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Non-Voting Creditors' Consent to Third Party Releases Can't Be Inferred

“New York and Delaware judges disagree on third party releases by non-voting creditors.”

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Disagreeing with some of his colleagues in New York and Delaware, Bankruptcy Judge Stuart M. Bernstein ruled that he had neither jurisdiction nor statutory power to issue a release of claims against non-debtor third parties held by creditors who did not vote on the confirmed chapter 11 plan of SunEdison, Inc., a renewable energy developer.

Although he gave the debtors an opportunity to submit a modified release that he would approve, SunEdison might be unable to comply with the rigorous standards that Judge Bernstein imposed.

The SunEdison Plan

Although no one objected, Judge Bernstein said at the confirmation hearing in late July that he had questions about the propriety of the broadly worded third party releases contained in the plan. Judge Bernstein called for further briefing on the releases but went ahead and confirmed the plan, because the debtors and affected parties were willing to accept the risk that the judge would knock out the releases later.

In his Nov. 8 opinion, Judge Bernstein said that the claims to be released and the parties benefitting from the releases were equally broad. The releases bound not only creditors who voted for the plan but also creditors who did not vote at all. He said that non-voting creditors “would release a largely unidentified group of non-debtors from liability based on pre-petition, post-petition and post-confirmation (i.e., future) conduct occurring through the plan’s future effective date that related in any way to their claims or those bankruptcy cases.”

Deemed Consent

First, Judge Bernstein analyzed whether non-voting creditors impliedly consented to the releases, much like the Supreme Court in *Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 191 L. Ed. 2d 911, 4337 (2015), said that creditors’ inaction can result in implied consent to the bankruptcy court’s authority to issue a final order.

Rather than focus on constitutional principles, Judge Bernstein analyzed contract law to decide whether non-voting creditors were deemed to consent to the releases, because they were warned in the disclosure statement that inaction might be taken as consent.

Judge Bernstein began from the proposition that silence does not constitute consent, absent a duty to speak. He cited the New York Court of Appeals for saying that silence operates as an estoppel “only when it has the effect to mislead.”

Judge Bernstein disagreed with several New York and Delaware bankruptcy court decisions holding that non-voting creditors were deemed to consent to third party releases. He agreed, however, with other Delaware cases holding that third party releases only bound creditors who voted for the plan.

Explaining why he reached that conclusion, Judge Bernstein said that the debtors did not “identify” the source of the creditors’ “duty to speak.” Despite the warning in the disclosure statement that silence may equal consent, he said the debtors failed to show how the non-voting creditors’ “silence was misleading or that it signified their consent.”

Observing that the plan only provided a recovery of less than 3% for unsecured creditors, Judge Bernstein left the door open to the possibility of inferring consent if the dividend were meaningful.

Jurisdiction

Having decided that consent could not be implied, Judge Bernstein turned to the question of whether the court had jurisdiction and statutory authority to enjoin creditors’ unasserted claims against third parties. Assuming there were jurisdiction, he said that third party releases “are proper only in rare and unique circumstances,” citing *Deutsche Bank AG v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136 (2d Cir. 2005).

The debtors argued that the court had jurisdiction because claims against the third parties would give rise to indemnification obligations running in favor of officers, directors, employees and agents. Judge Bernstein conceded that potential indemnification claims would give rise to a “conceivable effect” on the estate, thus giving the court jurisdiction to enjoin.

However, he said, the proposed releases were “much broader than the indemnification obligations.” He also said that the releases were not “limited to the potential indemnified parties listed by the debtors.”

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Consequently, Judge Bernstein said that the debtors "failed to sustain their burden of proving that the court has subject matter jurisdiction to approve the Release in its current form." He also said that the releases were not "appropriate" under *Metromedia*.

A Second Bite at the Apple

Judge Bernstein refused to approve the releases contained in the plan, but he gave the debtors 30 days to submit a new form.

Nonetheless, the new releases, Judge Bernstein said, "must specify the releasee by name or readily identifiable group and the claims to be released, demonstrate how the outcome of the claims to be released might have a conceivable effect on the debtors' estates, and show that this is one of the rare cases involving unique circumstances in which the release of the claims is appropriate under *Metromedia*."

Opinion Link: [Opinion Link](#) 

Judge Name: Stuart M. Bernstein

Case Citation: In re SunEdison Inc., 16-10992 (Bankr. S.D.N.Y. Nov. 8, 2017)

Case Name: In re SunEdison Inc.

Case Type: Business

Court: 2nd Circuit

New York

New York Southern District

Bankruptcy Tags: Claims

Plan Confirmation

Business Reorganization

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Marijuana Advisors Are Not Precluded from All Relief in Bankruptcy Courts

“Ninth Circuit B.A.P. shows sympathy for legal marijuana businesses.”

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Although a bankruptcy court cannot entertain the bankruptcy of a company in the medical marijuana business, the court can now assess damages against creditors for filing an unsuccessful involuntary petition.

Creditors filed an involuntary chapter 7 petition against a company that advised medical marijuana dispensaries in Arizona, where it is legal. After a hearing that dealt only with the legality of the alleged debtor’s business, the bankruptcy court dismissed the involuntary petition after concluding that a trustee inevitably would be in the position of violating the federal Controlled Substances Act.

Alternatively, the bankruptcy court dismissed the involuntary petition because the creditors had unclean hands since they knew or should have known that the alleged debtor’s business was illegal under federal law.

Although the bankruptcy court never developed a record focusing on the petitioners’ bad faith, the bankruptcy judge also denied the alleged debtor’s motion for damages under Section 303(i).

The Ninth Circuit Bankruptcy Appellate Panel, in a non-precedential opinion on June 3, reversed the bankruptcy court for failing to allow the alleged debtor to introduce evidence about the petitioners’ bad faith.

Although a marijuana business legal under state law is ineligible for bankruptcy relief, the B.A.P.’s opinion means that an alleged debtor advising marijuana dealers is not precluded from obtaining all forms of relief in federal court, such as the imposition of damages for filing an unsuccessful involuntary petition.

The opinion does not necessarily mean that actual marijuana dispensaries can obtain damages for defeating involuntary petitions, because the appeal before the B.A.P. only dealt with an advisor where imposing damages on the creditors would not run the risk of violating federal drug laws.

Still, the B.A.P. opinion implies that the unclean hands of someone in the marijuana business does not preclude all forms of relief from a federal court.

Case Citation: Medpoint Management LLC v. Jensen (In re Medpoint Management LLC), 15-1130 (B.A.P. 9th Cir. June 3, 2016)

Case Name: In re Medpoint Management LLC

Case Type: Business

Court: 9th Circuit

Bankruptcy Tags: Practice and Procedure
Business Reorganization

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17-06

Opinion No. 17-06

Utah Ethics Opinion

Utah State Bar Ethics Advisory Opinion Committee

September 27, 2017

1. **Issues.** This opinion request involves several issues in the practice of consumer Chapter Seven (liquidation) bankruptcies. These issues include:

a. Is a lawyer's advertisement of a "\$99" or "Zero Down" for a consumer Chapter Seven liquidation bankruptcy misleading under Rule 7.1? Is it misleading to advertise that this price is good for a limited time or that a promotion with this price was extended?

b. What are the ethical constraints when requesting the client to sign a post-petition attorney fee contract which will not be discharged?

c. What disclosure must be made, if the lawyer intends to sell the rights to collect the post-petition attorney fee contract to a litigation financing company? Does a relationship with the buyer of the attorney fee contract create a conflict of interest under Rule 1.7?

d. Are the attorney fees reflected in the post-petition contract reasonable when the attorney sells her rights to those fees at a deep discount under Rule 1.5?

2. Opinions.

a. Without providing the consumer further information, advertisement of a "\$99" bankruptcy or a "Zero Down" bankruptcy is misleading under Rule 7.1 because the price refers only to the filing of the initial petition. The price does not include the mandatory filing fee as well as work to be done subsequent to the filing of the petition such as preparation of schedules, meeting of creditors and reaffirmation agreements. All of these subsequent activities are necessary to obtain final discharge of debt which, of course, is the purpose of a consumer bankruptcy. Unless the follow up work is done, the bankruptcy will ultimately be dismissed. The consumer will have wasted both time and money.

b. In connection with the disclosures required under Subsection 2.a above, an attorney must disclose that her fees for post-petition work will be more substantial and not dischargeable in the consumer bankruptcy. The attorney cannot "unbundle" the filing of the petition unless it is

reasonable under the circumstances to do so.

c. While it is not a violation of the rules to sell a lawyer's accounts receivable, the client must be fully informed with respect to the transaction. The client must be offered the same discounted price. The client must consent in writing to the sale and must be informed that the legal fees for post-petition work are not dischargeable. The legal financing company will collect the fee and if there is a dispute between the finance company and the client, the lawyer would not represent the client.

d. The fee charged the client (including the finance company discount) must be reasonable. Reasonable fees in consumer bankruptcy are governed by Rule 1.5(a).

3. **Discussion.** This request reflects the growing disconnect between individuals of modest means who need legal services and the ability for lawyers to serve those needs without incurring personal financial hardship. The Utah Bar Association has long recognized this disconnect. Programs have been established to serve the needs of modest means consumers. Every lawyer has a duty to perform pro bono services. Yet, individuals who need to file Chapter Seven liquidation do so because creditors are garnishing wages or threatening foreclosure. The bar cannot reasonably expect that these needs will be met pro bono. Accordingly, it is not sufficient in this opinion to merely declare practices of the consumer bankruptcy bar unethical. Rather, this opinion is intended as a guide to the consumer bankruptcy bar in order to aid them to serve their clients while avoiding violations of the Rules of Professional Conduct. While this opinion discusses the consumer bankruptcy bar, the provisions on advertising, unbundling of services where allowed by law, and full disclosure to the clients are applicable to all lawyers.

4. It takes money to do a consumer bankruptcy. There is a substantial filing fee which may be paid in installments. If the filing fee is not paid, the case will be dismissed. In order to get relief from creditors, a petition must be filed with the court. Typically, the low advertised price refers to the attorney's work in preparation of the petition. Thereafter, there is post-petition work including filing a schedule of the debtor's affairs, attending a meeting of creditors and negotiating any affirmation of debt agreements. In the hypothetical given the committee, the post-petition, attorney fees range from \$1000 to \$2000.

5. Most individuals in Chapter Seven liquidation do not have funds to pay the lawyer for post-petition work which will not be discharged in the bankruptcy.[1] Accordingly, according to the hypothetical, the lawyer informs the client that additional work must be done in order to accomplish

the goal of discharged debt. The client has the choice of hiring the filing lawyer, hiring another lawyer, or doing the work themselves *pro se*.

6. Pre-petition attorney fees are dischargeable as any other debt. Post-petition attorney fees are not dischargeable and must be paid even after all other debts are discharged. Care must be taken to include only fees generated post-petition in the post-petition attorney fee contract. Care must also be given to full disclosure of the necessity for further work and the amount to be charged. As individuals in consumer bankruptcy are perhaps hiring a lawyer for the first time in their lives, the lawyer has a duty of clarity in these matters.

7. In the hypothetical given the committee indicated that a law firm "factoring" company will buy the notes of debtors covering post-petition attorney fee costs. It is reported that the discount on such contracts is thirty percent. In cases of non-payment, the "factoring" company will "gently" pursue payment from the client. The factoring company has no recourse to the lawyer but looks solely to the client for payment. The hypothetical indicates that a large percentage of Utah Chapter Seven bankruptcies are financed in this manner.

8. A lawyer is allowed to limit the scope of her engagement if limitation is reasonable under the circumstances and the client gives informed consent.^[2] See Rule 1.2(c). Rule 1.5(b) requires that scope of the representation and the basis or rate of the fee be communicated to the client, "preferably in writing." This is particularly applicable when the lawyer agrees to perform only a portion of the services needed to accomplish the goals of a legally unsophisticated client.

These facts present the legal issue of when consumer bankruptcy attorneys such as DeLuca may limit the scope of their representation, a practice colloquially referred to as "unbundling." While unbundling is permissible, it must be done consistent with the rules of ethics and professional responsibility binding on all attorneys. Those rules allow a lawyer to limit his or her representation **only when it is reasonable under the circumstances to do so, and only when the client gives informed consent to the limitation.** *In re Seare*, 493 B.R. 158 (Bankr. D. Nevada, April 9, 2013). (Emphasis added)

9. The *Seare* Court discusses the ethical problems of "unbundling" bankruptcy services at great length. The Committee adopts this discussion as reflecting Utah ethical concerns.

Unbundling raises concerns, however. The push to limit representation may come from the attorney, who often benefits from and has superior knowledge of the possible ramifications of excluding certain services.

There are strong reasons for protecting those who entrust vital concerns and confidential information to lawyers.... Clients inexperienced in such limitations may well have difficulty understanding important implications of limiting a lawyer's duty. Not every lawyer who will benefit from the limitation can be trusted to explain its costs and benefits fairly.... In the long run, moreover, a restriction could become a standard practice that constricts the rights of clients without compensating benefits. The administration of justice may suffer from distrust of the legal system that may result from such a practice. Those reasons support special scrutiny of noncustomary contracts limiting a lawyer's duties, particularly when the lawyer requests the limitation.

There is a particular concern in consumer bankruptcy practice that attorneys will unbundle services that are essential or fundamental to bankruptcy cases and clients' objectives.

A lawyer walks a perilous path in attempting to limit the services provided to bankruptcy debtors. Making an effective disclosure of the risks of such an arrangement, and obtaining informed consent, may be impossible in some cases. As noted, some lawyer services are so fundamental and essential to effective representation, no amount of disclosure and consent will suffice. Instructing a debtor to "go it alone" in any significant aspect of the bankruptcy case exposes counsel to possible criticism, and worse yet, a potential for sanction.

…

In spite of the concerns that unbundling raises, the ABA amended Model Rule 1.2(c) in 2002 to expressly allow limited-scope representation and provide a mechanism to regulate it. Struffolino, *supra*, at 215; AM. BAR ASS'N, ANNOTATED MODEL RULES OF PROF'L CONDUCT 38 (2011) ("ANNOTATED RULES"). The ABA's goal was to "encourage attorneys to provide some assistance to low- and moderate-income litigants who could not otherwise afford full representation." Struffolino, *supra* note 17, at 215 (citing AM. BAR ASS'N, STANDING COMM. ON THE DELIVERY OF LEGAL SERVS., AN ANALYSIS OF RULES THAT ENABLE LAWYERS TO SERVE PRO SE LITIGANTS 8 (2009)); ANNOTATED RULES 38 (citing AM. BAR ASS'N, LEGISLATIVE HISTORY: THE DEVELOPMENT OF THE ABA MODEL RULES OF PROF'L CONDUCT, 1982-2005 at 55 (2006)). ABA Model Rule 1.2, which Nevada has adopted verbatim, states that "[a] lawyer may limit the scope of representation if the limitation is *reasonable under the circumstances* and the client gives *informed consent*." NEV. RULE OF PROF'L CONDUCT 1.2(c) (2011) (emphasis supplied).

Shortly after the ABA amended the rule, the ABA

published the *ABA Handbook*, a report on limited scope legal assistance. The *ABA Handbook* emphasizes that the majority of people in our nation are low and moderate income, and that often they cannot afford to pay lawyers in litigation. *Id.* at 3. Limited scope legal representation can make the judicial process fairer by providing greater access to justice. *Id.* at 3–4. The ABA quoted a long time limited-service practitioner for the proposition that unbundling should be client driven—" [i]n this legal relationship, 'the client is in charge of selecting one or several discrete lawyering tasks contained within the full-service package.' " *Id.* at 7 (quoting FORREST S. MOSTEN, UNBUNDLING LEGAL SERVS.: A GUIDE TO DELIVERING LEGAL SERVS. A LA CARTE 1 (2000)). …

If limited representation is selected, "the lawyer must also alert the client to reasonably related problems and remedies that are beyond the scope of the limited-service agreement." In a related ethics opinion, the Los Angeles County Bar Association put it this way,

The attorney has a duty to alert the client to legal problems which are reasonably apparent, even though they fall outside the scope of retention, and to inform the client that the limitations on the representation create the possible need to obtain additional advice, including advice on issues collateral to representation.

10. A lawyer should not automatically assume that "unbundling" the filing of a petition is **reasonable under the circumstances** of the case. Indeed, propriety of unbundling a petition may be the **exception rather than the usual practice**. Recent bankruptcy ethics cases demonstrate the concerns of the bankruptcy courts. In *Seare*, the majority of the client's unsecured debt was a judgment for fraud. The lawyer knew this debt was non-dischargeable. Nevertheless, he filed an unbundled and worthless Chapter Seven petition. The attorney was required to disgorge all fees and present a copy of the court's opinion to any future client when the attorney proposed to unbundle the filing of a complaint.

11. *In re Minardi*, 399 B.R. 841 (Bankr. N.D. Oklahoma) concerned a lawyer's attempt to limit services to exclude negotiation of reaffirmation agreements. The court found that the "decision to reaffirm an otherwise dischargeable debt plays a critical role in the bankruptcy process—so critical, that assistance with the decision must be counted among the necessary services that make up competent representation of a Chapter Seven debtor." Particularly, the Court held that an agreement for limited representation does not exempt a lawyer from the duty to provide competent representation.

12. The Idaho Bankruptcy Court provides that "an attorney,

in accepting an engagement to represent a debtor in a bankruptcy, will find it exceedingly difficult to show that he properly contracts away any of the fundamental and core obligations such an engagement necessarily imposes. Proving competent, intelligent, informed, and knowing consent of the debtor to waive or limit such services inherent to the engagement will be required." *In re Grimmett*, 2017 WL 2437231 (United States Bankr. D. Idaho June 5, 2017) citing *In re Castorena*, 270 B.R. 504 (Bankr. D. Idaho 2001).

13. If a consumer bankruptcy lawyer presents unbundled legal services, she must comply with Rule 7.1's limitations on false or misleading communications. A representation is false or misleading if it "contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading." Rule 7.1(a). It would be materially misleading if a bankruptcy lawyer unbundled services and did not explain in detail, preferably in writing, what additional services would be needed to accomplish the client's goal. Just as in *Seare*, it would not be sufficient to remain silent when it is well known that an adversary proceeding is likely to occur. Further, statements indicating that the one-time fee is "for a limited time" or has "been held over" are misleading^[3] if not accurate.

14. It is not unlawful for lawyers to sell or encumber their accounts receivable, whether or not the work has been accomplished. Sale or encumbrance of accounts receivable is not sharing fees with a non-lawyer. (Rule 5.4(a)). This is equally true for consumer bankruptcy lawyers. The Texas Court explained:

The main thrust of Leibowitz's argument is that loans such as those at issue in this case fundamentally violate public policy as articulated in the disciplinary rules, which as a general rule prohibit lawyers from sharing legal fees with non-lawyers. However, Texas case law allows an attorney to assign accounts receivable, consisting of current or future, earned or unearned, attorney fees as property securing a transaction. *See Hennigan v. Hennigan*, 666 S.W.2d 322, 325 (Tex.App.-Houston [14th Dist.] 1984, writ ref'd n.r.e.) (concluding that future attorney's fees constitute "accounts" under section 9.106 of the Uniform Commercial Code).⁸ Moreover, as previously stated by this Court, there is a significant difference between sharing legal fees with a non-lawyer and paying a debt with legal fees. *See State Bar of Tex. v. Tinning*, 875 S.W.2d 403, 410 (Tex.App.-Corpus Christi 1994, writ denied)

15. There are a number of potential pitfalls, however, in litigation funding. All of these pitfalls must be discussed with the client. Because of a regular relationship with the funding company, the possibility of a current conflict of interest between the lawyer's interest, the client's interest

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and the interest of the funding company in being paid, the lawyer must comply with Rule 1.6(b). The client must give informed consent, confirmed in writing when waiving any such conflicts.

16. The lawyer has but one client and must maintain confidentiality and loyalty towards that client. "Although litigation funding companies are not subject to lawyers' rules of professional conduct, the lawyers whose clients receive funding are." Hazard, Hodes, & Jarvis, "The Law of Lawyering" 8.26 (2014 Supplement.) Chief among the pitfalls are client confidentiality and protecting the independence of the attorney. Further we call attention to Utah Ethics Advisory Opinion 13-05 which discusses the extent to which a lawyer may involve herself in assisting in the application for financial assistance.

17. Finally, the hypothetical raises questions as to the reasonableness of the consumer bankruptcy lawyer's fees. If the lawyer is willing to do the work with a thirty percent discount, we question (but do not resolve) whether the total fee is reasonable. There are, however, guidelines. The consumer bankruptcy lawyer, like all other lawyers, is subject to the reasonable fee provisions of Rule 1.5 which include the time and labor required, the novelty and difficulty of the questions involved and the skill required performing the legal services properly. Other factors include the likelihood that accepting this matter would preclude taking other employment by the lawyer. A reasonable fee might be the fee customarily charged in the locality for similar services. Finally, the reasonableness of a fee depends upon the experience, reputation and ability of the lawyer performing the service.

Notes:

[1] This is a major difference between Chapter 7 liquidation and Chapter Thirteen reorganization. Legal fees for Chapter 13 may be paid as part of the debtor's plan for reorganization. The lawyer, however, has a duty of competence and diligence under Rule 1.1 and 1.3 to effectively counsel the client as to the risks and benefits of relief under both chapters. It would be a violation of those rules if the attorney placed the client in Chapter Thirteen merely to enhance his ability to collect his fee.

[2] "Informed Consent" denotes the agreement by a person to a proposed course of action after the lawyer has communicated adequate information and explanation of the material risks of and reasonably available alternatives to the proposed course of action. See Rule 1.1(f).

[3] Those statements may be unlawful under the Utah Consumer Sales Practices Act. See U.C.A. 13-11-4(d). Such

statements are Misconduct pursuant to Rule 8.4 as they involve criminal conduct reflecting adversely upon a lawyer's honesty and the lawyer engages in conduct involving dishonesty, fraud, deceit or misrepresentation.

Dicta

BY HON. HARLIN D. HALE, AUBREY E. EDKINS AND NICOLE HAY

Set Me Free: Shared Policy Concerns on Nonconsensual Third-Party Releases



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Nonconsensual third-party releases have recently been thrust to the forefront of bankruptcy law, holding considerable sway with respect to forum choice for large chapter 11 cases. With circuits split and no set rule, the area is in need of clarification. From the bench, major policy concerns drive decisions, causing some disparity, but overall unity. A comparison of Second and Third Circuit cases to the Fifth Circuit cases reveals that the spectrum of opinion is really quite narrow and the difference between circuits, at least at the bankruptcy court level, is smaller than it first appears.

Nonconsensual third-party releases (*i.e.*, a release of nondebtors from direct claims held by creditors or other third-party stakeholders) are common in corporate reorganizations. There is, however, no explicit authority for them in the Bankruptcy Code.¹ Section 524(e)² is interpreted differently, depending on the circuit, to either restrict the discharge of any and all nondebtor debts, or to merely ensure that the discharge of a debtor's debts is not an automatic release from liability for nondebtors. The latter employ § 105(a)³ to allow third-party releases when necessary to fulfill a purpose under the Bankruptcy Code. However, even in these "permissive circuits," the lack of clear authority, as well as the potential for abuse, creates a general reluctance to grant nonconsensual third-party releases. To adopt the language of the Third Circuit in *In re Cont'l Airlines*,⁴ the authors will refer to these circuits as "flexible circuits" and correspondingly, more-restrictive circuits as "non-flexible circuits."

The main tension underlying the release debate is between the practicality of releases and due-process concerns. While a true fresh start for a debtor can require a release of claims against nondebtors, third-party releases can apply to known and unknown creditors who have no chance of being heard. In the extreme case, it is a discharge without notice. In the non-extreme case, it is still a discharge without consent. Yet, even in the Bankruptcy Code, it is recognized that sometimes

these releases can be so crucial to the plan as to be necessary.⁵ Even precedent from courts in the Fifth Circuit, often viewed as a non-flexible circuit,⁶ still allows for releases of claims against certain classes of third parties in light of this practical reality.⁷ As bankruptcy courts in the Fifth Circuit routinely confront this issue of nonconsensual releases, the classes of third parties that are released are expanding. At the same time, even the flexible circuits only allow nonconsensual third-party releases in the rarest of circumstances.⁸ In reality, the decisions of bankruptcy courts in the Second, Third and Fifth Circuits do not fit so seamlessly into the flexible and non-flexible classifications.⁹

In the Third Circuit, the controlling precedent, *In re Continental*, did not establish a rule for when nondebtor releases were allowed.¹⁰ Instead, the court outlined the "hallmarks" of permissible nonconsensual third-party releases: fairness, necessity to reorganization and specific factual findings to support conclusions.¹¹

Finding all the hallmarks missing on the facts in *Continental*, the Third Circuit rejected nonconsensual releases for nondebtor D&Os.¹² This ruling left the Third Circuit's bankruptcy courts with only minimal guidance as to the interpretation of these releases. The Second Circuit similarly set a controlling precedent with the potential for conflicting outcomes. In *In re Metromedia*, the Second Circuit allowed nondebtor releases, but only where truly unusual circumstances rendered the releases important to the plan's success (*i.e.*, only in rare cases).¹³

The unresolved tension between due process and practicality in third-party releases post-*Continental* and *Metromedia* is displayed in recent decisions from bankruptcy courts in the Second and Third Circuits. For example, in interpreting and applying

⁵ This concept was recognized even in the Bankruptcy Code through the creation of asbestos trusts. The latency period was so long that the release was necessary in order for the companies to ever think of reorganizing. 11 U.S.C.A. § 524(g) (West 2016).

⁶ See, e.g., Menachem O. Zelmanovitz, "Nondebtor Releases in Reorganization Plans: Are They Still Viable or a Thing of the Past in the Second Circuit," 25 *May Am. Bankr. Inst. J.* 16 (May 2006), available at abi.org/abi-journal.

⁷ See, e.g., *In re Texas Rangers Baseball Partners*, 2010 WL 4106713, *11 (Bankr. N.D. Tex. 2010).

⁸ *In re Cont'l Airlines*, 203 F.3d at 213 (3d Cir. 2000); see also *In re Vitro SAB de CV*, 701 F.3d 1031, 1061-62 (5th Cir. 2012).

⁹ The Ninth and Tenth Circuits, however, while outside the scope of this article, do tend to remain more truly prohibitory. See Zelmanovitz, *supra* n.6.

¹⁰ *In re Cont'l Airlines*, 203 F.3d at 203, 214 (3d Cir. 2000).

¹¹ *Id.*

¹² *Id.*

¹³ *In re Metromedia Fiber Network Inc.*, 416 F.3d 136, 143 (2d Cir. 2005).

¹ With the exception of asbestos cases, for which releases are specifically allowed. 11 U.S.C.A. § 524(g) (West 2016).

² "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C.A. § 524(e) (West 2016).

³ "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C.A. § 105 (West 2015).

⁴ *In re Cont'l Airlines*, 203 F.3d 203, 213 (3d Cir. 2000).

the Third Circuit decision of *Continental*, bankruptcy courts have produced conflicting rules and often harsh results — an uncomfortable fit for a flexible circuit. In *In re Washington Mutual*, noting that while the Third Circuit had not barred third-party releases, they were the exception and not the rule, the bankruptcy court proceeded to establish its own rule based on its precedent.¹⁴ The bankruptcy court held that any third-party release of a nondebtor needed to be based on the consent of the releasing party, either by contract or by voting in favor of the plan.¹⁵ By adopting this affirmative consent requirement, the court acknowledged the strength of the due process protection policy, winning out over the more practical concerns. Contrast this holding with *In re Millennium*. In that case, the court adopted the *Continental* hallmarks as the standard and upheld nonconsensual third-party releases for post-petition lenders, former equityholders and two corporate executives as fair and necessary to the reorganization.¹⁶

The contrast between the ruling in *In re Millennium* and *In re Washington Mutual* led to a direct certification of appeal to the Third Circuit. This certification was denied by the court of appeals, however, and the case is now pending before the U.S. District Court for the District of Delaware. The Third Circuit's refusal to state a rule in *In re Continental* and its denial of appeal in *In re Millennium* may show a hesitation to disturb the flexibility of a bankruptcy court's ability to balance the equities.

Similar variance in the treatment of nonconsensual third-party releases exists in the Second Circuit's bankruptcy courts' decisions. In *In re Chassix*, the U.S. Bankruptcy Court for the Southern District of New York construed the rationale behind the *Metromedia* holding, noting that there is no public policy in support of making third-party releases applicable to as many creditors as possible; rather, there is a clear policy that such releases are only appropriate in narrow and unusual circumstances.¹⁷ The bankruptcy court in *Chassix* thus required affirmative consent for third-party releases.¹⁸ Here, too, showing a policy determination in favor of due-process concerns over practical considerations is a rather restrictive approach in a flexible circuit. Moreover, in a recent U.S. Trustee objection filed in the U.S. Bankruptcy Court for the Southern District of New York in *In re Fairway Group*,¹⁹ an additional argument was raised in support of further limiting the circumstances under which nonconsensual third-party releases should be granted. Using *Chassix*, the U.S. Trustee argued that because a party is impaired if its legal, equitable and contractual rights are altered by the plan, parties affected by the release cannot be considered unimpaired by the plan for voting purposes, especially if the release was a condition of its confirmation.²⁰ Thus, even the Second Circuit places severe limitations on third-party releases, blurring further the distinctions between the circuit approaches.

In the meantime, bankruptcy courts across the Fifth Circuit have approved third-party nonconsensual releases

for certain classes of claims, despite Fifth Circuit precedent considered to be non-flexible. The seminal Fifth Circuit case dealing with nonconsensual third-party releases and exculpation clauses in a chapter 11 plan is *In re Pacific Lumber*, determined in 2009 in the context of an equitable-mootness argument.²¹ In *Pacific Lumber*, the Fifth Circuit considered a plan that, other than for willful misconduct or gross negligence, (1) released the plan proponents, reorganized entities, unsecured creditors' committee and their respective current members, officers, directors, employees, affiliates, agents and advisors from liability in connection with the bankruptcy case and administration of the plan; and (2) exculpated the plan proponents, their officers, directors and professionals, the unsecured creditors' committee, its members and professionals, and the reorganized entities, their officers, directors and professionals from liability related to the bankruptcy case and administration of the plan. As to the unsecured creditors' committee, the court determined that § 1103(c) impliedly granted the committee and its members qualified immunity for acts and omissions within the scope of their duties.²² Striking down the remaining releases and exculpations, the Fifth Circuit stated that its own precedent "seem[ed] to broadly foreclose nonconsensual, nondebtor releases and permanent injunctions."²³ It is noteworthy that the Fifth Circuit refused to address the releases and exculpations with regard to the reorganized entities because the objecting parties failed to brief the issue.²⁴ Despite the fact that the Fifth Circuit appears to be less flexible than the Second and Third Circuits, bankruptcy courts have been much more lenient in applying this precedent in the Fifth Circuit than in its flexible sister circuits.

In *Pilgrim's Pride*, the bankruptcy court upheld an injunction, release of pre-effective date claims and exculpations related to the bankruptcy case as to the debtor and reorganized entities, to the extent consistent with §§ 524 and 1141 of the Bankruptcy Code.²⁵ As to other third parties, which the court identified as the debtors' management and professionals and a guarantor, the bankruptcy court refused to uphold the proposed exculpatory provisions, but held that the management and professionals presumably received immunity for good-faith acts performed during the bankruptcy and retained jurisdiction over any such determination.²⁶ In addition, bankruptcy courts in the Fifth Circuit have approved nonconsensual third-party releases for plan proponents, secured lenders and their directors and officers, professionals and affiliates, chapter 11 trustees, receivers, receiverships, and their employees, officers, agents and attorneys as being in the form of a settlement under § 1123(b)(3)(A).²⁷ Likewise, in the paramount case of *In re Texas Rangers Baseball Partners*, the bankruptcy court upheld exculpation provisions for the debtor, reorganized debtor, purchaser, creditors' committee and its members related to acts and omissions taken post-petition in conjunc-

14 *In re Washington Mut. Inc.*, 442 B.R. 314, 351-52 (Bankr. D. Del. 2011).

15 *Id.* at 352.

16 See *In re Millennium Lab Holdings II LLC*, 543 B.R. 703, 706, 711 (Bankr. D. Del. 2016).

17 *In re Chassix Holdings Inc.*, 533 B.R. 64, 78 (Bankr. S.D.N.Y. 2015).

18 *Id.* at 81.

19 *In re Fairway Grp. Holdings Corp.*, No. 16-11241 (MEW), U.S. Trustee Objection, Docket No. 136 (June 2, 2016).

20 *Id.* at 7-8; *In re Chassix*, 533 B.R. at 81.

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

22 *Id.* at 253.

23 *Id.* at 252.

24 *Id.* at n.26.

25 *In re Pilgrim's Pride*, 2010 Bankr. LEXIS 72, **12-13 (Bankr. N.D. Tex. Jan. 14, 2010).

26 *Id.* at *17.

27 See, e.g., *In re Ondova Ltd.*, 2012 WL 5879147 (Bankr. N.D. Tex. Nov. 21, 2012); *In re Hallwood Energy LP*, 2009 Bankr. LEXIS 5099 (Bankr. N.D. Tex. Oct. 16, 2009).

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tion with the bankruptcy case.²⁸ In doing so, the bankruptcy court stated that these limited exculpations did not violate the precedent established by *Pacific Lumber* or §§ 524 or 1123 of the Bankruptcy Code.²⁹

Altogether, the growing number of bankruptcy court decisions dealing with nonconsensual third-party releases has reflected a breakdown in the general characterization of the Fifth, Second and Third Circuits within a flexible and non-flexible dichotomy. While all courts seem to disfavor nonconsensual third-party releases, courts are con-

sidering the factual circumstances on a case-by-case basis. It is apparent from the recent case law coming out of the bankruptcy courts that judges struggle with, on the one hand, the practical consideration of the need for a release to confirm the plan (to obtain the post-petition financing, and ultimately to “get the deal done”), and on the other hand, the requirement of notice and fairness to the third-party claimant. Practitioners in all circuits are encouraged to tailor releases narrowly, arrange for some consent mechanism, provide as much notice as possible and keep up with developments regarding this issue, which is ripe for review by the U.S. Supreme Court. [abi](#)

²⁸ *In re Texas Rangers Baseball Partners*, 2010 WL 4106713, *11 (Bankr. N.D. Tex. 2010).

²⁹ *Id.*

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On Our Watch

BY CLIFFORD J. WHITE III AND JOHN SHEAHAN

Why Marijuana Assets May Not Be Administered in Bankruptcy



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Marijuana continues to be regulated by Congress as a dangerous drug, and as the U.S. Supreme Court has recognized, the federal prohibition of marijuana takes precedence over state laws to the contrary.¹ The primacy of federal law over state law is hardly a novel proposition and has been the rule since the ratification of the Constitution. Thus, whenever a marijuana business files for bankruptcy relief, a threshold question is whether the debtor can be granted relief consistent with the Bankruptcy Code and other federal law. If the answer to that question is “no,” the U.S. Trustee Program (USTP), in its role as the watchdog of the bankruptcy system, will move to dismiss.

Illegal enterprises simply do not come through the doors of the bankruptcy courthouse seeking help to further their criminal activities. To obtain bankruptcy relief, some may try to hide the nature of their business or income, but bankruptcy courts require full financial disclosure and are not a hospitable forum for continuing a fraudulent or criminal scheme.

Marijuana businesses are a unique and unprecedented exception to this rule because they often involve companies that openly propose to continue their illegal activity during and after the bankruptcy case. Those cases present a challenge to the bankruptcy system because they generally involve assets that are illegal even to possess. In contrast to other types of cases involving illegal businesses, in which the criminal activity has already been terminated and the principal concern of the bankruptcy court is to resolve competing claims by victims for compensation, a marijuana bankruptcy case might involve a company that is not only continuing in its business, but even seeking the affirmative assistance of the bankruptcy court in order to reorganize its balance sheet and thereby facilitate its violations of the law going forward.

The USTP’s response to marijuana-related bankruptcy filings is guided by two straightforward and uncontroversial principles. First, the bankruptcy system may not be used as an instrument in the ongoing commission of a crime, and reorganization plans that permit or require continued illegal activity may not be confirmed. Second, bankruptcy trustees and other estate fiduciaries should not be required to administer assets if doing so would cause them to violate federal criminal law.

The USTP’s policy of seeking dismissal of marijuana bankruptcy cases that cannot lawfully be administered is not a new one; rather, it is a policy that has been applied consistently over two presidential administrations and under three attorneys general. Nor are these concerns unique to marijuana. These same principles would also guide the USTP’s response in a case involving any other type of ongoing criminal conduct or administration of illegal property.

[T]he USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal.

Although a recent *ABI Journal* article² takes the USTP to task for its marijuana-enforcement efforts, it is noteworthy that the author fully agrees with the USTP’s position as to the first of the two aforementioned principles and appears to agree to a significant extent with the second principle. As the author concedes, “it hardly needs explanation that a bankruptcy court should not supervise an ongoing criminal enterprise regardless of its status under state law.”³ As to the second principle, “[i]t would obviously violate federal law for the trustee to sell marijuana.”⁴

Given these concessions, the author’s disagreement with the USTP’s position would appear to be limited to a fairly narrow range of cases: those where the administration of the estate would not require the trustee to sell marijuana (but would require the trustee to administer other marijuana-derived property), and those where the debtor is a “downstream” participant in a marijuana business, such as a lessor of a building used for a marijuana dispensary.⁵

Yet under the CSA, there is no distinction between the seller or the grower of marijuana and the

¹ Controlled Substances Act, 21 U.S.C. § 801, *et seq.* (the “CSA”); *Gonzales v. Raich*, 545 U.S. 1, 12 (2005).

² Steven J. Boyajian, “Just Say No to Drugs? Creditors Not Getting a Fair Shake When Marijuana-Related Cases Are Dismissed,” XXXVII *ABI Journal* 9, 24-25, 74-75, September 2017, available at abi.org/abi-journal.

³ *Id.* at 25.

⁴ *Id.*

⁵ *Id.* at 74.

supposedly more “downstream” participants whom the article proposes to protect: All are in violation of federal criminal law. In particular, § 856 of the CSA specifically prohibits knowingly renting, managing or using property “for the purpose of manufacturing, distributing, or using any controlled substance;” § 863 of the CSA makes it a crime to sell or offer for sale any drug paraphernalia, which is defined to include, among other things, “equipment, product, or material of any kind which is primarily intended or designed for use” in manufacturing a controlled substance; and § 855 provides for a fine against a person “who derives profits or proceeds from an offense [of the CSA].”⁶ Thus, not only would a trustee who offers marijuana for sale violate the law, so too would a trustee who liquidated the fertilizer or equipment used to grow marijuana, who collected rent from a marijuana business tenant or who sought to collect the profits of a marijuana investment.

Although cases involving illicit proceeds of Ponzi schemes and other criminal activities — seen in such notorious cases as *Enron*, *Dreier LLP* and *Madoff* — are administered in bankruptcy, they deal with the aftermath of fraud, usually after individual wrongdoers have been removed from the business. Such cases are wholly inapposite analogies to a marijuana case, where the illegal activity is still continuing through the bankruptcy administration process and where bankruptcy relief might allow the company to expand its violations of law in the future. Nor do any of those cases involve proposed chapter 11 and 13 plans where the feasibility of the plan itself is directly premised on the continued

receipt of profits from an illegal enterprise. And none of them requires the courts or trustees to deal with property of the kind described in the CSA, for which mere possession is a federal crime.

Similarly, although the author cites two decades-old decisions in support of his claim that “courts have not always shied away from handling marijuana-related bankruptcies,”⁷ it is noteworthy that neither of those decisions involved active marijuana operations or would have required a bankruptcy trustee to administer any illegal marijuana assets.⁸ Both *Chapman* and *Kurth Ranch* involved bankruptcy cases that were filed *after* law enforcement had arrested and seized the assets of marijuana growers. The legal issues raised by the current wave of marijuana filings were simply not present in those cases: Neither case involved an ongoing violation of law, and in neither case were there any marijuana assets to be administered, because all illegal assets had been seized and disposed of pre-petition.

Finally, the article suggests that the “ongoing conflict over marijuana policy” is one that should take place outside the bankruptcy system. The USTP agrees. However, that does not mean that the USTP or the courts should turn a blind eye to bankruptcy filings by marijuana businesses. Rather than make its own marijuana policy, the USTP will continue to enforce the legislative judgment of Congress by preventing the bankruptcy system from being used for purposes that Congress has determined are illegal. **abi**

6 Controlled Substances Act, 21 U.S.C. § 801, *et seq.*

7 *Id.* at 25.

8 See *Dep't of Revenue v. Kurth Ranch*, 511 U.S. 767 (1994); *In re Chapman*, 264 B.R. 565 (B.A.P. 9th Cir. 2001).

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An amendment to Rule 3015(c)(1) is currently under review that will permit courts to “opt out” and use a Local Form Plan. Public comment ended on Oct. 3, 2016, and it looks as if Official Form 113, also known as the National Form Plan, and the related Rule amendments will go into effect on Dec. 1, 2017, absent intervention from the Judicial Conference, the Supreme Court or Congress.

This imminent inevitability has led many bankruptcy courts to consider opting out of the National Form Plan. Instead of adopting the Official Form, a district may require a local form plan, provided it satisfies proposed Rule 3015.1. This option seems attractive. At a recent court conference, an overwhelming majority of those with whom I spoke about the proposal told me the same thing: The National Form Plan cannot be used.

While bases for rejection of the national form vary, I will narrow the focus to one common refrain: “You can’t avoid a lien in a plan.” I work in a district in which its local form plan provides the ability to avoid certain liens through confirmation. Consequently, I began to wonder whether our form plan was errant. If it was not, I questioned why access to an easy mechanism for certain actions under a federal code should not be implemented on a national level pursuant to a standard form — that is, why should a debtor in one district have to expend more resources, including both time and money, than a debtor in another district to take advantage of the same benefit simply based on his venue?

Section 3.4 of the National Form Plan permits a debtor to avoid judicial liens or nonpossessory, nonpurchase-money security interests that impair exemptions to which the debtor would be entitled under § 522(b). Section 3.4 requires the debtor to complete a three-column table. First, the debtor must provide information on the lien, including the name of the creditor, the collateral securing the lien, and the identifying information of the recorded lien. The second column, “Calculation of lien avoidance,” requires the debtor to demonstrate that the lien impairs an exemption. This calculation tracks the analysis in § 522(f)(2). If only a portion is avoided, the third column sets out the treatment to pay the remaining secured claim in full. Any resulting unsecured claim, to the extent allowed, is paid according to Part 5 of the plan, which deals with nonpriority unsecured claims.

The opposition to Section 3.4 of the National Form Plan appears strictly procedural. Currently, Rule 4003(d) provides that the § 522(f) lien avoidance shall be brought by motion in accordance with Rule 9014. Accordingly, unlike other avoidance actions under the Bankruptcy Code that require an adversary proceeding, this type of lien avoidance is simply a contested matter. Procedural due process associated with contested matters is addressed in Rule 9014(a). “[R]easonable notice and opportunity for hearing shall be afforded the party against whom relief is sought.” Consistent with this Rule, Part 1 (“Notices,” on the first page of the National Form Plan) requires a debtor to check a box indicating whether “Included” or “Not Included” in the plan is a provision for the “[a]voidance of a judicial lien or nonpossessory, nonpurchase-money security interest, set out in Section 3.4.” The debtor is cautioned: “If an item is checked as ‘Not Included’ or if both boxes are checked, the provision will be ineffective if set out later in the plan.”

Contested matters must be served according to Rule 7004 in the same way as serving a summons and complaint. Rule 9006(d) requires that the lien-avoidance action and notice of hearing be served not later than seven days prior to the hearing date. This period is less than the 28 days’ notice for the confirmation hearing pursuant to Rule 2002(b). Consistent with these Rules, as long as the debtor serves his plan pursuant to Rule 7004 on the judgment lienholder, the lienholder is given adequate notice and more than ample opportunity to object or respond.

Some courts currently require a separate motion to avoid a lien pursuant to § 522(f). Typically, those courts hold that lien avoidance through a plan is not authorized in § 1322. Other courts recognize that a plan may provide lien avoidance pursuant to §§ 522(f) and 1322(b)(2). Fortunately, the Advisory Committee on Bankruptcy Rules has resolved this divisive procedural question through proposed amendments to Rule 4003, which will provide for § 522(f) lien avoidance in a chapter 13 plan. This will give definitive procedural effect to Section 3.4.

Bankruptcy courts must always scrutinize the requirements of confirmation. The plan must satisfy the requirements of § 1325 and comply with all the applicable provisions of the Bankruptcy Code. As the Committee Note to the National Form Plan clarifies, “Nothing in the Official Form requires confirmation of a plan containing provisions inconsistent with applicable law.” Section 3.4 notes that the lien will be avoided “[u]nless otherwise ordered by the court.” The court may require more evidence or support for the calculation in Section 3.4. Ultimately, confirmation of the plan may be

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denied, or the lien avoidance request may be denied in the confirmation order. Court scrutiny of Section 3.4, procedural clarification of amended Rule 4003(d), and general safeguards of due process should calm concerns over the adoption of the National Form Plan. Stated differently, the form does not avoid the lien; the form contains a motion to avoid, and it is the confirmation order that either grants or denies that request.

Opting out does not provide a refuge. Even though Rule 3015.1(d) will not require a local form plan to contain a lien-avoidance section, Rule 3015.1(c) does require the local form plan to include an initial paragraph for the debtor to provide notice if the plan avoids a lien. This reinforces the fact that debtors may avoid a judgment lien through their chapter 13 plans. Courts may craft their local form plan to accomplish this lien avoidance in a way that addresses their individual concerns. In the end, chapter 13 debtors will need an efficient mechanism to accomplish § 522(f) lien avoidance and achieve confirmation of a plan that modifies the secured claim. [1] Although not currently universally accepted, the National Form Plan should have wide appeal, particularly for mechanical § 522(f) lien avoidance. Use of Section 3.4 efficiently consumes debtors' limited resources and facilitates counsel in achieving a fresh start for their clients. Uniformity benefits those who routinely review chapter 13 plans, including creditors holding avoidable liens, trustees, judges and even law clerks. Scrutinizing Section 3.4 shall prove more efficient than combing through "nonstandard" provisions or deciphering locally devised motions.

The National Form Plan might not be perfect, and it certainly has its weaknesses. But it also has its strengths, arguably including a mechanism for lien avoidance. Before rushing to opt out, perhaps consider that the National Form Plan could be "employed by the court and the parties to secure the just, speedy, and inexpensive determination of every action and proceeding." [2]

[1] See 11 U.S.C. § 1322(b)(2).

[2] See Fed. R. Civ. P. 1.

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Trustee Talk

BY RONDA J. WINNECOUR

New Form Plan May Nationalize Chapter 13 Practice

The biggest national change in consumer bankruptcy since the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is lurking on the horizon. The Advisory Committee on Bankruptcy Rules, through its Chapter 13 Form Plan Working Group, has recommended both a new national Official Form for the Chapter 13 plan and many amended rules attendant to all areas of consumer bankruptcy. The new form and amended rules will materially transform bankruptcy practice in chapters 7, 12 and 13.

The memorandum from the Working Group is available online¹ and contains both the draft National Plan Form and the recommendations of the committee for changes with regard to the rules. The draft rules and form have not yet been forwarded to the Advisory Committee on Bankruptcy Rules. Unusually, the Working Group seeks comments from the bankruptcy community concerning the changes, and the opportunity is ripe for all stakeholders to share concerns and recommendations for improvement. The decision of the Working Group to share its work product and encourage comment affords an amazing opportunity to judges, trustees, creditors, debtors and their counsel to influence the project in meaningful ways.

The concept of the National Plan Form was proposed by a group of bankruptcy judges and chapter 13 trustees in 2001 at the National Association of Chapter 13 Trustees (NACTT) annual conference in San Juan, P.R. The rationale behind the proposal is to eliminate the parochial aspects of chapter 13 practice, to nationalize and standardize the treatment of creditors, valuation proceedings and avoidance of secondary liens, and to minimize the work of debtors' attorneys in multi-plan jurisdictions.

There are more than 200 plan forms currently in use across the country, and many districts have no recommended or required plan form at all. Creditors, particularly national lenders, are precluded from using data-enabled technology to download their treatment and are required to waste resources individually reviewing each chapter 13 plan. Simultaneously, debtor practice varies dramatically from district to district with respect to matters such as lienstripping, valuation and the effect of confirmation. Some jurisdictions require that matters such

as valuation, claim disputes and lien avoidance be brought by motion, some allow the confirmed plan to control, and many require adversary proceedings. The Working Group is attempting to standardize practice in consumer cases in a manner that consistently improves the process.

The concept is a single, uniform plan coupled with significant changes to the rules that govern consumer bankruptcy. Creditors, debtors and trustees are materially affected by these changes and the form, but the primary impact of the changes in the National Plan Form and Rules falls upon chapter 13 standing trustees.

One mandatory, nine-page, data-enabled, official plan form will be required in all chapter 13 cases.² The draft rule precludes nonstandard provisions unless they are delineated in the section of the official form that is specially designated for nonstandard provisions.³ Nonstandard provisions must be identified in accordance with the requirements of the National Plan Form.⁴

Creditors must receive a copy of the plan prior to confirmation.⁵ Creditors must file objections to confirmation seven days before the scheduled confirmation, or plan confirmation (and the resulting resolutions of contested matters) will occur by default.⁶ Contested matters—such as valuation, lien avoidance under 11 U.S.C. § 522(f), fixing mortgage arrears and many other claim disputes—will be resolved by the confirmation process in chapter 12 or 13 cases. The Working Group envisions that the draft uniform plan will obviate the need to file a motion, adversary proceeding or objection to claim to resolve most matters.

The value of a secured claim, as well as the amount of a claim that is to be given priority status, may be asserted in the draft plan. Determination of mortgage arrears may also be resolved through the confirmation process. Because these matters are significant to creditors, the draft rules also require enhanced service; notice must be consistent with the requirements of Rule 7004.⁷

Avoidance of liens under 11 U.S.C. § 522(f) may also be provided for in the plan.⁸ A plan that



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¹ See www.uscourts.gov/uscourts/RulesAndPolicies/rules/Agenda%20Books/Bankruptcy/BK2012-09.pdf.

² See Advisory Committee on Bankruptcy Rules (2012) at 187, www.uscourts.gov/uscourts/RulesAndPolicies/rules/Agenda%20Books/Bankruptcy/BK2012-09.pdf.

³ *Id.* at 174.

⁴ *Id.* at 174.

⁵ *Id.* at 174.

⁶ *Id.* at 174.

⁷ *Id.* at 172.

⁸ *Id.* at 176.

proposes to avoid such a lien must also be served in accordance with Rule 7004.⁹

Because confirmation will resolve most contested matters, creditors will be well served to carefully review the plan and object promptly. Debtors' attorneys and trustees will no longer be required to file objections to proofs of claim, motions or adversaries to resolve most claims, secondary liens or valuation.

Draft Rule 3015(g) provides that the confirmation of chapter 13 plans controls over contrary proofs of claim,¹⁰ and the rule is consistent with *United Student Aid Funds Inc. v. Espinosa*.¹¹ Failure to object in a timely fashion will result in confirmation by default.

Trustees and debtors have long been frustrated by the nonsensical glitch in existing rules that allows secured creditors to fail to assert a claim, ignore the plan and confirmation orders, and subsequently pounce on the debtor for asserted delinquencies post-discharge. The Working Group has addressed this concern by requiring that secured creditors actually file proofs of claim or be bound by the order confirming the plan. The Working Group reasoned that "it would be helpful to have a proof of claim from each secured creditor filed before the confirmation hearing. That way, any differences between the debtor's plan and the proof of claim could be addressed at the confirmation hearing."¹² Therefore the draft of new Rule 3002(a) requires that "[a] secured creditor, unsecured creditor and equity security-holder must file a proof of claim or interest for the claim or interest to be allowed, except as provided in Rules 1019(3), 3003, 3004 and 3005. A lien that secures a claim against the debtor is not void due only to the failure of any entity to file a proof of claim."¹³ The primary result of the changes is that virtually all creditors must file a proof of claim or risk a confirmation order that limits the right of the creditor to be paid in full.

Perhaps the most controversial proposal is the draft amended Rule 3002(c), which resets the claims bar date for nongovernmental creditors.¹⁴ In all consumer cases, but particularly in chapter 12 and 13 matters, early confirmation and resolution of issues can only occur if there is certainty about the funds—how much money and to whom the trustee is being asked to disburse. To raise the level of certainty and accelerate the timing of certainty, the bar date for nongovernmental creditors is set at 60 days from the filing of the petition. This change dramatically shortens the current bar date of 90 days from the first meeting of creditors. The new bar date applies not only to chapter 13 cases but also to voluntary chapter 7 cases and all chapter 12 cases as well. The bar date is set at 90 days from the date of the order for relief in an involuntary chapter 7 case.¹⁵

The bar date change has been criticized by secured creditors, particularly mortgage creditors, who claim that it fails to afford them sufficient time to evaluate and support the claim. This argument does not seem well reasoned since bankruptcy often follows a notice of foreclosure, and the creditor should already have a supported assessment

of arrears by that time. Additionally, creditors will benefit significantly from the shortened time period between the petition and first distribution in chapter 12 and 13 cases. Further, the Working Group envisions the confirmation hearing as the time to resolve all issues attendant to claims disparities. By forcing the creditor to clarify the extent of the claim and to file written objections to confirmation of a plan that provides otherwise, the creditor will be forced to review the debt and its treatment by the debtor and assert its rights in a timely fashion. Creditors will be rewarded for this review by earlier payment of allowed claims. They will also benefit from standard chapter 13 practices, reducing the time constraints on their staff, which will minimize the time necessary to file accurate proofs of claims.

[T]he draft National Form is a collection of ideas from many local plans and is an attempt to incorporate many of the common denominators of chapter 13 practice.

An exception to the claims bar date is provided in the event that the debtor fails to include a creditor on the list or if the notice was mailed to a creditor at a foreign address. The court is permitted to extend the time by 60 days from the date of the court's determination of insufficient notice.¹⁶ This is the first time that the rules have addressed the problem of unscheduled creditors. The current FRBP 3007 will be amended to provide an exception to the need to file an objection to a claim if it is allowed pursuant to confirmation of chapter 12 or chapter 13 plans,¹⁷ which is consistent with the Working Group's commitment to confirmation as the resolution of claims issues.

Creditors should be alerted to the proposed changes to FRBP 3012.¹⁸ The new provision is entitled "Determination of the Amount of Secured and Priority Claims," under which the debtor is permitted to seek a determination of valuation under 11 U.S.C. § 506(a) and pre-petition cure and priority status under § 507. The debtor is authorized to seek these determinations by objection to claim or motion, or by proposing it in a chapter 12 or 13 plan. The Working Group specially notes that it decided to add the determination of mortgage cure in the confirmed plan. To protect the creditor, it also added a provision that requires service of the plan on creditors in accordance with Rule 7004.

Many chapter 13 trustees are concerned by FRBP 3015, which requires that an official form be used for all chapter 13 plans.¹⁹ The rule precludes nonstandard provisions except in conformity with the official plan form. Creditors must receive a copy of the plan prior to confirmation. Confirmation will occur by default if no objection to confirmation has been

⁹ *Id.* at 172.

¹⁰ *Id.* at 175.

¹¹ 130 S.Ct. 1367 (2010).

¹² See Advisory Committee on Bankruptcy Rules (2012) at 168.

¹³ *Id.* at 169. The draft rule not only applies in consumer cases, but may also affect business chapter 11s.

¹⁴ *Id.* at 169.

¹⁵ *Id.* at 169.

¹⁶ *Id.* at 170.

¹⁷ *Id.* at 170.

¹⁸ *Id.* at 172.

¹⁹ *Id.* at 174.

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filed seven days before the hearing and, most importantly, confirmation of a chapter 13 plan trumps any contrary proof of claim. The form itself starts by alerting the creditors to the possibility of modification of a secured claim, avoidance of judicial lien and avoidance of a nonpurchase money security interest or nonstandard provisions. Thereafter, it proposes plan payments and length of plan, treatment of secured claims including determination and claim modification, administrative and priority claims, nonpriority unsecured claims, executory contracts and unexpired leases, as well as the order of distribution, summary of plan disbursements, governmental units and vesting options.

There are many districts already using a local mandatory plan form, and most have a recommended form of some sort. The trustees, their staff (the people responsible for policing the provisions of the plan), and the local judiciary and bar are concerned that the national form will erode the differences in local practice. Many trustees pay only pre-petition obligations, some trustees are conduit trustees paying post-petition obligations in many cases, and at least one trustee pays all post-petition debts in every case. Some districts have an early confirmation process, while some do not confirm until both the regular and governmental bar dates have expired. It is hard to envision a single plan form that will resolve all of the variations.

Chapter 12 and 13 plans may provide for the avoidance of liens in accord with 11 U.S.C. § 522(f). Confirmation of the plan will establish the terms of lien avoidance and valuation.²⁰ A draft rule permits the debtor to obtain an order establishing that secured claims have been satisfied.²¹ The debtor will be permitted to request such an order at any time after the lien is satisfied. A chapter 7, 12 or 13 case will be deemed fully administered and closed when the trustee has filed a final report and final account and certified that the estate was fully administered.²²

Clearly, the goals of the Working Group are uniformity and clarity. By inviting comments, the Working Group has tried to avoid engaging in disputes about who has the “best” local plan form. Instead, the draft National Form is a collection of ideas from many local plans and is an attempt to incorporate many of the common denominators of chapter 13 practice. All stakeholders should review the form and draft rules and offer their assistance to the Working Group in the form of constructive comment. Suggestions and comments can be sent to **Troy McKenzie** and/or Hon. **Eugene Wedoff**. This is everyone’s chance to influence the process.²³ **abi**

²⁰ *Id.* at 176.

²¹ *Id.* at 176.

²² *Id.* at 176.

²³ *Id.* at 187.

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