise Services of North America, Inc. v. United States Trustee, et al.*, No. 18-90006, Doc. 00514341142 (5th Cir. Feb. 8, 2018)(*per curiam*). On May 22, 2018, the Fifth Circuit issued a panel decision. See *Franchise Services of North America, Inc. v. United States Trustee, et al.*, No. 18-60093, 2018 WL 2325909 (5th Cir. May 22, 2018). The Fifth Circuit held that “[f]ederal law does not prevent a bona fide shareholder from exercising its right to vote against a bankruptcy petition just because it is also an unsecured creditor.” *Id.* at *1.

However, such a decision should not be read as a blessing of golden share provisions. Indeed, the Fifth Circuit, in order to avoid rendering an advisory opinion, specifically narrowed the certified questions to the following single question: Whether parties, under U.S. and Delaware law, can “amend a corporate charter to allow a non-fiduciary shareholder fully controlled by an unsecured creditor to prevent a voluntary bankruptcy petition.” *Id.* at *4. The Court distinguished the blocking director/golden share cases and held:

This is not an advisory opinion, and our holding is limited to the facts actually presented in this case. We hold simply that federal bankruptcy law does not prevent a bona fide equity holder from exercising its voting rights to prevent the corporation from filing a voluntary bankruptcy petition just because it also holds a debt owed by the corporation and owes no fiduciary duty to the corporation or its fellow shareholders. **A different result might be warranted if a creditor with no stake in the company held the right. So too might a different result be warranted if there were evidence that a creditor took an equity stake simply as a ruse to guarantee a debt. We leave those questions for another day.**

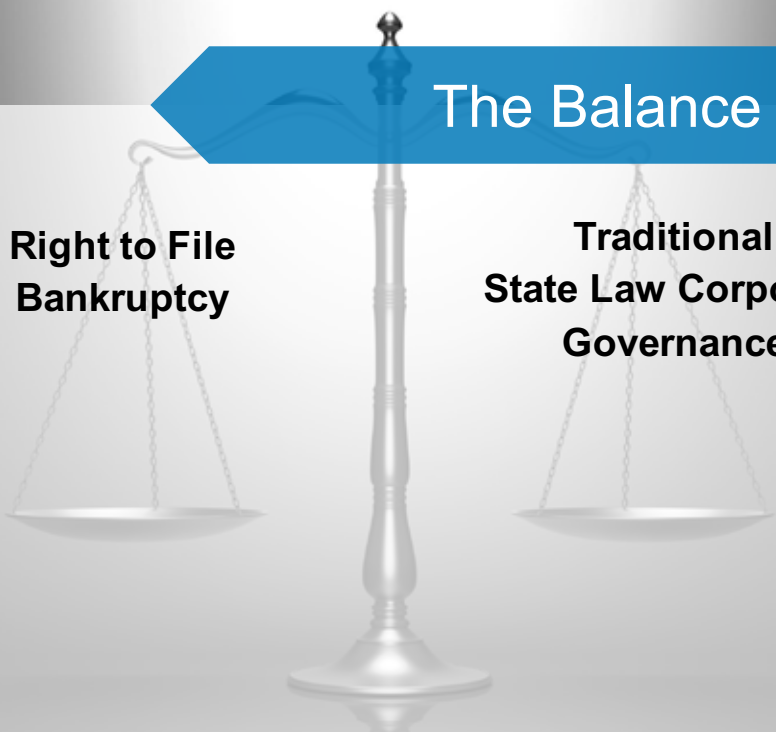
See *id.* at *5-7 (emphasis added).

REMOTE CONTROL: Is a Bankruptcy Remote Company Truly Possible?

25th Annual Central States Bankruptcy Workshop
Eric L. Johnson
Spencer Fane LLP



Bankruptcy Remote ≠ Bankruptcy Proof



The Balance

Right to File
Bankruptcy

Traditional
State Law Corporate
Governance

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The slide features a central graphic of a pair of scales of justice. The left pan is slightly higher than the right pan. A blue arrow-shaped banner at the top points to the right and contains the title 'The Balance'. The left pan is labeled 'Right to File Bankruptcy' and the right pan is labeled 'Traditional State Law Corporate Governance'. The background is a light gray gradient.



What Doesn't Work

- **Absolute Bankruptcy Prohibition**
- **Blocking Directors with No Discretion**
- **Golden Shares Issued at Forbearance**

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The slide features a background image of a 'SLIPPERY SLOPE AHEAD' warning sign. A blue arrow-shaped banner at the top points to the right and contains the title 'What Doesn't Work'. The sign is tilted and the text is in a bold, sans-serif font. The background is a light gray gradient.

What May Work

- **“Bad Person” Guarantees**
- **Independent Directors with Discretion**
- **Creditor as Investor**

A Rose Is a Rose Is a Rose:
Is the Same True for Transfers?

Ronald R. Peterson
Central States Conference
American Bankruptcy Institute
Lake Geneva, Wisconsin
June 9, 2018

Wikipedia tells us that Gertrude Stein wrote the sentence “Rose is a rose is a rose is a rose” as part of the 1913 poem “Sacred Emily”. “A rose is a rose is a rose” is among her most famous quotations, and is often interpreted as meaning “things are what they are”. But can the same be said for transfers of the debtor’s property to a bank? When a debtor deposits cash in its bank account, for example, is that deposit an avoidable transfer? In 2017, three different Courts of Appeals opined on this question and failed to give a consistent answer. In two of these decisions, the Courts said that all of the elements of the transfer were present, but there was not really a transfer. The third case by contrast held that there was a transfer. This paper shall review the history and rationale of these cases to try to see if deposits to the debtor’s bank accounts are a rose or a thorn.

As we study these cases, keep in mind that Courts of Appeals Judges look cases before from different paradigms. Some judges are ridged textualists, while others look at the legislative history to fathom what Congress meant. Yet, other judges look at the ramifications of their decisions, while still others look for achieving good social policies. See which judges decided these csaes.

Several trustees have attempted to avoid all transfers made to a bank by the debtor as fraudulent transfers. To prevail in a fraudulent transfer action,

the trustee must show that: first, there was a transfer to the bank; second, the transfer was made with the actual intent to delay, hinder or defraud creditors or was constructively fraudulent; and finally, that the bank was actual transferee or benefited from the transfer. Therefore, the threshold question, as in any avoidance action, is was there a transfer?

The Bankruptcy Act of 1898 in Section 1(30) as amended defined “transfer” as follows:

“Transfer” shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor[.]

Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *as amended by* Chandler Act, ch. 575, 52 Stat. 840, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

The U.S. Supreme Court looked at this issue in *N.Y. Cty. Nat’l Bank v. Massey*, 192 U.S. 138 (1904). This case involved a deposit by an insolvent debtor into his unrestricted demand account. The bank subsequently set off the cash in the account against an otherwise unsecured loan. The trustee sought to avoid the deposit as a preference. The Bankruptcy Referee and the District Court held that this was a permissible set off under Section 68 of the Act of 1898, but the Court of Appeals for the Second Circuit held that the debtor’s deposits were voidable preferences.

The Supreme Court reversed the Court of Appeals and held that:

A deposit of money to one's credit in a bank does not operate to diminishes the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw a check against it. It is not a transfer of property as a payment, pledge, mortgage, gift or security.

Massey, 192 U.S. at 147.

That seemed to be the state of the law until the passage of the Code of 1978. The Code's definition of "transfer" in 11 U.S.C. § 101(54) provides:

The term "transfer" means—

- (A) The creation of a lien;
- (B) The retention of title as a security interest;
- (C) The foreclosure of a debtor's equity of redemption; or
- (D) Each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with —
 - (i) property; or
 - (ii) an interest in property

11 U.S.C. § 101(54).

The House Report explains the Code's definition thus:

Transfer. It is derived and adapted with stylistic changes from Section 1(30) of the Bankruptcy Act. A transfer is a disposition of an interest in property. The definition of transfer is as broad as possible many of the potentially limiting words in current law are deleted, and the language is simplified. . . . Any transfer of an interest in property is a transfer, including a transfer of possession, custody or control even if there is no transfer of title, because possession, custody, and control are interest in property. **A deposit in a bank account or similar account is a transfer.**

H.R. Rep 95-595, at 314 (1977) (emphasis added).

The Senate Report is almost identical and also emphasizes that a deposit into a checking account is a transfer. See S. Rep. 95-989, at 27 (1978).

Despite Congress' apparently clear intent, the Courts have been troubled by this concept. An early seminal case was *Bonded Fin. Servs., Inc. v. Eur. Am.*

Bank, 838 F.2d 890 (7th Cir. 1988). *Bonded Financial* involved efforts by the owner of a currency exchange, Michael Ryan, to retire the debts he owed to a bank related to his race horses. Ryan was convicted of fraud and was sent to a gated community operated by the U.S. Department of Justice. On the eve of bankruptcy Ryan directed one of his currency exchanges, Bonded, to transfer \$200,000 to his personal bank account. Subsequently, Ryan wrote a check on that account to retire his personal debt to the bank. The trustee claimed that this was a fraudulent transfer, that the bank was the initial transferee, and that the transfer was made for the bank's ultimate benefit. The note accompanying the check said "deposit this check". It did not say "and pay down my race loan". Had the latter been true, the Court would have had little trouble finding for the trustee.

As a general policy matter, the Court was troubled by the havoc trustees could create by suing banks to recover the debtor's deposits. The Court noted that even in the 1990's hundreds of millions of dollars of deposits were flowing through the country's banking system and to make deposits voidable could cripple the system. To remedy the Court's fears, the Court held that the bank was mere financial intermediary. It received no benefit. Ryan's loan was fully secured and not in arrears, so the bank did not even acquire a valuable right to offset its loan against the funds in Ryan's account. The Court noted that the Bankruptcy code does not define "transferee" and that there is no legislative history on point. However, the Court did not address the Senate or the House reports noted above. If a bank deposit is a transfer, who on earth could be the

transferee other than the bank? The Court did find that the bank incredibly had no dominion over the money. However, if this money was not placed in a safety deposit box or in a fiduciary account, the bank could have used the money for any purpose, including a Christmas party for the bank's president. If that is not dominion, what is?

The Court of Appeals for the 10th circuit indicated that it would follow *Bonded in Malloy v. Citizens Bank (In re First Sec. Mortgage Co.)* 33 F.3d 42 (10th Cir. 1994). The important factual variance was that the account in question was an attorney's trust account. The Court simply applies the *Bonded* dominion and control test and asks whether the bank had the right to put the money to one's own purposes.

This issue remained quiet at the Court of Appeals level until 2017, when three different Courts of Appeal each took a stab at the question. The first decision was *Ivey v. First Citizens Bank & Tr. Co. (In re Whitley)*, 848 F.3d 205 (4th Cir. 2017). This case involved the nefarious affairs of a Ponzi operator, James Edward Whitley. In 2009, like most Ponzi schemes, Whitley's empire collapsed and he was subject to an involuntary petition in bankruptcy. Following Ryan's proud tradition, Whitney was convicted of fraud and also sent to a gated community. In the meantime, the trustee, Charles Ivey, sued the bank to avoid all of the deposits, approximately \$1.6 million, Whitley had made into the bank, on the ground that Whitney had made these deposits with the actual intent to delay, hinder and defraud his creditors. The Bankruptcy Court for the Middle District of North Carolina granted summary judgment in favor of the bank. The District Court affirmed on the grounds that the transfer could not be avoided

because it did not deplete the estate or remove property from the estate and the funds remained readily available to the debtor's creditors.

The Court of Appeals affirmed, but not for the reasons raised by the parties. The Court, instead, ruled that there was no transfer. Following the Supreme Court in *Massey*, the Court of Appeals for the Fourth Circuit adopted a rule providing that if the debtor could have recovered the deposit upon demand, there was no transfer at all. While the Court conceded that 11 U.S.C. § 101(54) was broader than its Act counterpart, the Court, without looking to the legislative history cited above, held that its own precedents mandated a finding that there was no transfer. The trustee asked the U.S. Supreme Court to grant *certiorari*, but the Supreme Court denied the petition on October 10, 2017. 2017 U.S. Lexis 6235.

Next up, was the decision by the Court of Appeals in *Meoli v. Huntington Nat'l Bank*, 848 F.3d 716 (6th Cir. 2017). Like *Ivey*, this case dealt with a failed Ponzi scheme, by a Baron Watson, but one which involved a lot more money than *Ivey*. Unlike the first two Ponzi operators, Mr. Watson found a more permanent way of procuring a discharge from the debts of a lifetime by committing suicide.

The trustee sued the Huntington National Bank for the return of \$72 million in deposits which the trustee claimed were made by Barton and his corporations to the Bank. Besides the transfer issue, the case has a fascinatingly detailed review of the issue of when a bank should have become aware of the

scheme and the proper standard for the bank's awareness: actual knowledge, constructive knowledge, willful blindness, or under the totality of the circumstances. The case is well worth the practitioner reading for its treatment that issue alone.

As in *Ivey*, the Court of Appeals in *Meoli* also concluded that there was not any transfer, but again without discussing the legislative history cited above. The Court held that the bank did not have dominion or control over the funds. The Court repeated the test in *Bonded Financial* that the depository bank must have dominion over the money or other assets that is, the right to use the money for its own purposes. The Court distinguished mere possession to ownership. Under this reasoning, the bank cannot be considered an initial transferee if it is merely an agent who has no legal authority to stop the principal, the debtor, from doing what he or she likes with the funds at issue. In support, the Court approved the holding of the Court of Appeals for the Eleventh Circuit in *Menotte v. United States (In re Custom Contracts, LLC)*, 745 F.3d 1342 (11th Cir. 2014), which held that there was no transfer even though [d]epository banks turn profits by employing customers' deposits to earn money at a higher rate than it pays interest to the comers. In other words, depository banks have 'legal rights to put deposited funds to use.'" *Meoli*, 848 F.3d at 726 (quoting *Menotte*, 745 F.3d at 1350). Thus, the Court allowed the trustee to avoid transfer to the bank only to the extent that the bank used the deposits to retire its loan. The excess deposits were not avoidable. Don't reach hastily conclusions.

The final case in 2017 is *Schoenmann v. Bank of the West (In re Tenderloin Health)*, 849 F.3d 1231 (9th Cir. 2017). While this case has very complicated facts, its main issue is whether the hypothetical “greater than” test in preference law should include a hypothetical preference recovery as part of the analysis under § 547(b)(5). In this case, the debtor had deposited \$526,402.05 in the bank and the trustee sought to recover \$190,595.50 paid to the bank within 90 days of the debtor’s petition date. The trustee lost in the Bankruptcy Court and the District Court.

The Court of Appeals reversed, holding that when considering whether the trustee can satisfy the “greater than” test in a preference action, the court may assume that the trustee could have brought a hypothetical avoidance action in the hypothetical chapter 7 case. After the bank in *Schoenmann* lost on the double hypothetical issue, the Bank then followed the crowd and argued that there was no transfer at all. *Schoenmann* was the only case reviewed that cited the legislative history and concluded that new definition of “transfer” in the Code superseded the holding in *Massey*. The Court of Appeals for the Ninth Circuit has even held years earlier that withdrawing money from a bank account and placing the money in the debtor’s safe is a transfer. See *Bernard v. Sheaffer (In re Bernard)*, 96 F.3d 1279, 1282 (9th Circuit 1996). Thus, in the Ninth Circuit, at least, a bank deposit is a transfer.

If the dominion and control test is correct then there is many transactions where a transfer does not occur. For example, what if the debtor lent the bank money and evidenced the loan with a demand note. Was there a

transfer? What if the debtor gave a piece of machinery to a third party with the understanding that the debtor could have the machinery back on demand?

The dominion and control test is a slippery slope.

Whether a naked deposit into a demand account is voidable or not should not rest on an unrealistic results orientated definition of transfer. Rather, it is my opinion that the District Court in *Ivey* got it right. See *Ivey v. First Citizens Bank & Tr. Co.*, 539 B.R. 77 (M.D.N.C. 2015). If there is no injury and the funds were not removed from reach of creditors, the deposit should not be voidable. In any event, even if the deposit were a voidable transfer under these facts, 11 U.S.C. § 548(c) gives the bank a complete defense if the bank gave value, in good faith and without knowledge of the fraud. Is the good faith transferee for value defense not a sufficient ground to prevent trustees from reaping windfalls and disrupting the banking system? Relying on that defense to protect banks, instead of the *Bonded* fiction, would have the added bonus of allowing the courts to view deposits for what they are: transfers. The bottom line is a transfer is a transfer and by any other name a transfer.

Ultimately, this issue may go to go to the Supreme Court based upon the circuit split that now exists. Stay tuned.

ABI Talks

**Hon. Phillip J. Shefferly
Chief Bankruptcy Judge for the
United States Bankruptcy Court,
Eastern District of Michigan
Detroit, Michigan**

Bankruptcy Venue Reform Act of 2018

1. What is the purpose of venue in our federal judicial system?
 - *Gulf Oil v. Gilbert* (Supreme Court 1947): “In cases which touch the affairs of many persons, there is reason for holding the trial in their view and reach rather than in remote parts of the country where they can learn of it by report only. There is a local interest in having localized controversies decided at home.”
2. What venue options do the current provisions of Title 28, § 1408 permit for an entity filing a Chapter 11 case?
 - Permits venue in the state of incorporation, principal place of business, where principal assets are located, or where an affiliate has a pending case.
3. What is the extent of forum shopping in Chapter 11 cases that has taken place under the existing venue statute?
 - For the year 2017, 10% of all Chapter 11 business filings were made in the District of Delaware, and 8% of all Chapter 11 business filings were made in the Southern District of New York. Taken together, 18% of the Chapter 11 business cases in 2017 were filed in those two courts alone.
4. What arguments have been raised against forum shopping under the existing venue statute?
 - Disenfranchises employees, pensioners, creditors and other local community stakeholders because it is too costly to attend hearings in remote districts.

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- Limits Chapter 11 decisional law to two districts and two circuits. This also results in fewer potential circuit splits that might warrant Supreme Court clarification.
- Eliminates opportunities for contributions to bankruptcy jurisprudence by bankruptcy judges, attorneys and professionals in other jurisdictions.
- Undermines public confidence in the integrity of the bankruptcy system.
- Permits Chapter 11 debtors to avoid facing the music with local media, creditors and employees.

5. Title 28, § 1412 provides that a bankruptcy court may transfer a Chapter 11 case to another district “in the interest of justice or for the convenience of the parties.” Doesn’t this statute provide an effective way of dealing with forum shopping?

- There is a presumption that a case is filed in the correct district and the debtor’s choice is given “great weight.”
- The party moving to transfer venue has the burden of proof by a preponderance of evidence (e.g., *Enron*).
- *Patriot Coal* took four months to litigate a venue transfer motion that resulted in a 61 page opinion on largely uncontested facts; the fee applications showed that the debtor’s professionals spent \$2 million and the creditors’ professionals spent \$1 million to litigate the motion.

6. On January 8, 2018, Senator John Cornyn, a Republican, and Senator Elizabeth Warren, a Democrat, introduced a bipartisan bill, Senate Bill 2282, titled “Bankruptcy Venue

Reform Act of 2018.” What are the main provisions of this bill, and how does it change the existing venue statute?

- Eliminates venue in the place of incorporation.
- Eliminates venue in the place where an affiliate case is pending, unless it is a parent corporation or general partner with controlling interest.
- Places burden of proof on the filing entity to show venue is proper by clear and convincing evidence.
- Requires bankruptcy court to enter an order on any objection to venue or request to change venue no later than 14 days after the filing of the objection or request.

7. What arguments are being advanced against the venue reform act?

- World class bench and bar of New York and Delaware; lack of comparable experience in other districts.
- Administrative efficiencies and expedited hearings and procedures.
- Senator Coons: “When the company is big and complicated . . . businesses want to be able to go to the Mayo Clinic of bankruptcy, which is why they come to Delaware.”
- Senator Coons: “If you had a rare, life-threatening disease, would you want the nation’s premier specialist, or would you want the generalist on duty at the local clinic?”
- Senator Coons: “The Cornyn-Warren bill will sure make the area around 8th and Market Streets look different. Suddenly, many of those local lawyers, consultants, and court employees would be out of a job. That means paralegals, secretaries, stenographers, and couriers would be out of luck. And what about the

restaurants and coffee shops who keep everyone fed and caffeinated to make the whole system work? They'd suffer too.”

- New York City Bar: “The Venue bill would strip away a corporation’s right to seek bankruptcy protection in the jurisdiction that best protects its enterprise value.”
- New York City Bar: “Worst of all, the Venue bill would subject debtors . . . to potentially unfavorable law in the jurisdiction where the limited aspects of their corporate presence require them to file. . . . When considering venue, corporate debtors routinely consider the impact of the case law in the different circuits (or districts) in which they may file. . . . [F]orcing debtors to file in districts with adverse law at the circuit level will risk the loss of millions or tens of millions of enterprise value – all to the loss of the creditors, employees and the communities the Venue bill is supposed to help.”
- New York City Bar: “The Venue bill assumes that existing venue rules prevent employees, small businesses, retirees and other parties from ‘fully participating in bankruptcy cases’. That argument rests on a myth. . . . [I]nterested parties have greater bankruptcy court access today than when the venue rules were originally adopted as a result of substantial advances in technology and revised local rules of bankruptcy procedure. Telephonic appearances at court hearings and instantaneous online access to electronic court dockets are now commonplace.”
- The Loan Syndications and Trading Association: Passage of the venue reform act would have a negative effect on the capital markets and would harm secured lenders because “bankruptcy courts have significant leeway, and local courts

2018 CENTRAL STATES BANKRUPTCY WORKSHOP

might be inclined to worry more about creditors further down the priority scale rather than the less sympathetic secured creditors.”

8. There have been other attempts at venue reform in 2005 and 2011. Is there any reason to believe that the current bankruptcy venue reform act will have any more likelihood of success?

9. Who are some of the organizations and interest groups that have weighed in on this issue?

- Bankruptcy law professors, 2/26/2018 letter.
- Bar associations:
 - Texas.
 - Boston.
 - Minnesota.
 - New York City.
- State legislatures – Indiana.
- NCBJ.



115TH CONGRESS
2D SESSION

S. 2282

To amend title 28, United States Code, to modify venue requirements relating to bankruptcy proceedings.

IN THE SENATE OF THE UNITED STATES

JANUARY 8, 2018

Mr. CORNYN (for himself and Ms. WARREN) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To amend title 28, United States Code, to modify venue requirements relating to bankruptcy proceedings.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Bankruptcy Venue Re-
5 form Act of 2018”.

6 **SEC. 2. FINDINGS AND PURPOSE.**

7 (a) FINDINGS.—Congress finds that—

8 (1) bankruptcy law provides a number of venue
9 options for filing bankruptcy under chapter 11 of
10 title 11, United States Code, including place of in-

1 corporation, principal place of business and assets,
2 or where an affiliate has filed a case under chapter
3 11;

4 (2) the wide range of permissible bankruptcy
5 venue options has led to an increase in companies
6 filing for bankruptcy outside of their home States,
7 or the district in which their principal place of busi-
8 ness or principal assets are located, a practice
9 known as forum shopping, and has resulted in a
10 concentration of bankruptcy cases in a few districts;

11 (3) bankruptcy forum shopping prevents small
12 businesses, employees, retirees, creditors, and other
13 important stakeholders from fully participating in
14 bankruptcy cases that will have tremendous impacts
15 on their lives, communities, and local economies, and
16 deprives district courts of the United States of the
17 opportunity to contribute to the development of
18 bankruptcy law in their jurisdictions; and

19 (4) reducing forum shopping and manipulation
20 in the bankruptcy system will strengthen the integ-
21 rity, build public confidence, and ensure fairness in
22 the bankruptcy system.

23 (b) PURPOSE.—The purpose of this Act is to prevent
24 the practice of forum shopping in cases filed under chapter
25 11 of title 11, United States Code.

1 **SEC. 3. VENUE OF CASES UNDER TITLE 11.**

2 Title 28, United States Code, is amended—

3 (1) by striking section 1408 and inserting the
4 following:

5 **“§ 1408. Venue of cases under title 11**

6 “(a) DEFINITION.—In this section, the term ‘prin-
7 cipal place of business’ means, with respect to a person
8 or entity that is subject to the reporting requirements of
9 section 13 or 15(d) of the Securities Exchange Act of
10 1934 (15 U.S.C. 78m, 78o(d)), the address of the prin-
11 cipal executive office of the person or entity as stated in
12 the last annual report filed under that Act prior to the
13 commencement of a case under title 11 by the person or
14 entity, unless another address is shown to be the principal
15 place of business by clear and convincing evidence.

16 “(b) VENUE.—Except as provided in section 1410,
17 a case under title 11 may be commenced only in the dis-
18 trict court for the district—

19 “(1) in which the domicile, residence, or prin-
20 cipal assets in the United States of an individual
21 who is the subject of the case have been located for
22 the 180 days immediately preceding such commence-
23 ment, or for a longer portion of the 180-day period
24 than the domicile, residence, or principal assets in
25 the United States of the individual were located in
26 any other district;

1 “(2) in which the principal assets or principal
2 place of business in the United States of a person
3 or entity, other than an individual, that is the sub-
4 ject of the case have been located for the 180 days
5 immediately preceding the commencement, or for a
6 longer portion of the 180-day period than the prin-
7 cipal place of business or principal assets in the
8 United States of the person or entity were located
9 in any other district; or

10 “(3) in which there is already pending a case
11 under title 11 concerning an affiliate that directly or
12 indirectly owns, controls, is the general partner, or
13 holds 50 percent or more of the outstanding voting
14 securities, of the person or entity that is the subject
15 of the later filed case if the pending case was prop-
16 erly filed in that district under this section.

17 “(c) LIMITATIONS.—

18 “(1) IN GENERAL.—For the purposes of para-
19 graphs (2) and (3) of subsection (b), no effect shall
20 be given to a change in the ownership or control of
21 a person or entity that is the subject of the case or
22 its affiliate, or to a transfer of the principal assets
23 or principal place of business of a person or entity
24 that is the subject of the case or its affiliate to an-
25 other district, that takes place—

1 “(A) within 1 year before the date on
2 which the case is commenced; or

3 “(B) for the purpose of establishing venue.

4 “(2) PRINCIPAL ASSETS.—For the purposes of
5 subsection (b)(2) and paragraph (1) of this sub-
6 section, principal assets do not include cash or cash
7 equivalents.

8 “(d) BURDEN.—The person or entity that com-
9 mences a case under title 11 shall bear the burden of es-
10 tablishing by clear and convincing evidence that venue is
11 proper under this section.”; and

12 (2) by striking section 1412 and inserting the
13 following:

14 “§ 1412. **Change of venue**

15 “Notwithstanding that a case or proceeding under
16 title 11 is filed in the correct division or district, a district
17 court may nevertheless transfer a case or proceeding
18 under title 11 to a district court for another district or
19 division, in the interest of justice or for the convenience
20 of the parties. If a case or proceeding under title 11 is
21 filed in the wrong division or district, the district court
22 shall transfer, dismiss the case or proceeding, or, if it be
23 in the interest of justice, transfer the case or proceeding
24 under title 11 to any district or division in which it could
25 have been brought. The court shall enter an order on any

6

1 objection to or request to change venue of a case or pro-
2 ceeding under title 11 not later than 14 days after the
3 filing of such objection or request.”.

○

•S 2282 IS

ABI Commission on Consumer Bankruptcy

The Commission on Consumer Bankruptcy is modeled after ABI's successful Commission to Study the Reform of Chapter 11.

ABI's website does a great job of explaining the Commission's work.

Let's take a look.

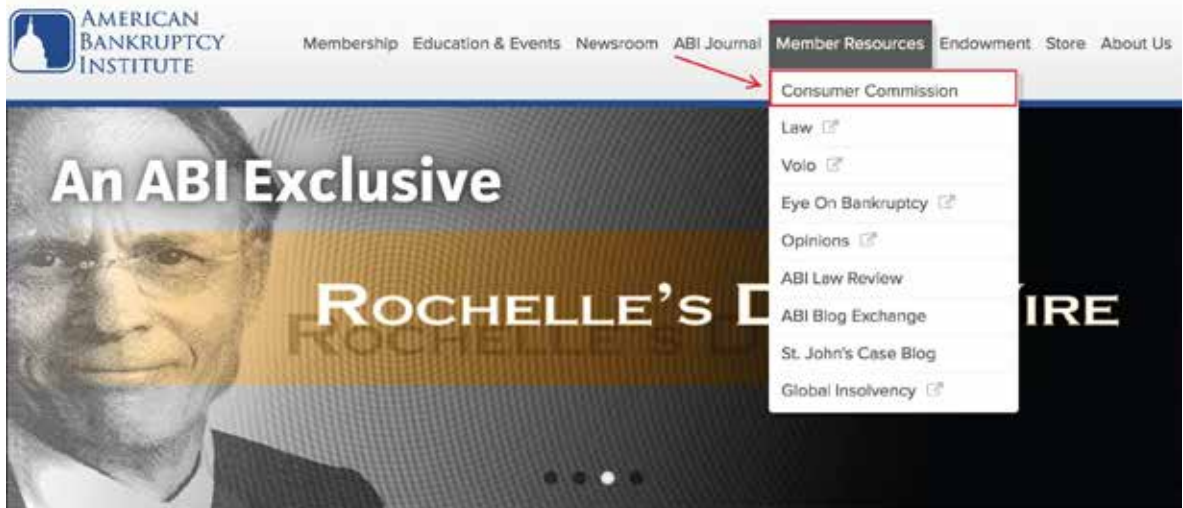
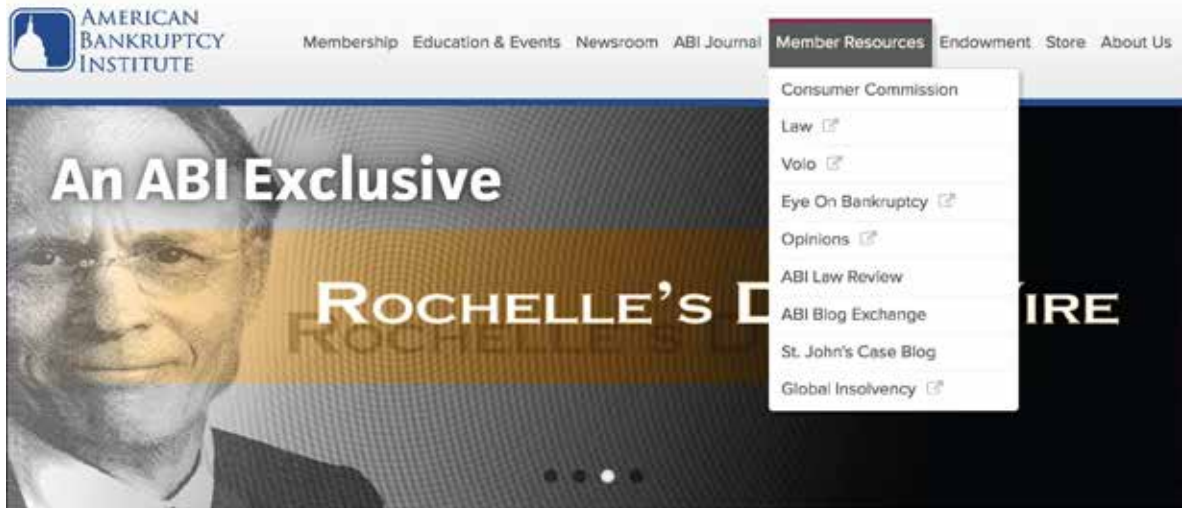


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The ABI Commission on Consumer Bankruptcy is charged with researching and recommending improvements to the consumer bankruptcy system that can be implemented within its existing structure. These changes might include amendments to the Bankruptcy Code, changes to the Federal Rules of Bankruptcy Procedure, administrative rules or actions, recommendations on proper interpretations of existing law and other best practices that judges, trustees and lawyers can implement. To view a fact sheet on the Commission, please [click here](#).

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ABI Commission on Consumer Bankruptcy Fact Sheet

- Created by the executive committee of ABI's Board of Directors in December 2016.
- Comprised of a 17-member expert panel who will examine the consumer bankruptcy system and issue a report with recommended improvements that can be implemented within the existing structure.
- The Commission is utilizing an open, information-gathering process that will allow interested parties across the consumer bankruptcy spectrum to provide input.

ABI Commission on Consumer Bankruptcy Fact Sheet

- Co-chaired by retired Bankruptcy Judges William Houston Brown and Elizabeth Perris with 50 years of combined judicial experience.
- The Commission Reporter is Robert Lawless, the Max L. Rowe Professor of Law and co- director of the Program on Law, Behavior & Social Science at the University of Illinois College of Law.

ABI Commission on Consumer Bankruptcy Fact Sheet

- The Commission has been supported by three committees: the Committee on Case Administration and the Estate, the Committee on Chapter 7, and the Committee on Chapter 13.
- Each committee is comprised of five commissioners and 10 other bankruptcy experts.
- Committee recommendations that are approved by a two-thirds majority of the Commission will become part of the Commission's final report.



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COMMISSION MEMBERS



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AMERICAN BANKRUPTCY INSTITUTE



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Chapter 13 Trustee



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Ronald R. Peterson
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John Rao
National Consumer Law
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Wendell Sherk
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National Consumer
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COMMISSION MEMBERS



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Commissioners: Edward C. Boltz, Dalie Jimenez, Richardo I. Kilpatrick and Tara Twomey

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4. Franklin Drake, Smith Debnam Narron Wyche Saintsing & Myers, LLP (Raleigh, NC)
5. Jim J. Haller, Sulaiman Law Group, Ltd. (Oak Brook, IL)
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7. Susan L. Myers, Legal Aid Center of Southern Nevada (Las Vegas, NV)
8. Brian D. Shapiro, Law Office of Brian D. Shapiro (Las Vegas, NV)
9. Brian L. Shaw, Shaw Fishman Glantz & Towbin LLC (Chicago, IL)
10. Alice L. Whitten, Wells Fargo Law Department (Minneapolis, MN)

Committee Chairs: Bruce A. Markell

Commissioners: Rudy J. Cerone, Ariane Holtschlag, Ronald R. Peterson and Wendell J. Sherk

ADVISORY COMMITTEE MEMBERS:

1. Cynthia L. Carroll, Cynthia L. Carroll, PA (Newark, DE)
2. Karen Cordry, National Association of Attorneys General (Washington, DC)
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5. Mark C. Leffler, Boleman Law Firm, PC (Richmond, VA)
6. Dennis J. LeVine, Kelley Kronenberg (Tampa, FL)
7. Nathalie D. Martin, University of New Mexico School of Law (Albuquerque, NM)
8. Faiq Mihar, Heavner, Beyers & Mihar, LLC (Decatur, IL)
9. Kate E. Nicholson, Nicholson Herrick LLP (Cambridge, MA)
10. Joseph R. Prochaska, Prochaska, Quinn & Ferraro, P.C. (Nashville, TN)

Committee Chairs: Randall L. Dunn

Committee on Chapter 13

Commissioners: Michael T. Bates, Alane A. Becket, Henry E. Hildebrand, III and John Rao.

ADVISORY COMMITTEE MEMBERS:

1. Beverly M. Burden, Chapter 13 Trustee, EDKY (Lexington, KY)
2. Daniel L. Cummings, Norman, Hanson & DeTroy, LLC (Portland, ME)
3. Alex Jeffrey Dolhancyk, The Dolhancyk Law Firm, PC (Jonesboro, GA)
4. Jenny L. Doling, Doling Shaw & Hanover (Palm Desert, CA)
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7. Leslie N. Mann, Mackie Wolf Zientz & Mann, P.C. (Little Rock, AR)
8. Jason P. Miller, Santander Consumer USA, Inc. (Dallas, TX)
9. James F. Molleur, Molleur Law Office (Biddeford, ME)
10. David G. Peake, Chapter 13 Trustee (Houston, TX)

Committee Chairs: David W. Houston, III



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**LIST OF TOPICS FOR
ABI'S COMMISSION ON CONSUMER BANKRUPTCY
*Committee on Case Administration & the Estate***

1. Student loans
2. Roles and responsibilities of attorneys
3. Roles and responsibilities of U.S. Trustee/Bankruptcy Administrator
4. Systems issues
 - a. New bankruptcy forms
5. Notice and service issues
6. Prepetition repossession
7. Exemptions

**LIST OF TOPICS FOR
ABI'S COMMISSION ON CONSUMER BANKRUPTCY
*Committee on Chapter 7***

1. Prepetition credit counseling and postpetition financial management course
2. Chapter 7 trustees [compensation; hiring counsel]
3. Dischargeability and discharge issues [523(a)(1)]
4. Means test
5. Property of the estate
6. Surrender
7. Redemption
8. Reaffirmation

**LIST OF TOPICS FOR
ABI'S COMMISSION ON CONSUMER BANKRUPTCY
*Committee on Chapter 13***

1. Chapter 13 eligibility [debt limits]
2. FRBP 3002.1 issues
3. Homeowner issues [underwater mortgages]
4. Chapter 13 plans [conduit vs. direct pay]
5. Credit reporting and bankruptcy
6. Local legal culture and chapter 13 [chapter choice]
7. Section 1306, scope of estate property in unclosed cases

COMMENTS AND FINAL REPORT

The Commission has just held its final public meeting, but written statements can still be submitted via e-mail at ConsumerCommission@abiworld.org.

The final report of the Commission is currently scheduled to be presented at the 2018 Winter Leadership Conference, Dec. 6-8.